REPORT ON THE BALANCE OF PAYMENTS

2024
OCTOBER

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

Letters 27
Gábor Bethlen

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

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

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

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

The Report is based on information pertaining to the period ending 25 September 2024.

Summary

Hungary's external balance continued to improve in 2024 Q2, with the four-quarter current account balance surplus rising to 2.3 per cent of GDP (and the seasonally adjusted quarterly figure to 3.3 per cent), while net lending reached 2.9 per cent of GDP. The Q2 increase in the external position stemmed mainly from a higher goods balance, which was supported by an improvement in the energy balance and a fall in imports as investment slowed. The surplus on the services balance as a percentage of GDP and the deficit on the income balance were essentially unchanged from the previous quarter, while the transfer balance declined slightly. In contrast to the developments in Hungary, external balance indicators in the countries of the region deteriorated slightly in the second quarter. The balance of payments revision resulted in an increase of 0.5 percentage point in the current account balance as a share of GDP last year compared to what was previously reported, reaching 0.7 per cent of GDP.

In line with developments in the real economy, the economy's four-quarter financial balance sheet position also rose slightly in 2024 Q2. In the quarter, net outflows of direct investment were significant, reflecting a one-off factor, while debt liabilities continued to rise. Net external debt thus rose slightly to above 11 per cent of GDP at the end of June 2024, according to the underlying trends, mainly linked to an increase in the private sector ratio. After having declined substantially in 2023, the gross external debt ratio remained unchanged in 2024 Q2 at just about 64 per cent of GDP. The level of international reserves was close to an historic high at EUR 46.3 billion at the end of June, exceeding the level of short-term external debt, which is closely monitored by investors, by nearly EUR 15 billion.

Sectoral savings patterns suggest that the net lending position increased as a result of contrasting effects: the declining budget deficit and the increasing financial saving of households were largely offset by the higher financing needs of companies. The government deficit narrowed thanks to higher tax revenues and subdued spending. Household savings increased on the back of rising real wages, while corporate financing needs rose amid falling corporate profits. Within household savings, inflows into deposits were the strongest, and the stock of government securities continued to grow at a faster pace, while investment fund holdings also continued to grow briskly.

The special topic in this issue of the Report focuses on developments in the earnings of foreign-owned companies. Based on the actual figures received, foreign-owned firms' profits as a share of GDP fell in 2023, partly due to subdued exports in the context of low foreign demand and partly due to the profit-reducing effect of the extra profit tax. The reinvestment ratio of non-financial corporations moderated slightly, but remains high, whereas the dividend ratio of banks decreased. The profits of resident companies' foreign subsidiaries rose to an historic high, driven mainly by strong profits in the banking sector. In the countries of the region, the return on equity ratio typically declined, which, unlike in Hungary, was reflected mainly in a decline in reinvestment.

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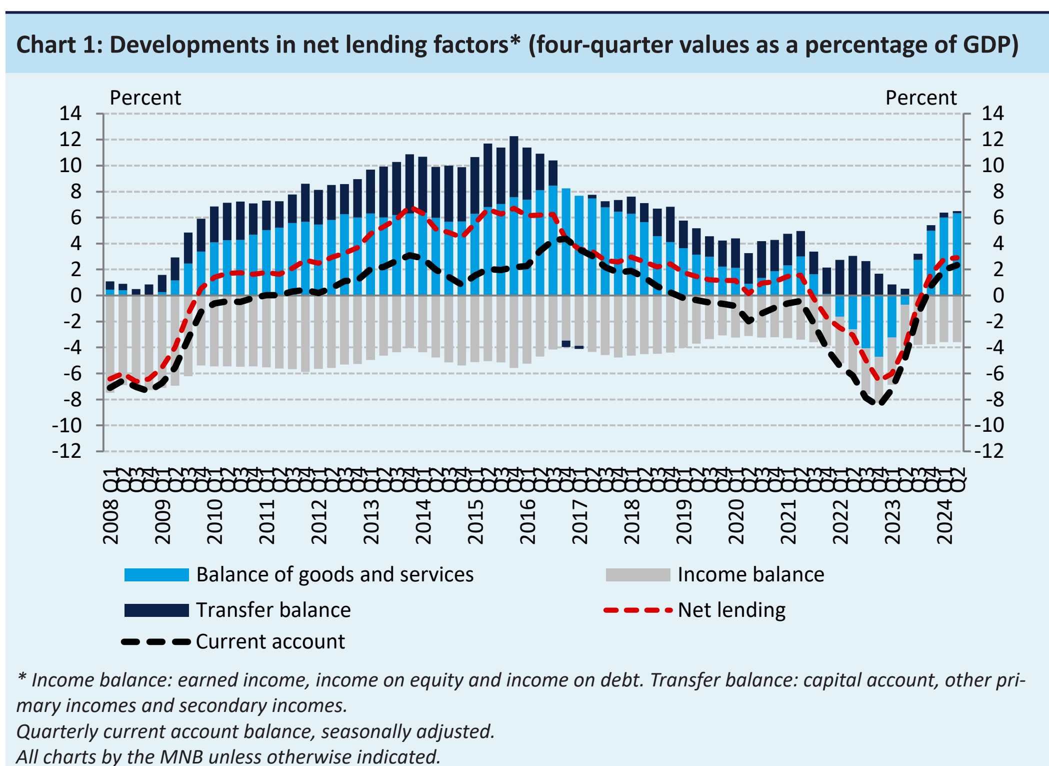
1 Real economy approach

The real economy approach shows that Hungary's four-quarter net lending amounted to 2.9 percent of GDP in 2024 Q2, with the current account surplus reaching 2.3 percent of GDP and the four-quarter adjusted current account balance showing a surplus of 3.3 percent. The improvement in the external balance indicators was linked to an increase in the goods balance, including an improvement in the energy balance and a fall in imports owing to lower investment. The surplus on the services balance as a share of GDP and the deficit on the income balance remained broadly unchanged versus the previous quarter, while the transfer balance declined moderately due to lower net absorption of EU transfers. In contrast to the developments in Hungary, the position of external balance indicators in the countries of the region deteriorated slightly in the second quarter.

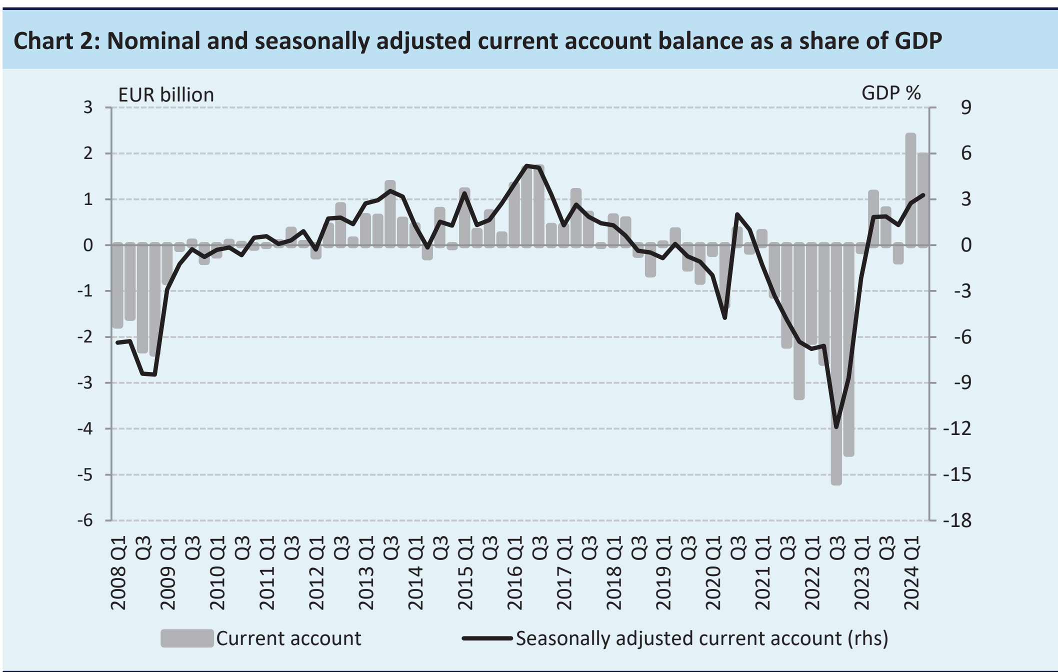
According to the real economy approach, Hungary's four-quarter net lending amounted to 2.9 percent of GDP in 2024 Q2, while the current account surplus rose to 2.3 percent of GDP (Chart 1). Based on quarterly data, which better reflect short-term developments, the current account surplus reached 3.3 percent of GDP in 2024 Q2. According to *unadjusted quarterly* data, net lending amounted to EUR 2,012 million in the second quarter, consisting of a large surplus of EUR 1,953 million on the current account (Chart 2) and a surplus of EUR 59 million on the capital account. The improvement in the trade balance was the main contributor to the rise in four-quarter net lending.

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



** Income balance: earned income, income on equity and income on debt. Transfer balance: capital account, other primary incomes and secondary incomes.*
Quarterly current account balance, seasonally adjusted.
All charts by the MNB unless otherwise indicated.

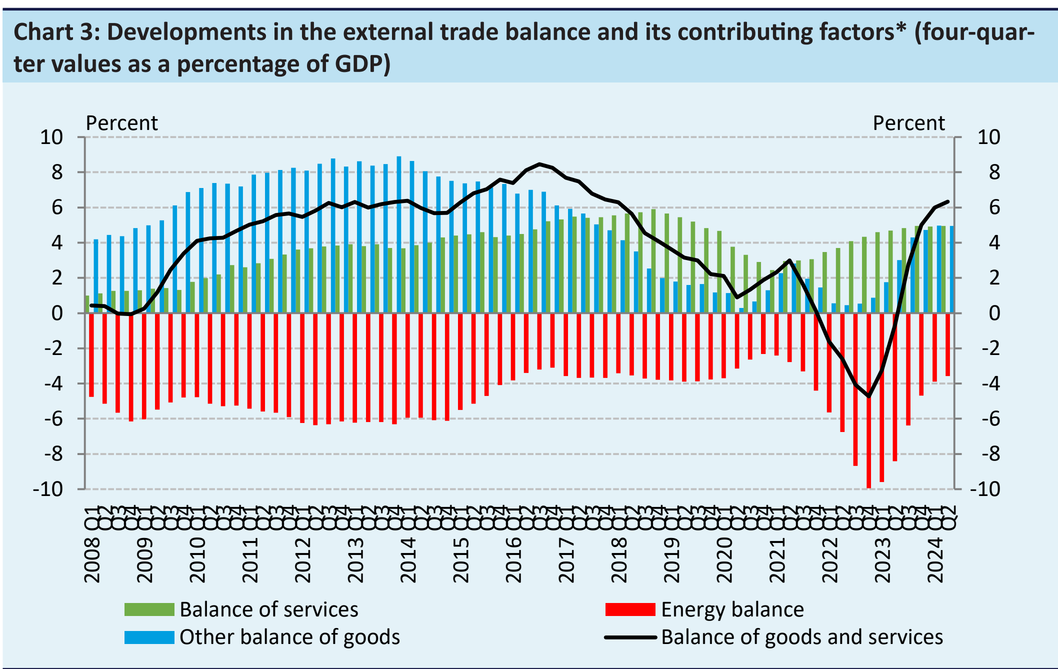
Chart 2: Nominal and seasonally adjusted current account balance as a share of GDP



1.1 Trade balance

The four-quarter external trade surplus rose to 6.3 percent of GDP in 2024 Q2, on the back of continued growth in the goods balance and a stable services surplus (Chart 3). The increase in the goods balance was mainly linked to the correction in the energy balance following the 2022 energy price shock, as in previous quarters. The goods balance was also improved by a decline in other imports due to shrinking gross capital formation. Export growth also supported the goods balance in the first half of the previous year, but this effect then faded in 2023 H2 in the context of weaker external economic activity. Together with the increase in household consumption, this meant that the rise in the other goods balance, which started in 2022, slowed down by the end of 2023 and the balance declined slightly in 2024 Q2. The four-quarter surplus on the services balance stabilised in early 2023, following a steady improvement after the COVID-19 pandemic, and again amounted to around 5 percent of GDP in the first and the second quarter of this year. The improvement in the balance of services until the beginning of 2023 was driven by dynamic growth in tourism and a recovery in the balance of transportation services. Within the services balance, tourism remained the most dominant sector, but in the second quarter the surpluses on contract manufacturing and on telecommunications and information services increased the most.

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



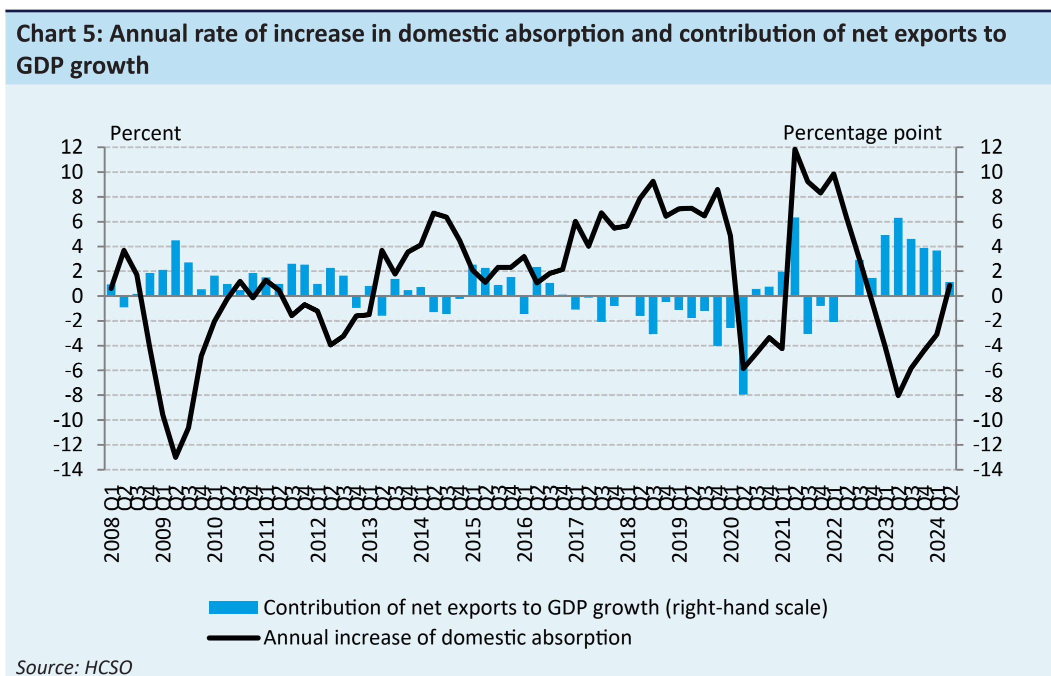
On an annual basis, both export and import volumes declined less in 2024 Q2 than at the beginning of the year, while the export-import gap continued to narrow (Chart 4). Domestic industrial production in most manufacturing branches remained weak, but an increase in services exports supported the improvement in export dynamics. The fall in imports is mainly due to lower exports and investment holding back imports. The volume of exports fell by 1.8 percent year-on-year in the second quarter, while imports declined by 3.2 percent.

Chart 4: Annual real growth of exports and imports

Source: HCSO, MNB

In this context, the contribution of net exports to growth declined significantly in the second quarter (Chart 5). After two years of contraction, domestic absorption increased again on an annual basis, driven by a rebound in household consumption, which was enabled by a renewed increase in real household income following the period of high inflation. At the same time, the decline in investments continued to accelerate during the quarter; also taking into account the poor performance of exports, this suggests that the positive growth contribution of net exports was still largely driven by lower gross capital formation.

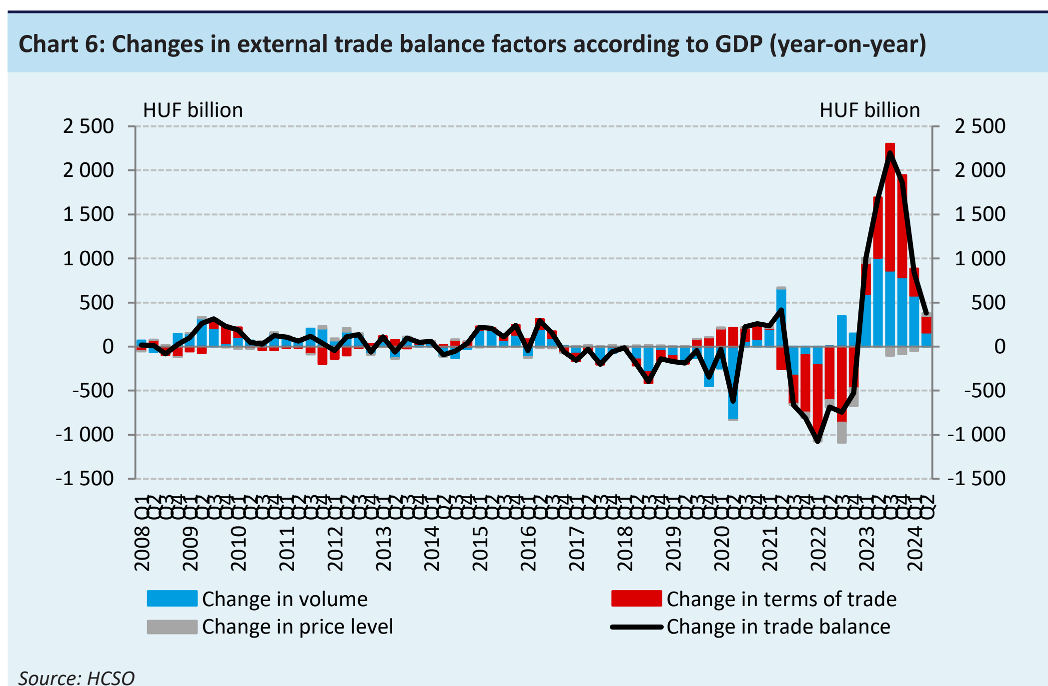
Chart 5: Annual rate of increase in domestic absorption and contribution of net exports to GDP growth



Source: HCSO

The positive year-on-year change in the external trade balance in 2024 Q2 is due in nearly equal parts to volumes and the terms of trade effect, although both factors contributed to the improvement to a much lesser extent than in previous quarters (Chart 6). The external trade balance, which includes the balance of goods and services, mainly improved owing to a year-on-year decrease in imports, which was partly driven by subdued domestic demand. The continued decline in energy prices contributed to an improvement in the terms of trade, which had a positive impact on the nominal volume of net exports. In the second quarter, the effect of the change in the terms of trade weakened in comparison to the previous quarters. In addition to the above two factors, the moderate increase in the trade balance in the second quarter was also driven by the price level effect.

Chart 6: Changes in external trade balance factors according to GDP (year-on-year)



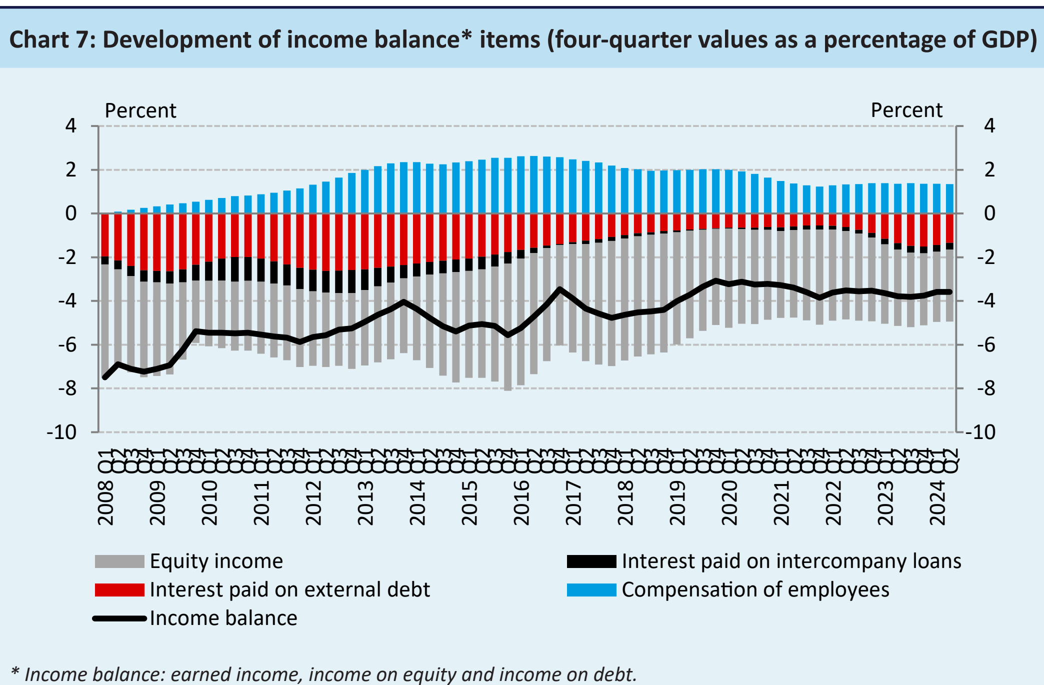
Source: HCSO

1.2 Income balance

The income balance deficit as a share of GDP was 3.6 percent of GDP, similar to 2024 Q1 (Chart 7). A large part of the income balance is accounted for by the profits of foreign-owned enterprises, which stood at around 3.3 percent of GDP in 2023 (for more details on the 2023 earnings of foreign-owned enterprises, see the special topic), and remained at this level in the second quarter of this year.[1] The net interest deficit on external lending and borrowing as a share of GDP narrowed by 0.1 percentage point to 1.3 percent in the second quarter of this year, reflecting the declining interest rate level. The income of Hungarians working abroad on a temporary basis remained at the low level observed after the pandemic and thus continued to make only a moderate contribution to improving the indicator. As a combined result of these factors, the current account deficit stabilised at 3.6 percent of GDP by the end of the second quarter, similar to the previous quarter.

[1] Since quarterly data on the 2024 profitability of foreign-owned enterprises operating in Hungary are limited, information on quarterly profit outflows is based on estimates until the receipt of corporate questionnaires in September 2025. For more detail, see the publication 'Methodological notes to the Balance of Payments and Investment Position Statistics'.

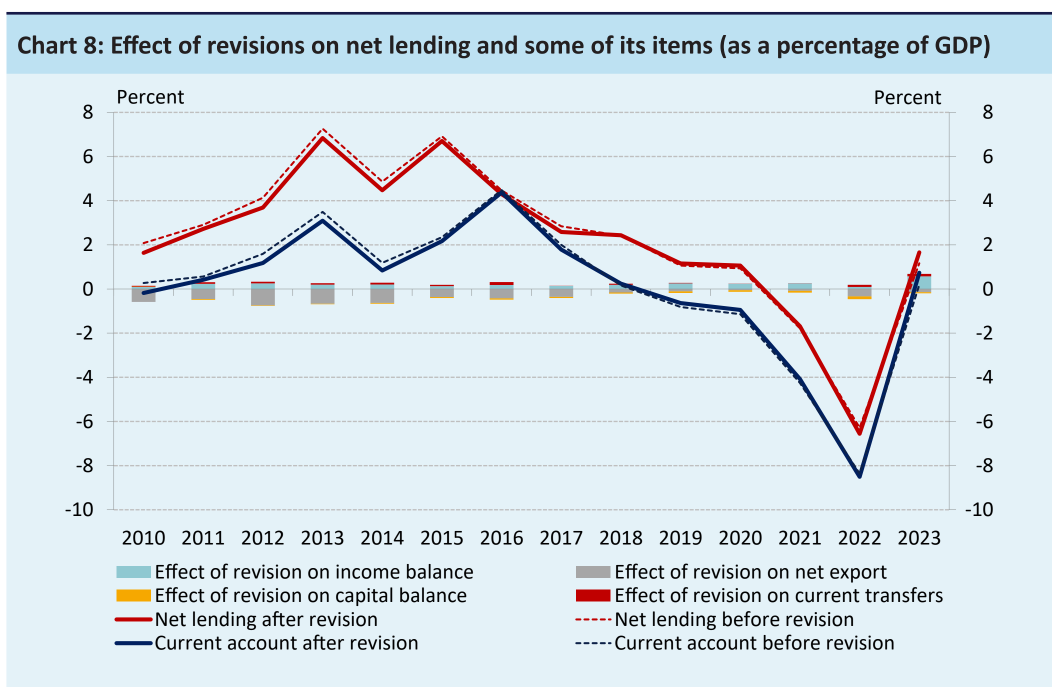
Chart 7: Development of income balance* items (four-quarter values as a percentage of GDP)



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

The balance of payments revisions led to an increase of 0.5 percentage point in the current account balance as a share of GDP, but the revisions did not substantially influence the external balance trends overall. The Q2 balance of payments data include for the first time information on the 2023 earnings of foreign-owned enterprises, based on enterprise questionnaires (previously only an estimate was available for this item). According to this information, the deficit on the income balance of foreign-owned enterprises was 0.5 percent of GDP smaller last year: to a larger degree, this was driven by the higher-than-estimated income of domestically-owned enterprises operating abroad, but to a lesser degree the lower profits of foreign-owned enterprises operating in Hungary were also behind this development (for more details on the income of foreign-owned enterprises, see the special topic). This usual change in September was complemented this year by a more comprehensive revision: every 5 years, the statistics allow for the possibility of revising the previously published data to reflect new estimates arising in the meantime over a longer period. As a result, however, the revision of data for previous years and other items was only minor (around 0.1 to 0.4 percent of annual GDP). The September revisions thus essentially confirmed the previously observed patterns in the evolution of the current account and net lending (Chart 8).

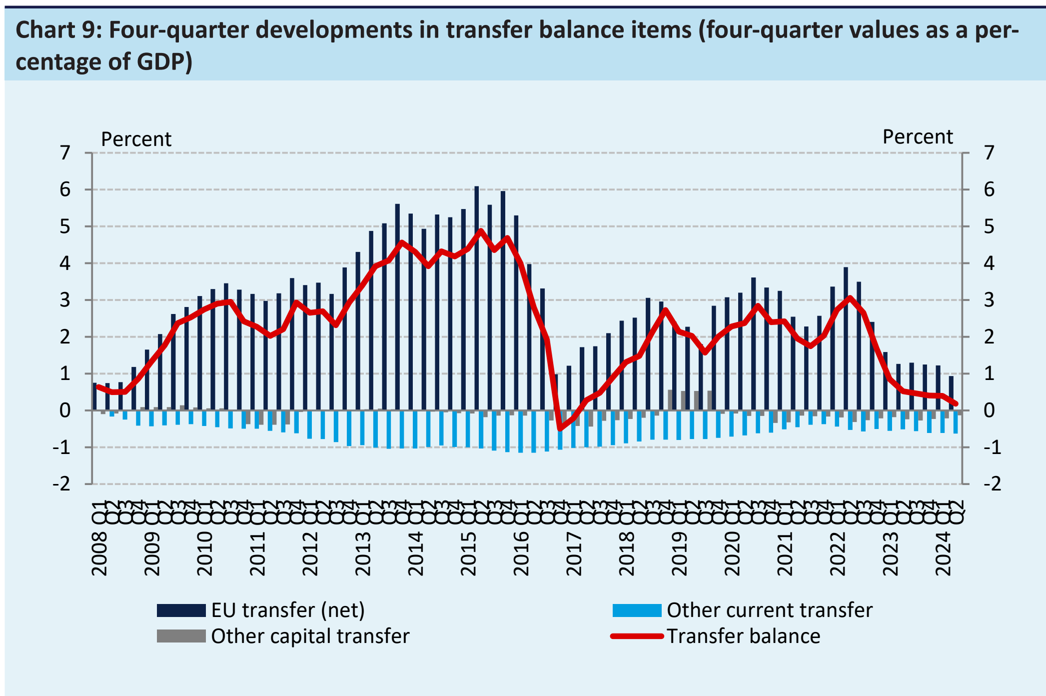
Chart 8: Effect of revisions on net lending and some of its items (as a percentage of GDP)



1.3 Transfer balance

The four-quarter surplus of the transfer balance as a share of GDP in 2024 Q2 declined from 0.4 percent in the previous two quarters to 0.2 percent, mainly due to the still low level of net EU transfers (Chart 9). The use of net EU transfers typically amounted to around 2.0 to 3.5 percent of GDP in recent years, but the four-quarterly net EU transfer balance fell to 1.2 percent of GDP at the end of 2023 and in 2024 Q1, before dropping further to 0.9 percent of GDP in the second quarter. This was due to the end of the 2014–2020 EU budget cycle and the delay in accessing the new seven-year cycle and the Recovery and Resilience Facility (RRF), which was set up to help with recovery from the COVID-19 crisis. The Q2 transfer balance was also reduced by the recording of a fine of around EUR 200 million imposed by the European Court of Justice. Meanwhile, the four-quarter balance of other current transfers remained broadly unchanged, while other capital transfers improved slightly compared to the previous quarter.

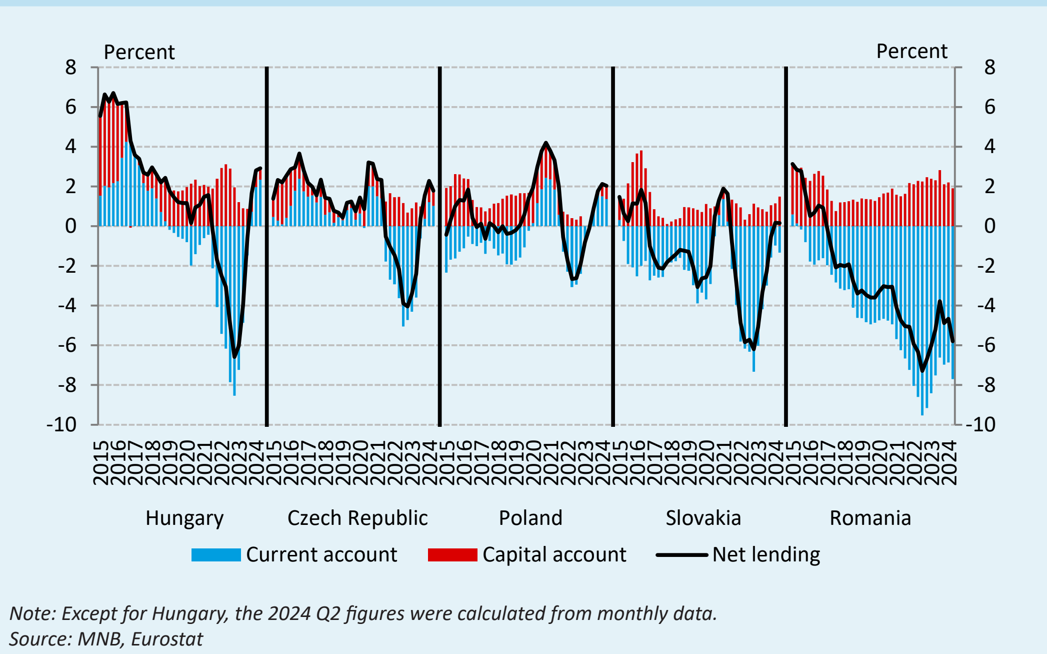
Chart 9: Four-quarter developments in transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

Based on the monthly data, external balance indicators deteriorated slightly in most of the countries in the region in the second quarter, but regional countries remain in a net lending position, with the exception of Romania (Chart 10). In 2024 Q2, the energy balance deficit continued to decline in Hungary and the Czech Republic, while in the other countries the deficit stabilised at levels from before the 2022 energy crisis. At the same time, final consumption (including both household and government consumption) increased year-on-year in all countries in the region, and domestic absorption increased in all but the Czech Republic. In line with the rise in consumption, the four-quarter current account balance deteriorated slightly in the second quarter in all the regional countries except Hungary, but this was partly offset by an increase in the capital account in Poland and Slovakia. Overall, the Czech and the Polish four-quarter net lending reached around 2 percent of GDP in the second quarter, while Hungary's figure was somewhat higher than that, at around 3 percent of GDP. Slovakia's net lending remained close to balance, while Romania's net borrowing approached 6 percent of GDP.

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



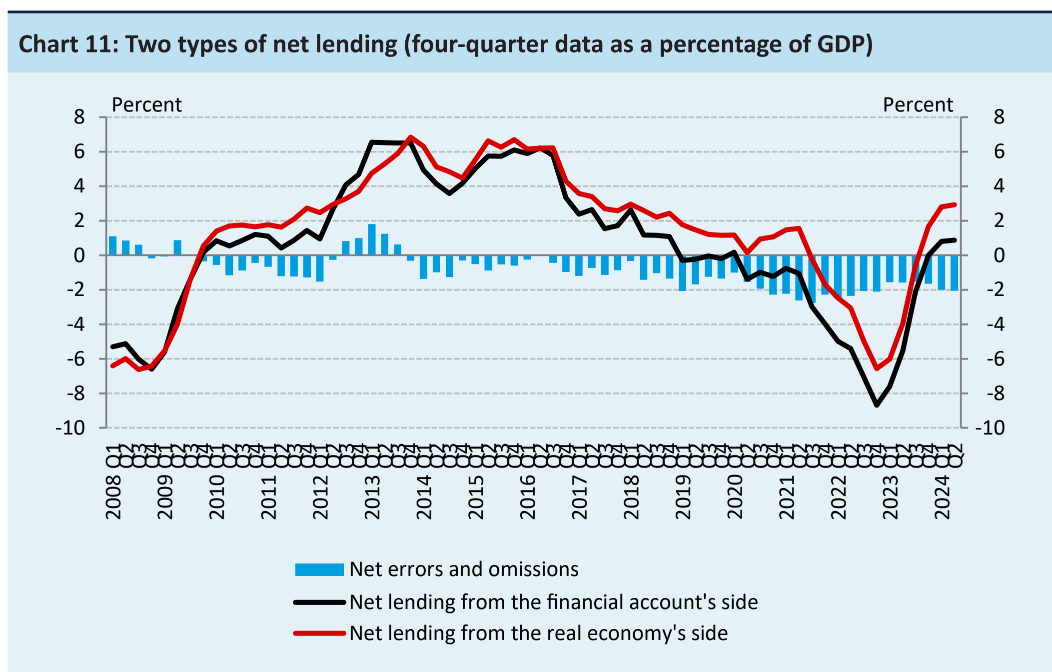
Note: Except for Hungary, the 2024 Q2 figures were calculated from monthly data.
Source: MNB, Eurostat

2 Financing approach and debt ratios

In 2024 Q2, the four-quarter external balance position of the economy according to the financial balance also increased slightly. During the quarter, net outflows of direct investment were significant, reflecting a one-off factor, while debt liabilities continued to rise. Net external debt thus rose slightly to above 11 percent of GDP at the end of June 2024, according to underlying trends, mainly linked to an increase in the banking system and corporate indicators, while the general government debt ratio fell slightly. The gross external debt ratio, after having declined substantially in 2023, was unchanged in 2024 Q2, remaining close at to 64 percent of GDP. The level of international reserves was close to an historic high at EUR 46.3 billion at the end of June, exceeding the level of short-term external debt, which is closely monitored by investors, by nearly EUR 15 billion.

In 2024 Q2, the external balance position continued to improve slightly, as demonstrated by the financing data. Similar to the external position on the real economy side, the economy's net lending also increased slightly over the four quarters to 0.9 percent of GDP in the second quarter (Chart 11). The divergence between the external balance indicators calculated on the basis of the two approaches (the 'Balance of net errors and omissions'[2]) was also around 2 percent of GDP in the second quarter.

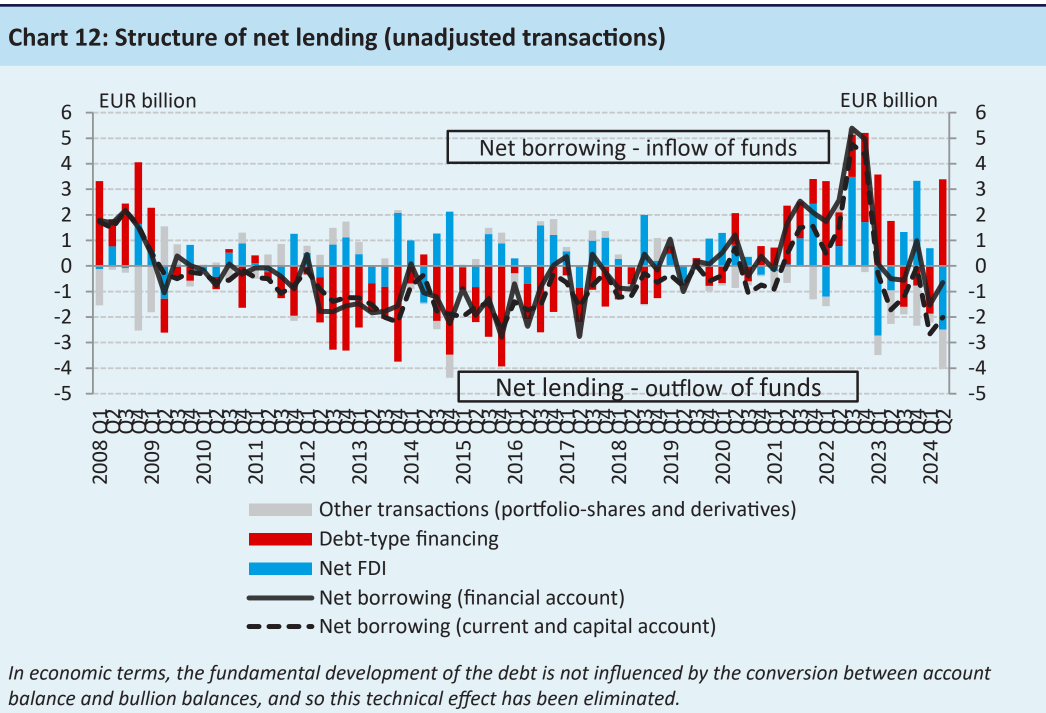
Chart 11: Two types of net lending (four-quarter data as a percentage of GDP)



According to quarterly data, in 2024 Q2, the economy's net position showed a financing capacity of EUR 0.7 billion, mainly due to a decline in net direct investment, while net external debt increased (Chart 12). Net external debt resulting from transactions increased (the last time this was seen was a year ago) in the amount of EUR 3.4 billion. Similar to 2023 Q1, the net FDI outflow of EUR 2.5 billion in 2024 Q2 was linked to a single transaction, namely the acquisition of a foreign-owned company (Budapest Airport) by a resident.

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

Chart 12: Structure of net lending (unadjusted transactions)

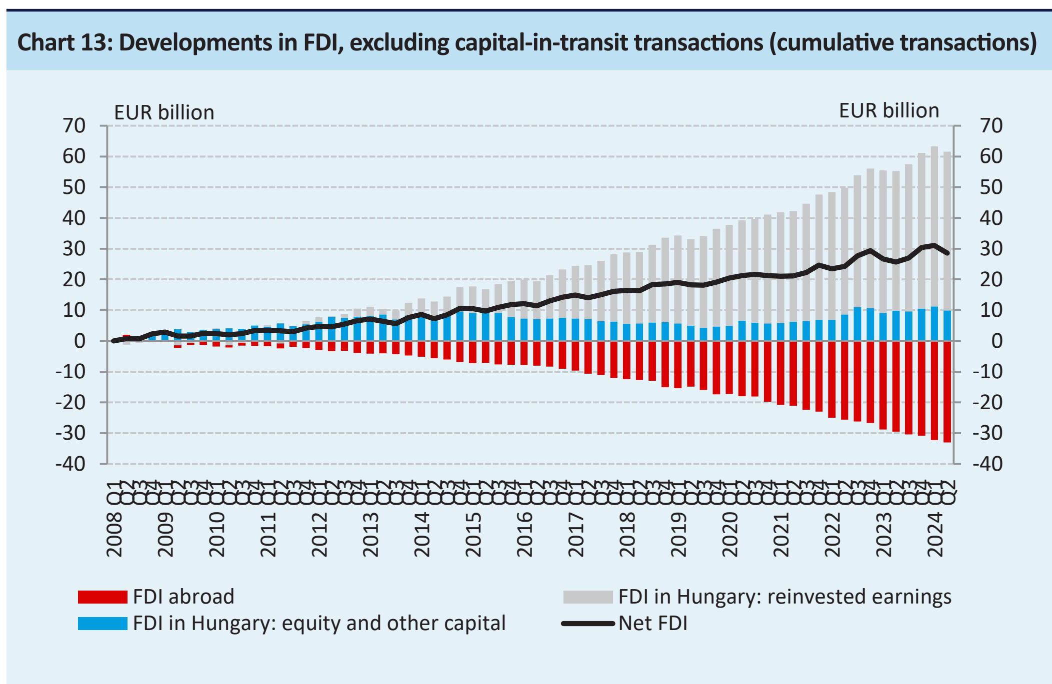


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and so this technical effect has been eliminated.

2.1 Non-debt type funds

In the second quarter, in addition to the acquisition of Budapest Airport, the usual dividend payments that were approved also increased net FDI outflows (Chart 13). Foreign direct investment in Hungary by non-residents reduced FDI shares to some extent through the dividend payments approved in the second quarter (via a fall in reinvested earnings); nevertheless, most of these have not yet been paid out, thus increasing inter-company loans. In addition, the state's purchase of an 80-percent stake in Budapest Airport also contributed to the increase in net FDI outflows. At the same time, domestic actors' investments abroad increased by a total of EUR 0.8 billion during the quarter. As a combined result of the above, net FDI outflow, which excludes pass-through investment, amounted to EUR 2.5 billion in 2024 Q2.

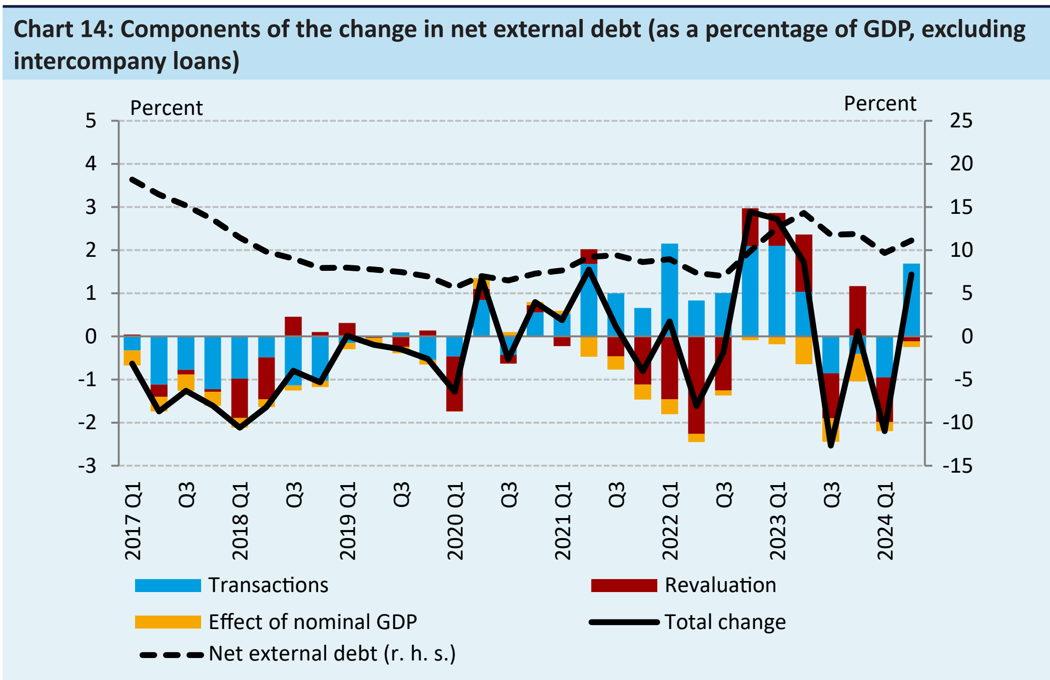
Chart 13: Developments in FDI, excluding capital-in-transit transactions (cumulative transactions)



2.2 Developments in debt indicators

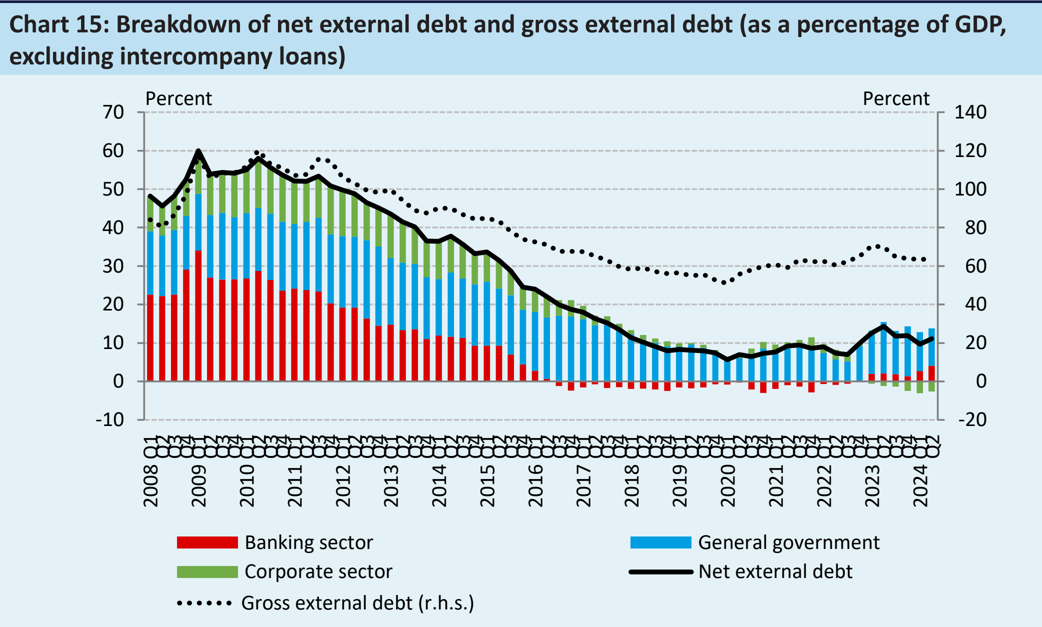
In 2024 Q2, the economy's net external debt according to underlying trends once again rose to 11 percent of GDP. In addition to the substantial inflows of debt-type liabilities described earlier, the increase in the debt ratio was due to the rise in transactions, while revaluation and a decline in economic output had a small opposite effect (Chart 14). Inflows of debt-type funds boosted net external debt by 1.7 percentage points, mainly related to the banking system and, to a lesser extent, to the corporate sector as well. The revaluation and the increase in nominal GDP, linked to changes in yields and the exchange rate, reduced the value of the indicator slightly, by 0.1 percent of GDP.

Chart 14: Components of the change in net external debt (as a percentage of GDP, excluding intercompany loans)



The rise in the net external debt ratio was mainly linked to the banking sector, but the debt indicator of non-financial corporations also contributed to the increase (Chart 15). The GDP-proportionate net external debt of the *general government sector including the MNB* fell by 0.4 percentage points, mainly reflecting the impact of the outflow of government debt-type funds (e.g. the maturity of net debt in relation to a reduction in central bank discount bonds held by non-residents). In addition, the use of EU transfers in the quarter also reduced the debt indicator. However, the net outflow of funds was reduced by the EUR 200 million fine imposed by the Court of Justice of the European Union and, in the absence of an agreement, by the daily fine of EUR 1 million. Private sector net external debt as a share of GDP increased by almost 2 percentage points overall, mainly related to the banking system debt ratio, but also to an expansion in corporate net external debt. The change in the net external debt of banks was linked to an increase in foreign liabilities, while a decrease in receivables also contributed to a substantial rise in the ratio. Thus, no change was observed in the situation that has been prevailing since the end of 2022: the banking sector's foreign liabilities still exceed its foreign receivables, i.e. the sector's net debt indicator remains in positive territory, in contrast to the negative, close-to-zero level from after 2017. *Corporate* net external debt as a share of GDP increased by 0.5 percentage point: foreign receivables decreased, mainly related to loans with a maturity of over one year and an increase in trade credits. At the same time, foreign receivables declined, albeit to a lesser extent. The corporate net external debt indicator remained slightly negative at the end of the second quarter, meaning that the sector's foreign assets exceeded its external debt stock.

Chart 15: Breakdown of net external debt and gross external debt (as a percentage of GDP, excluding intercompany loans)



At the end of 2024 Q2, Hungary's gross external debt as a percentage of GDP amounted to 64 percent of GDP. Following a rise at the end of 2022, the upward trend reversed in 2023 Q3, and since then the debt indicator has fallen by 5 percentage points, which for the most part reflected the decline in the general government's external debt. The *general government indicator, consolidated with the MNB*, declined in the context of a reduction in the MNB's HUF-denominated discount bond issued to foreigners, while the Chinese loan taken out by the government in the spring partly offset this. For the banking sector, the increase in foreign liabilities was mainly related to the rise in foreign bonds. The increase in gross corporate external debt as a share of GDP was mainly linked to the rise in loans with a maturity of over one year and trade credits.

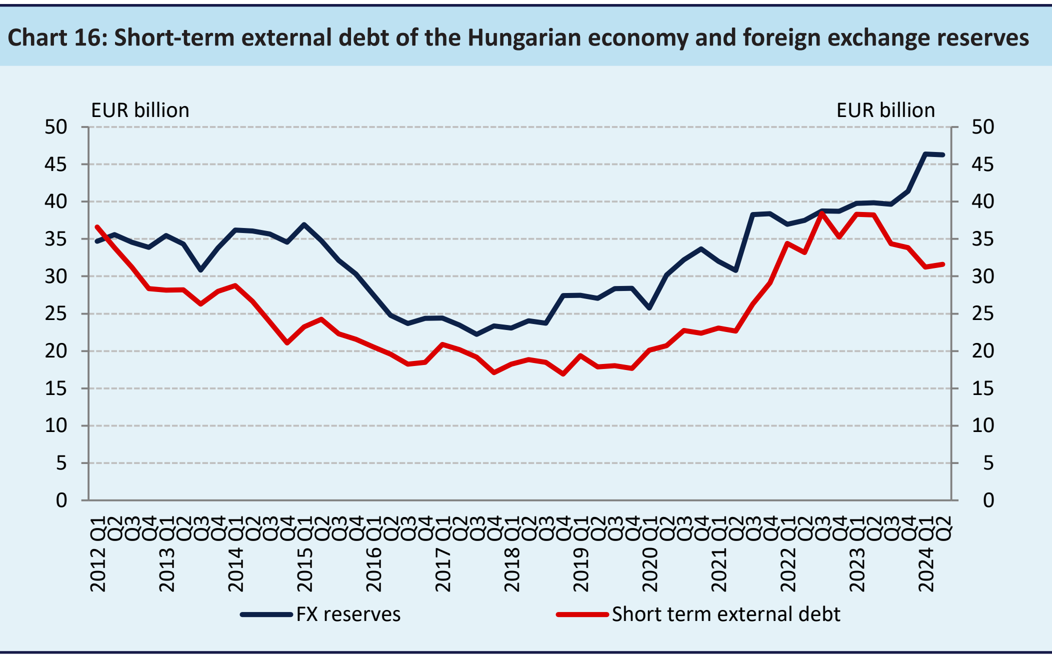
2.3 Reserve adequacy

International reserves stood at EUR 46.3 billion at the end of 2024 Q2, reflecting a modest decrease of EUR 0.1 billion versus the end of the previous quarter. Developments in international reserves were influenced by numerous factors, the most important of which were the following:

- The net reserve-increasing effect of *EU funds* amounted to EUR 0.5 billion, which was primarily related to the inflow of agricultural funds and remaining amounts of 2014–2020 cohesion funds.
- Other material effects on foreign exchange reserves included the *realised return on portfolios* and the *revaluation* of reserve items denominated in currencies other than the euro, which together had an impact of EUR 0.7 billion.
- The *net FX financing operations of the Government Debt Management Agency* reduced the reserves by a total of EUR 0.4 billion. According to the financing data of the Government Debt Management Agency, borrowing in foreign currency took place, which increased the reserves. During the quarter, the acquisition of Budapest Airport Ltd. was completed, and the foreign exchange outflow related to the transaction affected the government's deposit account held with the MNB, reducing the level of reserves.
- The reserve-reducing effect of the *Hungarian State Treasury's foreign currency transactions* amounted to nearly EUR 0.5 billion.
- The development of commercial banks' foreign currency deposits also led to an overall reduction in the level of reserves during the period.

At the end of 2024 Q2, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by nearly EUR 15 billion. At end-June 2024, international reserves and short-term external debt amounted to EUR 46.3 billion and EUR 31.6 billion, respectively. The leeway above the Guidotti-Greenspan indicator, which is closely followed by both the central bank and investors, amounted to EUR 14.7 billion at the end of 2024 Q2 (Chart 16).

Chart 16: Short-term external debt of the Hungarian economy and foreign exchange reserves

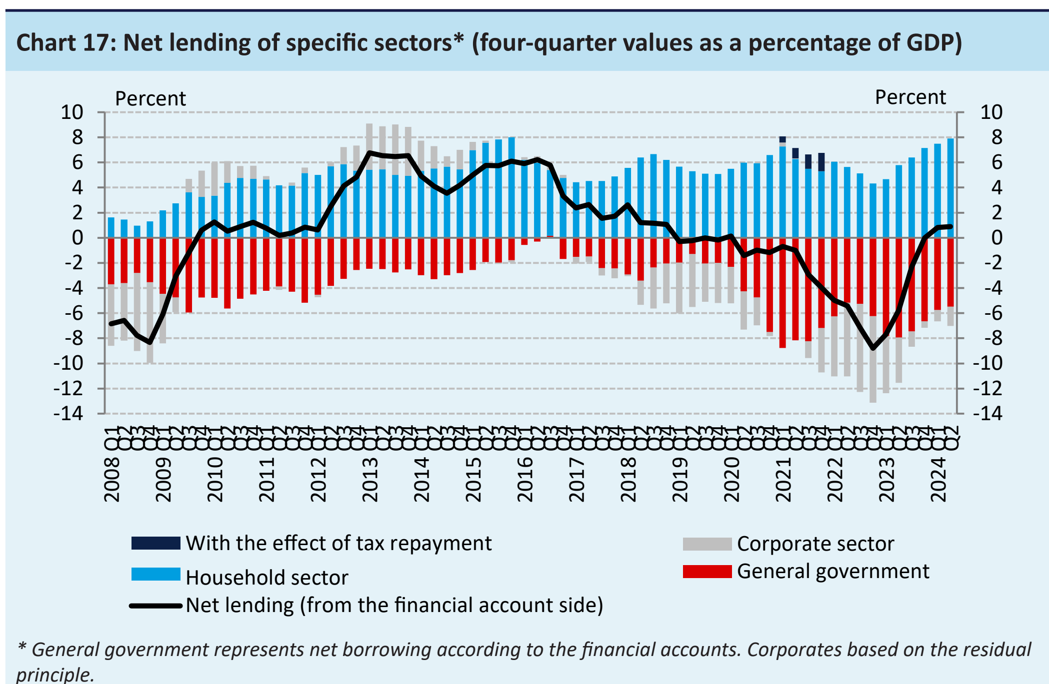


3 Sectors' savings approach

In 2024 Q2, the net savings position of the sectors of the economy increased slightly, as a result of offsetting effects. The declining public deficit and the increasing net financial savings of the household sector were largely offset by an increase in the net borrowing of companies. The financing needs of the general government eased, thanks to higher tax revenues and subdued spending. Household savings increased on the back of rising real wages, while corporate financing needs rose amid falling corporate profits. Within household savings, inflows into deposits were the strongest, and the stock of government securities continued to grow at a faster pace, while investment fund holdings also continued to grow briskly.

As the financial savings of households continued to increase, the government deficit narrowed while the net borrowing of corporations expanded, resulting in a slight rise in the external position of the sectors' savings trends (Chart 17). In the second quarter, the four-quarter general government deficit dropped to 5.5 percent of GDP, due to rising tax revenues on labour and consumption, alongside significant wage growth, while expenditures were restrained. The net position of the household sector rose to 7.9 percent of GDP on the back of higher real incomes and subdued consumption. At the same time, companies' financing needs continued to rise, due to falling operating profits and a year-on-year increase in inventories. Overall, rising household savings and the falling government deficit were largely offset by mounting corporate sector financing needs, resulting in a four-quarter net lending figure in terms of savings of the economic sectors that was 0.1 percent of GDP above the previous quarter's level.

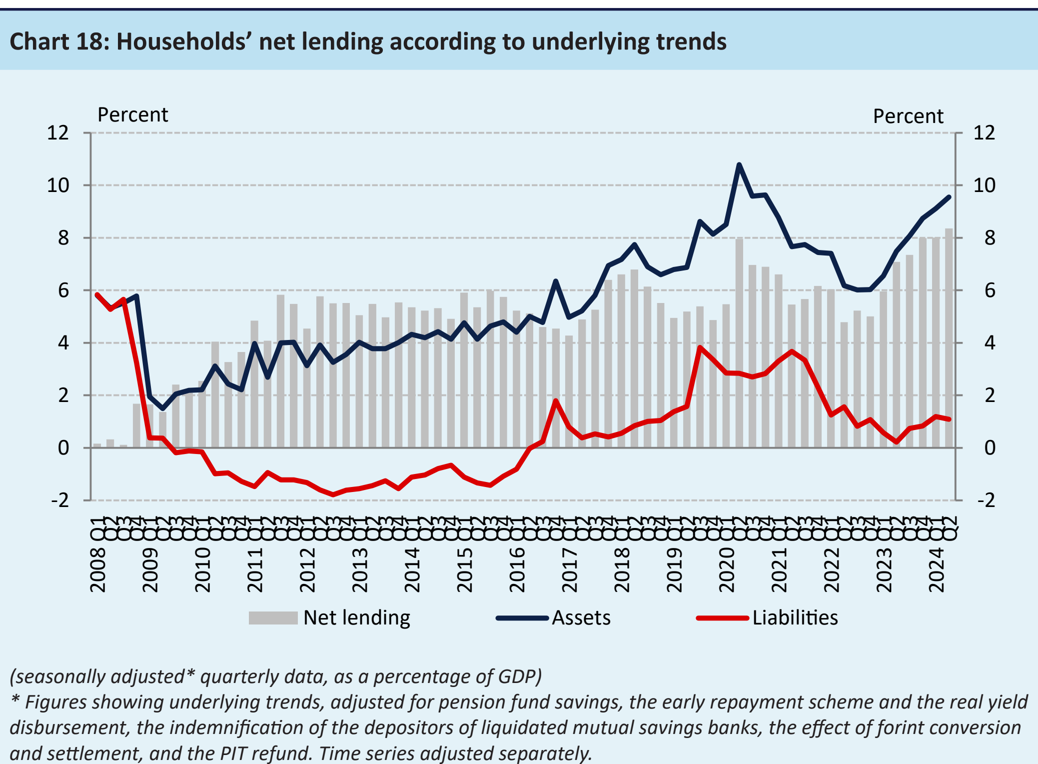
Chart 17: Net lending of specific sectors* (four-quarter values as a percentage of GDP)



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

In 2024 Q2, the seasonally adjusted net financial savings of households rose according to the underlying trends, while financial assets increased and debts remained at the same level (Chart 18). Due to economic considerations, the MNB excludes one-off effects (such as private pension fund savings, early repayment, real yield disbursement, indemnification of the depositors of liquidated mutual savings banks, FX debt conversion and settlement, personal income tax refunds) from the indicator based on underlying trends. One-off effects also influence the net indicator via the accumulation of financial assets and liabilities, and therefore the underlying trends are presented using net data along with the gross legs. According to the seasonally adjusted indicator, which is expressed as a percentage of GDP and captures the underlying trends, households' financial asset accumulation remains high, driven by rising real wages and, presumably, subdued consumption as a result of precautionary saving. As a result of the declining interest rate environment and rising activity in the housing market, net household borrowing was similar to the previous quarter, while other borrowing remained subdued.

Chart 18: Households' net lending according to underlying trends



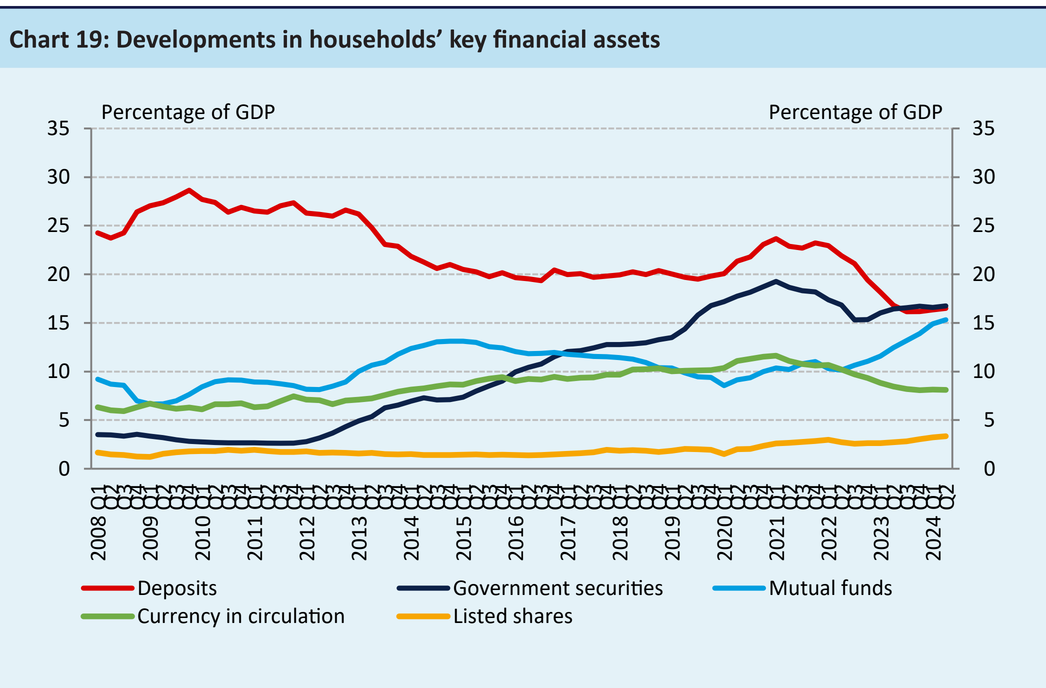
(seasonally adjusted quarterly data, as a percentage of GDP)*
** Figures showing underlying trends, adjusted for pension fund savings, the early repayment scheme and the real yield disbursement, the indemnification of the depositors of liquidated mutual savings banks, the effect of forint conversion and settlement, and the PIT refund. Time series adjusted separately.*

Within the growing financial asset accumulation, the strongest inflow was into deposits (Chart 19).

- The stock of overnight and other deposits increased by more than HUF 500 billion, at a faster pace than in the previous quarter, resulting in a slight rise of the indicator as a percentage of GDP.
- Household demand for government securities strengthened again in Q2: on the whole, households' government securities holdings increased by HUF 430 billion due to transactions. Within the government securities portfolio, the redemption of MÁP+ government securities accelerated slightly, while the stock of PMÁP securities increased again in the second quarter, expanding by some HUF 260 billion, after a decline in the first quarter. In parallel with this, in the segment of variable interest rate securities, demand for BMÁP showed a recovery, with holdings of this type rising more than HUF 70 billion due to transactions. Demand for the quarterly interest paying FixMÁP issued in January this year remained strong (after a rapid increase in the first few months, the stock rose to more than HUF 500 billion by the end of the second quarter), while of short-term fixed-rate securities, sales of 1MÁP declined. Overall, household holdings of government bonds stabilised at above 16 percent of GDP.
- During the second quarter, the stock of banknotes and coins held by households increased by nearly HUF 130 billion, leaving household cash holdings at around 8 percent of GDP.

The buoyant, trend-like increase in the stock of investment fund shares continued, albeit at a slightly slower pace than in previous quarters. In the second quarter, the stock of investment funds increased by HUF 440 billion to more than 15 percent of GDP, while the total stock increased by a larger amount of HUF 500 billion, including the revaluation effect.

Chart 19: Developments in households' key financial assets



4 Earnings of foreign-owned companies

The special topic in this issue of the Report on the Balance of Payments is the development of earnings of foreign-owned companies. Based on the actual figures received, foreign-owned firms' profits as a share of GDP fell in 2023, partly due to subdued exports in the context of slack foreign demand and partly due to the profit-reducing effect of the extra profit tax. The reinvestment rate of non-financial corporations fell slightly, but remains high, whereas the dividend payment ratio of banks decreased. The profits of resident companies' foreign subsidiaries rose to an historic high, driven mainly by strong profits in the banking sector. In the countries of the region, the return on equity ratio typically declined, which, unlike in Hungary, was reflected mainly in a decline in reinvestment.

Based on the annual data supplied, the September balance of payments report replaces the earlier estimates of 2023 corporate income with actual figures.[3] The data show a more favourable balance of profits in the income balance than previously reported. The nominal growth in the profits of foreign-owned companies operating in Hungary fell slightly, due to the extra profit tax and to lower export volumes, while the profit expansion of the foreign operations of Hungarian companies expanded significantly again.

The balance of payments statistics reflect companies' income from normal business activities, excluding outlier (one-off) profit items. According to the balance of payments methodology,[4] profits other than those from normal business activities, such as profits from exchange rate changes, are not included in earnings. Gains and losses from such sources are reported under changes in stocks outside transactions. The first subsection presents the development of the earnings of foreign-owned companies and its absorption in accordance with the balance of payments. This is followed by an overview of the earnings of foreign-owned non-financial companies and banks, after which the background to the changes in profits in 2023 is examined. After a presentation of companies' balance of payments performance, we look at the background behind the rapid growth in income from outward investments, and conclude the discussion of this special topic with a regional comparison.

4.1 Earnings of foreign-owned companies in the balance of payments

In 2023, the balance of foreign-owned companies' income from participating interests stabilised close to the level of a year earlier, at 5.2 percent of GDP (Chart 20). **Dividends paid to owners and reinvestments as a share of GDP were also around the 2022 level.** Following the 2008–2009 crisis, foreign companies' profits as a percentage of GDP fell as demand slowed. However, after 2013, the income generated by foreign companies increased in line with the acceleration in economic growth and support from external demand, which also helped exports to expand dynamically. The fall in profits starting in 2018 was exacerbated in 2020 by the effect of pandemic shutdowns through reduced profitability, although profits as a percentage of GDP remained relatively high and dividend payments[5] were subdued, resulting in significant reinvestment; this has played an important role in the inflows of foreign direct capital in recent years and thus also in the dynamic expansion of investments by companies. Overall, the post-pandemic recovery and stronger export revenues have led to an increase in corporate profits. However, the profits of foreign-owned companies as a percentage of GDP decreased to a lesser extent in 2022, reflecting the extra profit tax in addition to lower export volume growth, with the rapid growth of nominal GDP also contributing to this effect. The extra profit tax remaining in place in 2023 as well and continued subdued external demand were reflected in a further slight decline in foreign corporate profits as a share of GDP. The dividend payment-to-GDP ratio declined slightly, while reinvestment remained broadly stable, resulting in a slight improvement in the reinvestment rate.[6] Although bank profits expanded substantially in 2023, as discussed in more detail in the next chapter, more than three quarters of foreign companies' profits were still generated by non-financial corporations.

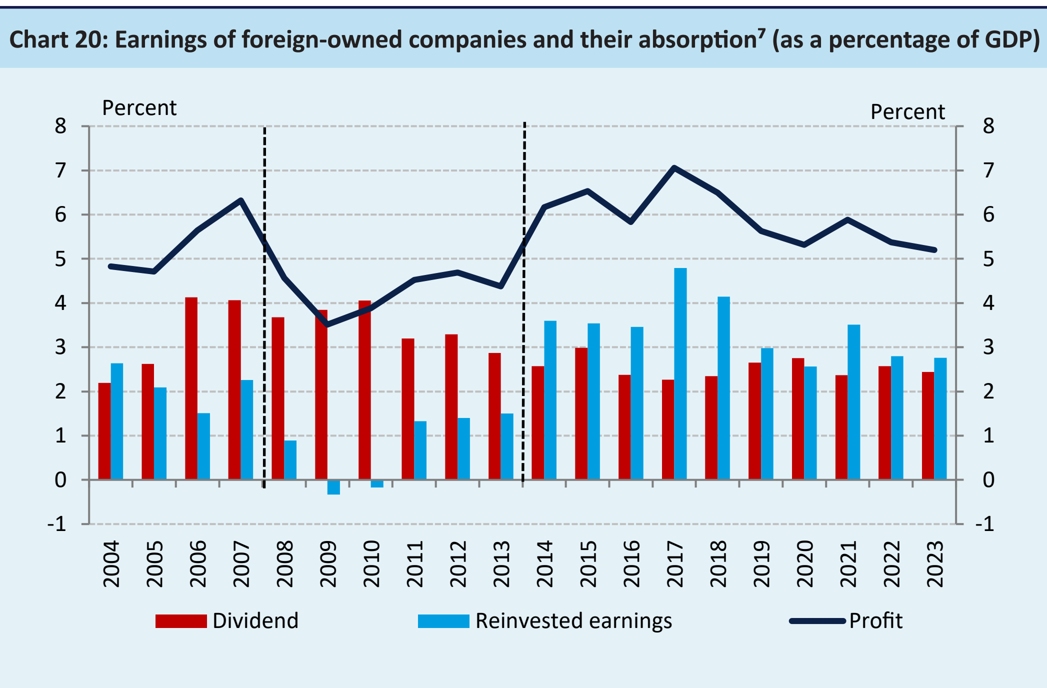
[3] For more details, see: Hungary's balance of payments and international investment position statistics, MNB (2014).

[4] Balance of Payment Manual, 6th edition.

[5] It is important to note here that in the balance of payments statistics dividend payments in excess of the profit for the year are not included in the income balance, as they are recorded as divestment in the financial account. The extent of this is reflected in the exceptional dividend figure, which, at above EUR 7 billion, was significantly higher in 2021 than in previous years. One major contributor to the exceptional dividend figure was the dividend payment by a multinational operating in Hungary, which had not paid dividends to its shareholder for an extended period prior to this, so that the dividend payment in fact reflected profits generated over the course of the previous years.

[6] Since reinvested earnings are the difference between the profits generated and the dividends paid, the COPC adjustment and the treatment of exceptional dividends have a significant impact on the value of reinvested earnings (for more details see the July 2017 Report on the Balance of Payments).

Chart 20: Earnings of foreign-owned companies and their absorption[7] (as a percentage of GDP)



4.2 Profitability of banks in comparison to the profitability of non-financial corporations

In 2023, the profit margin of banks continued to expand rapidly, whereas that of non-financial corporations remained stable. Prior to the 2008–2009 crisis, companies' return on direct investments was around 10 and 13 percent for companies and banks, respectively. After the crisis, the profit margin of non-financial companies fell, while banks' margins contracted to a substantial degree only in 2012.

Foreign banks' profit margins from normal business activities rose to nearly 9 percent in the 2017–2019 period as banks cleaned up their balance sheets and lending picked up in line with the economic cycle, before falling below 8 percent in 2020 as a result of the pandemic. The increase in the profit margin jumped from below 10 percent in 2021 to nearly 25 percent in 2022 and 37 percent in 2023, mainly due to higher interest income as a result of the rising yield environment.

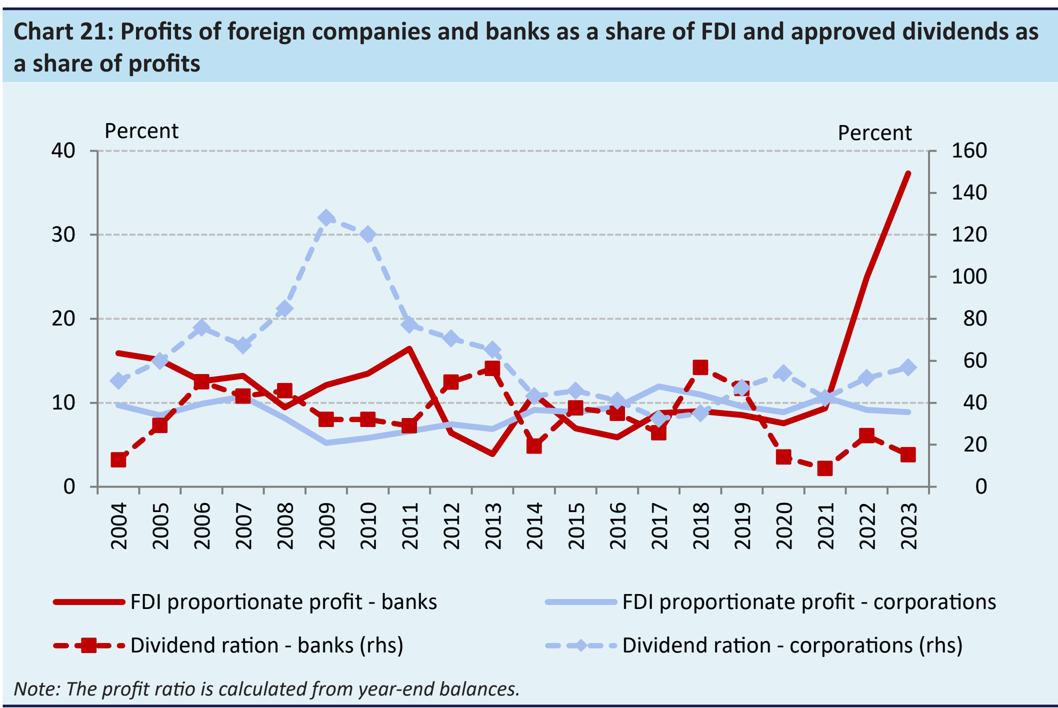
After the crisis, the profits of non-financial companies increased gradually to approximate 12 percent by 2017, but then started to decline again due to high wage outflows, falling even further in 2020 to nearly 9 percent due to restrictions and closures related to the pandemic and lost production due to disruptions in production chains. In 2022, there was a slight decline due to moderating export volume growth and the extra profit tax, which were factors that continued to restrain non-financial corporate earnings growth in 2023.

In 2023, the dividend payment ratio of non-financial corporations increased, while that of banks decreased substantially. Banks saw their dividend payments fall sharply in 2020 and then correct in 2022, which was mainly due to regulatory decisions. In March 2020, the MNB's Financial Stability Board adopted a comprehensive package of measures to mitigate the impact of the Covid-19 crisis on the financial intermediary sector, including a temporary restriction on dividend payments, which strengthened the liquidity and financial position of the Hungarian banking sector. The restriction was lifted at the end of 2021, resulting in an increase in dividend payments by banks in 2022. However, in 2023, despite the surge in profits, banks' dividend ratios fell again substantially (Chart 21), which could be due to the tightening of banks' liquidity requirements by the MNB. The tightening of liquidity requirements was necessary to address the liquidity risks

[7] Any analysis of the time series must take into account that, from 2008 onwards, profits (and hence reinvested earnings) only include the profits from normal business activities. However, it may be assumed that profit and loss items resulting from the significant shifts in exchange rates, i.e. not generated by the normal business activities, may have grown even after the crisis, so the time series is presumably suitable for comparisons with the earlier period. As a further complication, since 2013 dividends paid to foreign shareholders have been adjusted for exceptional dividends, which are then accounted for as a reduction in shareholding rather than as a dividend payment; this in turn has an effect on the allocation of profits between dividend payments and reinvestment.

posed by US bankruptcy events in 2023, increased financial market volatility, an uncertain economic outlook and potential draining effects on bank deposits. The dividend payment ratio for non-financial corporations rose from a low level in 2021 to above 50 percent in 2022 and then to a high of 57 percent in 2023. The increase in dividends may be an indication of the parent companies' growing demand for funds in an uncertain economic environment. In addition, falling investment may also have had the effect of reducing reinvested earnings and increasing dividends.

Chart 21: Profits of foreign companies and banks as a share of FDI and approved dividends as a share of profits

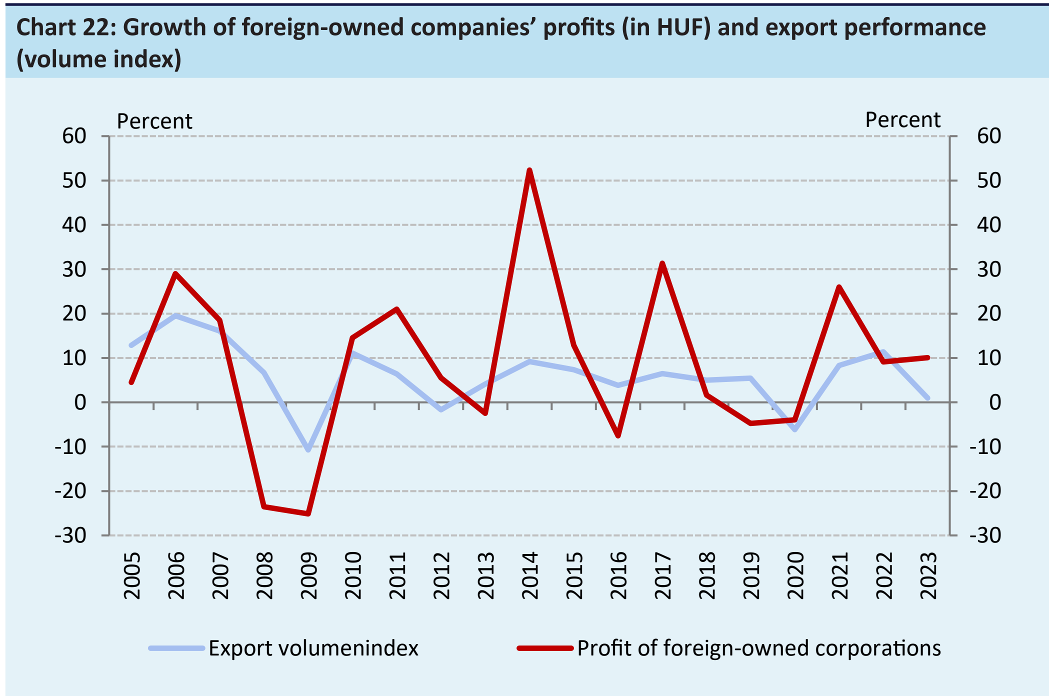


Note: The profit ratio is calculated from year-end balances.

4.3 What are the factors behind the changes in corporate profits?

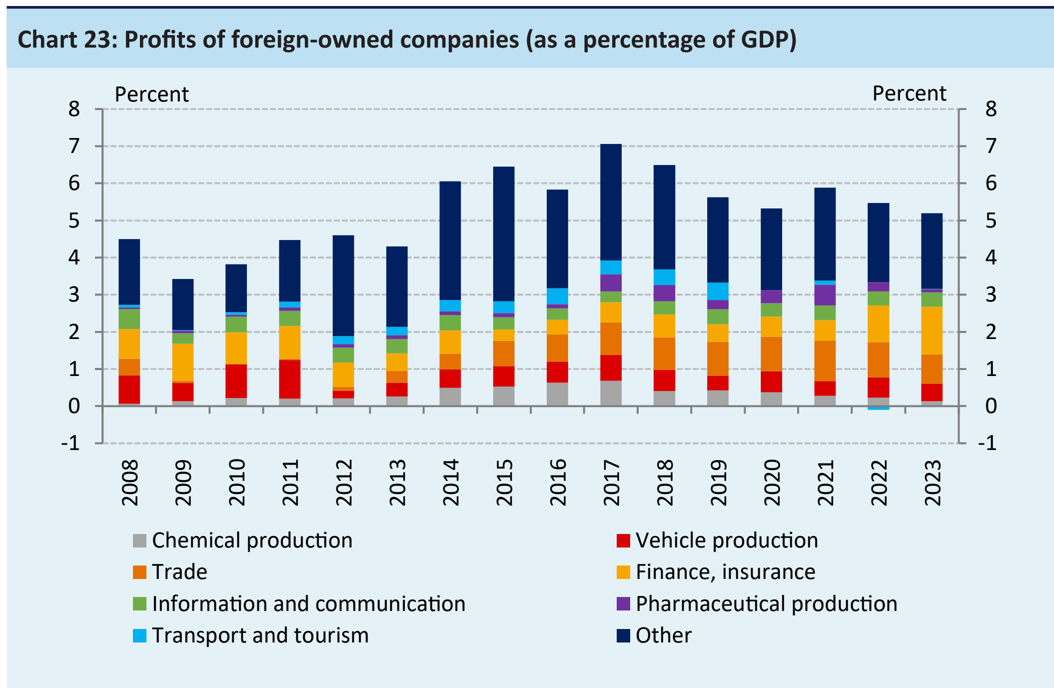
In 2023, corporate profit growth was also subdued as export volume growth continued to moderate. Given the fact that a significant proportion of foreign-owned companies are exporters and based on past experience, it is appropriate to compare the profits of foreign companies with export performance. Over the past decade, exports and profits have generally moved in the same direction, with rising or falling export revenues largely determining the evolution of profits (Chart 22). After the pandemic, export volumes rose sharply in 2021, at their steepest rate since the early 2000s, and companies' profits increased significantly in parallel. In 2022, while export growth continued in real terms, rising costs due to the surge in energy prices and the extra profit tax substantially reduced foreign companies' earnings, and accordingly their profits fell overall. In 2023, export volumes continued to decline, leading to a fall in non-financial corporate income, but a surge in bank profitability meant that overall foreign corporate income rose at the same pace as a year earlier.

Chart 22: Growth of foreign-owned companies' profits (in HUF) and export performance (volume index)



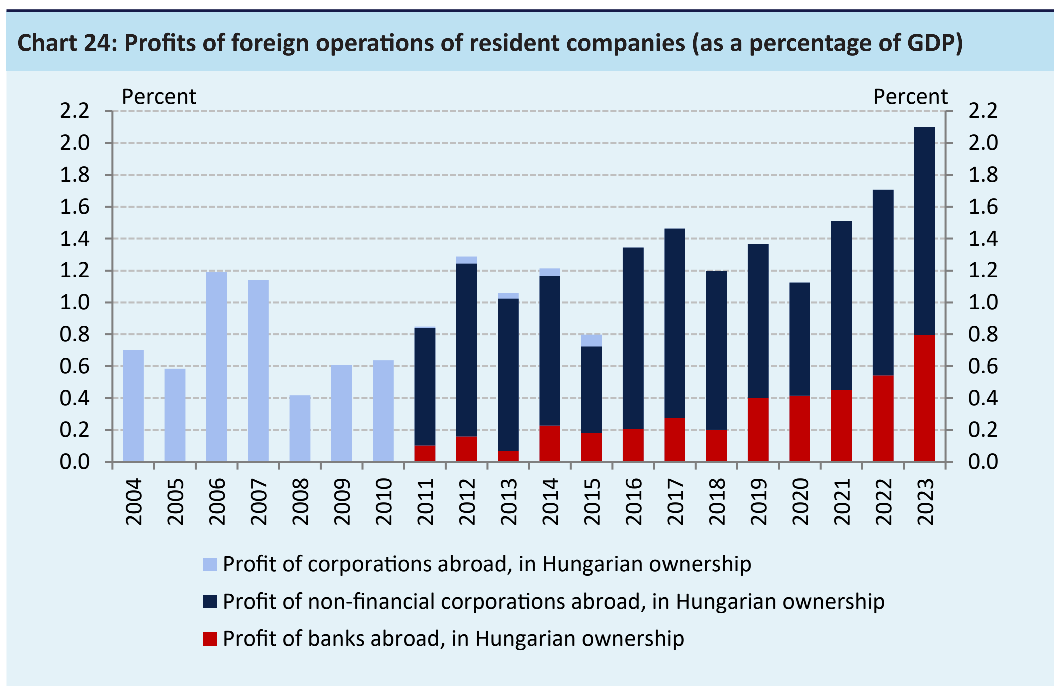
The concentration of foreign companies' profits on foreign direct investment increased significantly, with only four sectors accounting for 56 percent of profits. Until 2017, the increase in the profits of foreign-owned companies affected a wide range of sectors, although the profitability of the largest sectors was especially high. The decline in the profit-to-GDP ratio in 2018–2019 was also observable across the board, as it affected sectors of larger and smaller weight alike. In terms of sectoral profitability, there were more significant and more concentrated changes in 2020: while the profitability of most of the major sectors (e.g. chemicals and vehicle manufacturing, finance and insurance) improved, the economic impact of the pandemic hit transport and tourism particularly hard, causing their profits to fall to zero. By 2022, as the effects of the pandemic faded, losses in tourism were eliminated, but profitability was still well below the levels seen in the late 2010s. In 2023, profits as a share of GDP also fell significantly in chemicals, pharmaceuticals, trade and vehicle manufacturing. At the same time, the income of the financial and insurance sector as a share of GDP increased substantially, which can be explained by the high yield environment. Income in the transport sector also increased, which however was only enough to correct the previous year's loss. Other sectors showed a slight decline in income. The profits of foreign companies are increasingly shifting towards services: the financial sector accounted for almost one quarter of total profits, but trade (15 percent) and IT (8 percent) accounted for significant shares as well. Among the manufacturing sectors, the automotive sector is noteworthy, which continues to account for around 10 percent of foreign companies' profits. Overall, the profits of foreign firms became significantly concentrated, with these sectors accounting for 56 percent of total profits, while the previously significant contribution of chemicals, pharmaceuticals and transport and tourism declined (Chart 23).

Chart 23: Profits of foreign-owned companies (as a percentage of GDP)



In 2023, the profits of foreign subsidiaries of resident companies reached an historic high. In addition to the earnings of foreign companies operating in Hungary, the balance of payments income balance[8] also includes the profits of the foreign operations of Hungarian companies. Its value as a share of GDP rose further in 2023, following an increase in 2022. The rise was mainly linked to a significant improvement in the foreign profits of resident financial corporations, but non-bank profits also rose slightly. Consistently high since 2019, the profits of foreign banking subsidiaries rose further in 2023, despite the fact that market uncertainties in Ukraine and Russia reduced profits.

Chart 24: Profits of foreign operations of resident companies (as a percentage of GDP)

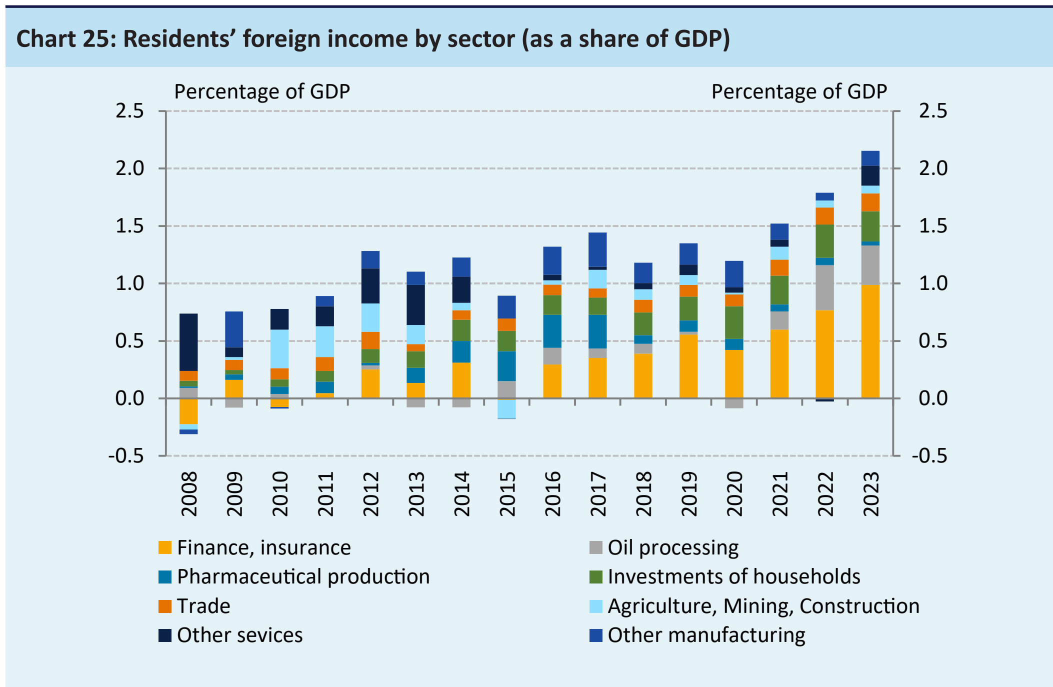


The main contributors to the rising profits of foreign subsidiaries of resident companies last year were the financial sector and petroleum processing. Since the financial crisis, residents' profits from outward investments increasingly shifted towards services, and within that the financial sector (Chart 25). In the years after 2008, mining and (within other manufacturing) computer products' manufacturing played a significant role, the profitability of pharmaceuticals picked

[8] For analytical purposes, primary income is shown in the income balance, except for other primary income, which in the previous methodology was part of unrequited transfers and is therefore included in the transfer balance.

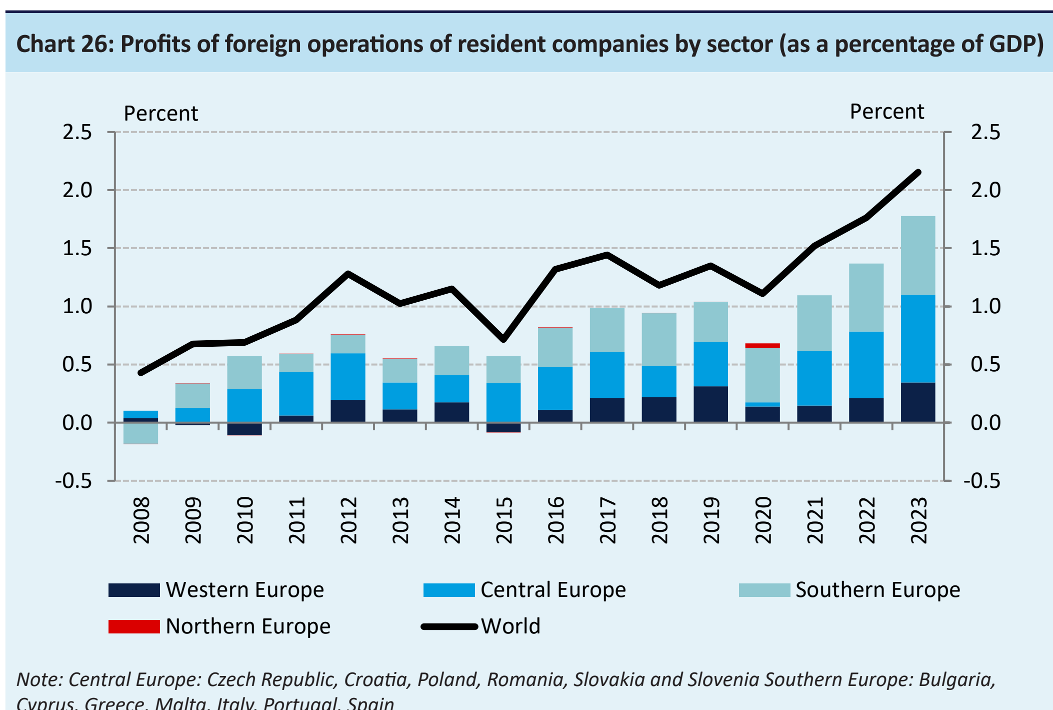
up in the middle of the decade, while in recent years the profitability of petroleum refining has increased significantly. At the same time, among the service sectors, trade accounted for a modest but relatively stable share of foreign profits of domestic companies, while the profitability of the financial sector increased steadily, accounting for almost half of foreign companies' profits in 2023.

Chart 25: Residents' foreign income by sector (as a share of GDP)



With the exception of 2020, since 2009 the vast majority of Hungarian direct investment outflows – almost 70 percent – were generated in Europe, and within that in Central and Southern Europe (Chart 26). Between 2021 and 2023, the main contributors to investment income growth in Central Europe were Slovakia and Croatia, while in Southern Europe, Cyprus and Bulgaria showed an increase. It is worth noting that Cyprus and Croatia also have significant outward investment by households. This may be because the lifting of restrictions after the pandemic allowed households to choose to invest in real estate abroad.

Chart 26: Profits of foreign operations of resident companies by sector (as a percentage of GDP)

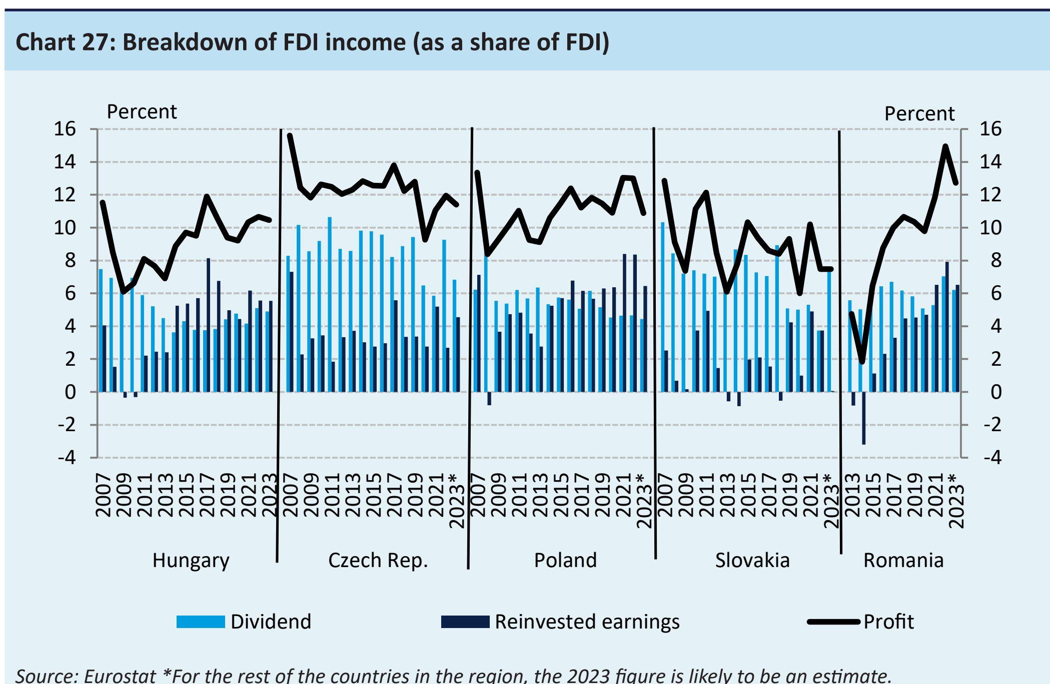


Note: Central Europe: Czech Republic, Croatia, Poland, Romania, Slovakia and Slovenia Southern Europe: Bulgaria, Cyprus, Greece, Malta, Italy, Portugal, Spain

4.4 International comparison

The profitability of foreign companies in 2023 generally declined in the region, but the return on domestic FDI of around 10 percent still only exceeds the level recorded in Slovakia (Chart 27). After the 2008 financial crisis, the profitability indicators of the countries in the region moved broadly in line with each other, driven by common external developments, with a slight upward trend after 2013. In 2020, the pandemic, together with economic growth, also reduced corporate profitability, but profit margins corrected in the following years. According to the latest information, which is presumably still just an estimate, the highest profit margin, of nearly 13 percent, was achieved in 2023 by foreign companies operating in Romania. Hungarian and Czech profit margins followed a similar trajectory after the pandemic, reaching 10–12 percent in 2023. By contrast, the Slovak indicator stabilised at around 8 percent of FDI, which is a low level compared to last year, even by regional standards. While the regional countries used to be characterised by relatively high dividend payments, especially the Czech Republic and Slovakia (according to preliminary data from Slovakia, foreign companies paid out their entire profits in dividends in 2023), in Hungary, after a period of declines until 2014, the dividend payment ratio stabilised at a low level.[9]

Chart 27: Breakdown of FDI income (as a share of FDI)

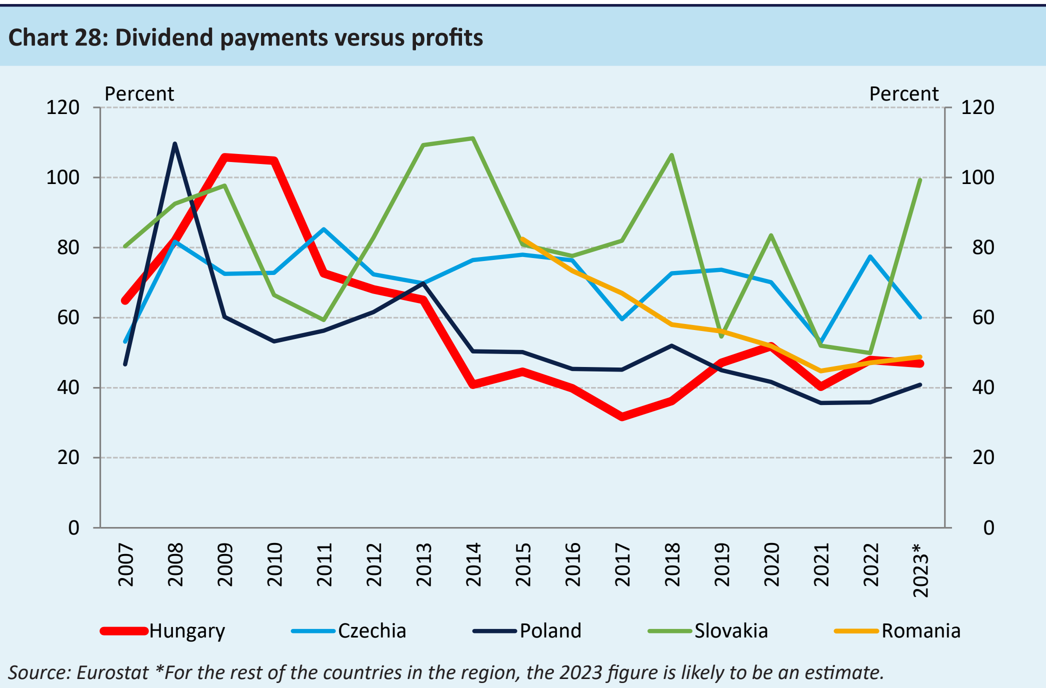


*Source: Eurostat *For the rest of the countries in the region, the 2023 figure is likely to be an estimate.*

In 2023, dividend payment ratios were mixed across the region, with Poland, Hungary and Romania showing the lowest dividend payment ratios (around 40–50 percent) and the Czech dividend payment ratio declining from almost 80 percent last year to 60 percent, while in Slovakia owners paid out almost all of their profits in dividends (Chart 28). The dividend-to-income ratios paid by foreign companies were relatively high in the region before 2009–2010. As a result of the increased liquidity needs of foreign parent companies due to the crisis and the downturn in the growth prospects of the countries in the region, companies in several countries paid dividends to their foreign shareholders against retained earnings accumulated in previous years. The dividend payment ratio declined in all countries by the end of the decade, doing so most notably in Hungary, where in 2017 foreign companies paid out only 32 percent of their earned income in dividends. Subsequently, the dividend ratio for foreign-owned subsidiaries changed to an upward trend and the ratio reached 47 percent in 2023. In 2023, the dividend payment ratio increased in several countries in the region, with only the Czech Republic and Hungary showing a decrease in their dividend-to-profit ratio. Overall, among the countries in the region, only Slovakia saw a sharp rise in the dividend-to-income ratio – up to 100 percent – while the other countries lagged behind substantially.

[9] However, from 2013, the Hungarian accounting of exceptional dividend payments may have played a role in this.

Chart 28: Dividend payments versus profits



*Source: Eurostat *For the rest of the countries in the region, the 2023 figure is likely to be an estimate.*

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Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

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