otp Research

BALANCE OF PAYMENTS REPORT

20 September 2018

Hungary's external surplus decreased further and could hit the bottom in 2019. External debt fell, despite the HUF depreciation in Q2

- The big picture has not changed, Hungary's external surplus decreased again as imports' growth is outpacing that of exports as a consequence of a strong increase in domestic demand, higher oil prices, and higher profitability in companies owned by non-residents. FDI inflow rose and external debt shrank further, despite the 6%+ depreciation of the HUF in Q2.
- Hungary's current account surplus may moderate to around 1.6% of GDP in 2018, down from 3.2% in 2017 and 6.3% in 2016. We expect further decline in 2019, to around 1%, which could be the bottom. From 2020 the slowdown in residential and EU-related investment could be a drag on imports' growth, so the current account surplus could rise by one percentage point in our estimation. The risks are tilted to the downside: if crude oil prices remain at 75-80 USD/barrel, Hungary's C/A surplus may approach zero in 2019. The MNB's new SME loan program also presents a downside risk, which can generate additional investment.

Indicators of external balance: all indicators decreased, as expected

- **Hungary's C/A surplus** sank to EUR 0.8 bn in Q2, down by 50% compared to a year earlier. In SA terms the deficit fell to 1.8% of GDP, from 2.6% in Q1 and 4.2% a year earlier (the peak was 6.5% of GDP in the middle of 2016). The main drivers of the lower surplus are the usual suspects in this phase of the business cycle. Strong domestic demand, fuelled by wage growth, fiscal policy, and EU-related public investment results in fast imports growth. Higher oil prices may reduce the trade balance by EUR 1 bn in 2018 compared to 2017, and by EUR 2 bn compared to 2016. Incomes from FDI are the same as a year earlier, but the four-quarter amount rose by EUR 0.8 bn.
- EFC1: external financing capacity, the sum of the C/A and the capital balance, fell to 2.6% of GDP, down from 4-5% characteristic for the past few quarters, as the current account balance worsened simultaneously with the moderation of the capital balance. As EU-fund-related public investment is booming, we consider the latter as a temporary phenomenon.
- EFC2 (EFC1 plus net errors and omissions): The indicator that we usually consider the first best indicator of external balance fell to 1.2% of GDP, down from around 2.5% in the past few quarters and from around 6% in 2015-2016.

Capital flows: FDI inflow rose moderately, strong debt repayment (Charts 3 and 4). It is in the second quarter when non-resident owners decide how much to repatriate from the corporate profits made last year. Therefore net FDI inflow was negative (around EUR -0.8 bn) in the second quarter of the past few years, but in Q2 2018 net FDI inflow was roughly 0. The four-quarter rolling average rose to 2.2% of GDP, and to 2.6% in the case of non-financial corporations, in line with stronger private investment activity. Despite the fall in the external surplus, net annual debt repayment still exceeds 3% of GDP.

Indebtedness and reserves: external debt is still falling (Charts 5-7). Hungary's gross external debt without SPVs and intercompany loans (which is more FDI-like than debt) fell by EUR 0.7 bn in Q2, to EUR 73 bn, despite the depreciation of the HUF and the revaluation (+EUR 2 bn) of external FX debt. So the debt-to-GDP ratio fell to 56.4% of GDP (down from 56.9% in Q1, from 64.5% a year ago, and from 114.3% at the peak), which could be labelled as average compared to Hungary's peers in the CEE region (Chart 7 – note that World Bank's data are marginally higher that those of the MNB). In Q2 net external debt fell to 8.9% of GDP, from 10% in Q1, 16% a year ago and 57% at the peak. Short-term external debt actually has been stagnating around 14% of GDP for a while (14.4% in Q2). Foreign currency reserves rose to EUR 23 bn, which could still be labelled as just adequate, taking into consideration the relevant reserve adequacy rules.

Trading Desks
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Fixed Income Desk

András Sovány
+36 1 288 7561
SoványA@otpbank.hu

Benedek Károly Szűts
+36 1 288 7560
SzutsB@otpbank.hu

FX Desk

András Marton
+36 1 288 7523
MartonA@otpbank.hu

József Horváth
+36 1 288 7514
Horvath.Jozsef@otpbank.hu

Money Market Desk

Gábor Fazekas
+36 1 288 7536
FazekasGa@otpbank.hu

Gábor Heidrich
+36 1 288 7534
HeidrichG@otpbank.hu

Judit Szombath
+36 1 288 7533
SzombathJ@otpbank.hu

FX Option Desk

Gábor Réthy
+36 1 288 7524
RethyG@otpbank.hu

Máté Kelemen
+36 1 288 7525
KelemenMat@otpbank.hu

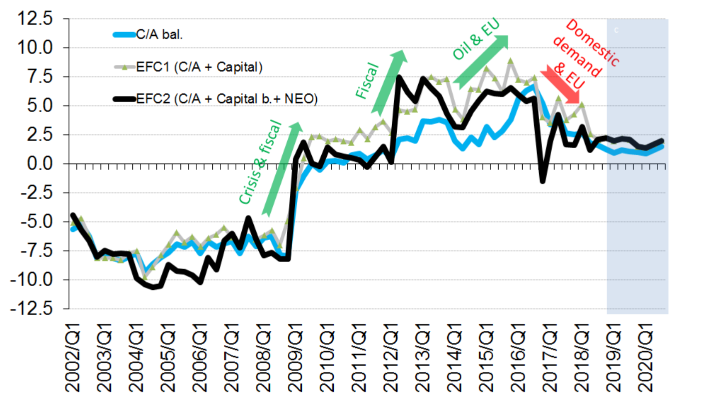
Analyst

Gergely Tardos
+36 1 473 7273
TardosG@otpbank.hu

Looking ahead, we expect the C/A surplus to decrease below 2% of GDP in 2018 and to fall to around 1% in 2019, mainly due to strong consumption and investment. However we do not expect further fiscal stimulus and we also expect oil prices to moderate. Risks, related to the recent oil price shock, are tilted to the downside: if crude oil prices remain at USD 75-80 per barrel level, Hungary's C/A surplus may approach zero in 2019. From 2020 the trend can change. We expect GDP growth to slow down in 2020, as both private residential investment (the VAT on new flats will return to 27% after a four-year-long preferential rate of 5%) and EU-related public investment could decrease, moderating demand for imports. These factors could push back the C/A surplus to around 2% of GDP.

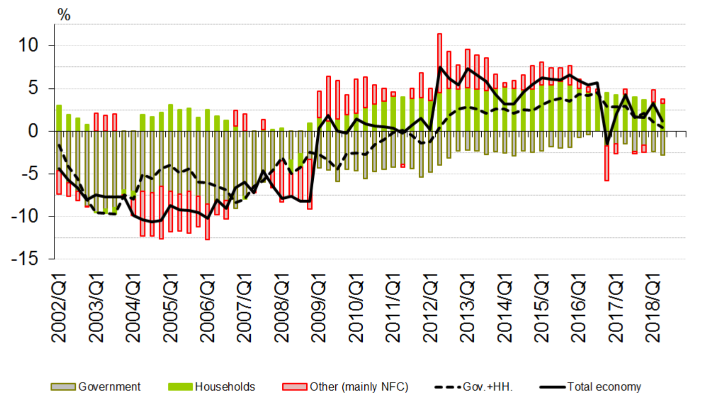
We expect the surplus of the capital balance to reach at last 3% of GDP in the coming years,while the NEO could remain around 2%, so the net financing capacity (EFC2) is expected to fluctuate areound 2-3% of GDP. We expect FDI to reach around 2% of GDP. These levels would allow external debt to stagnate even if the current accound deficit hits 4-5% of GDP. But as we expect the surplus to remain, net and gross external debt would fall further, the former could reach zero, while latter could decrease to around 50% of GDP by 2020.

Chart 1: Main indicators of external balance (as % of GDP, SA)



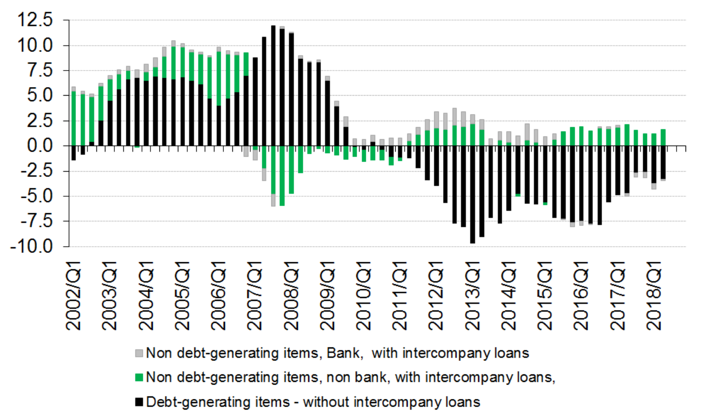
Sources: MNB, OTP Research

Chart 2: Net financing capacity of the main sectors and the whole economy (as % of GDP, SA)



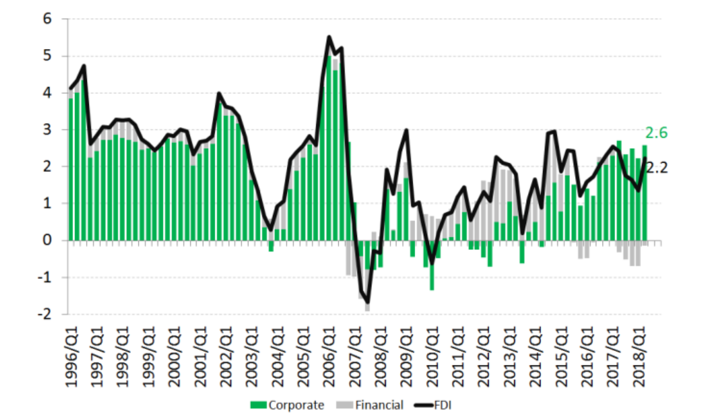
Sources: MNB, OTP Research

Chart 3: Structure of (net) capital flows (as % of GDP, four-quarter average)



Sources: MNB, KSH (negative numbers represent outflow)

Chart 4: Net FDI inflow (as % of GDP, four-quarter average)



Sources: MNB, OTP Research (negative numbers represent outflow)

Chart 5: Indicators of external indebtedness (as % of quarterly, SA, annualised GDP)

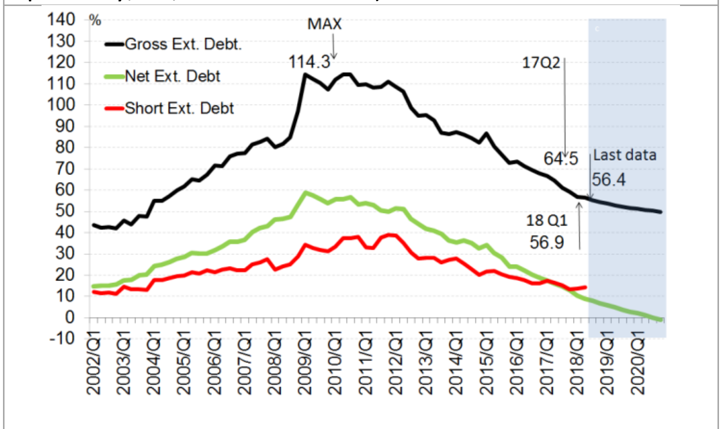
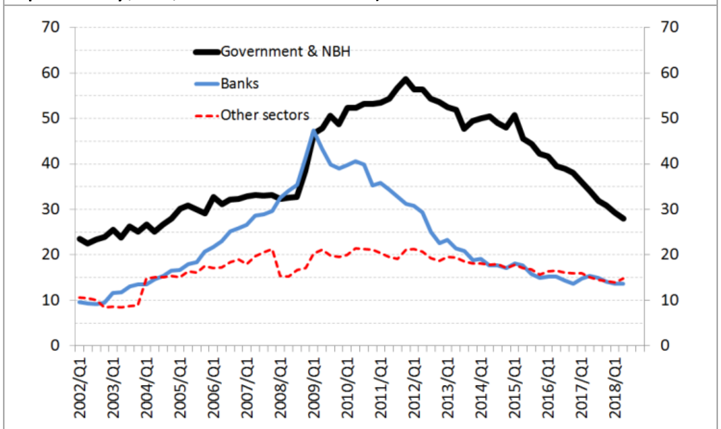


Chart 6: Gross external debt by sectors (as % of quarterly, SA, annualised GDP)



Sources: MNB, KSH (w/o intercompany debt)

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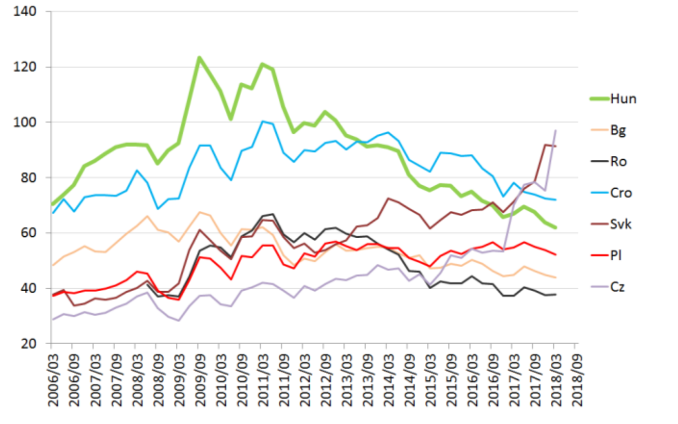
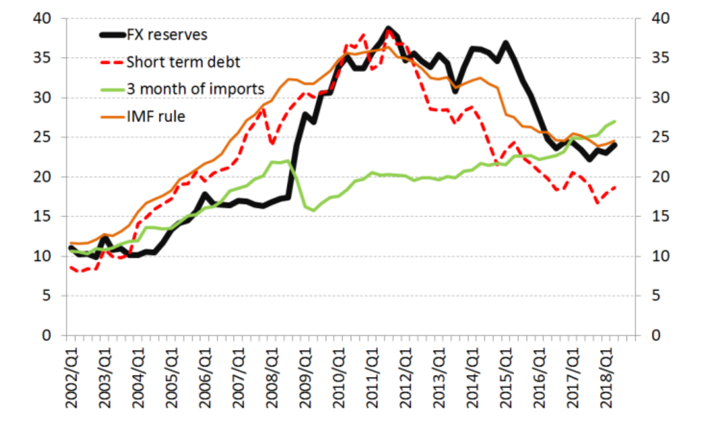
Chart 7: Gross external debt (w/o intercompany debt, as % of GDP)



Sources: World Bank JEDH, OTP Research

Chart 8: Reserves and reserve adequacy rules (EUR bn)



Source: MNB

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This document was prepared on 20 September 2018.