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NEWS OF THE MONTH

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I. Rapidly increasing public debt ratio in the Czech Republic

In the Czech Republic government debt has risen steadily over the past years due to a ballooning state budget deficit, but still remains well below dangerous levels. Overall public debt, including various public agencies and municipalities, had been estimated previously at 20 percent of GDP for last year, well below the 60 percent threshold set by the Maastricht criteria for joining the Eurozone, a step the Czech Republic is likely to take between 2007 and 2010. However, the International Monetary Fund, the EU and private economists have warned of the rapid pace of debt build-up and suggested that swift overhaul of public finances is needed to avoid economic instability in the future. A recent surge of arbitration lawsuits have exacerbated the situation.

The deterioration of the fiscal positions in Central Europe has been a general trend in the last couple of years. These developments are getting worrisome concerning the efforts of these countries for meeting the Maastricht criteria.

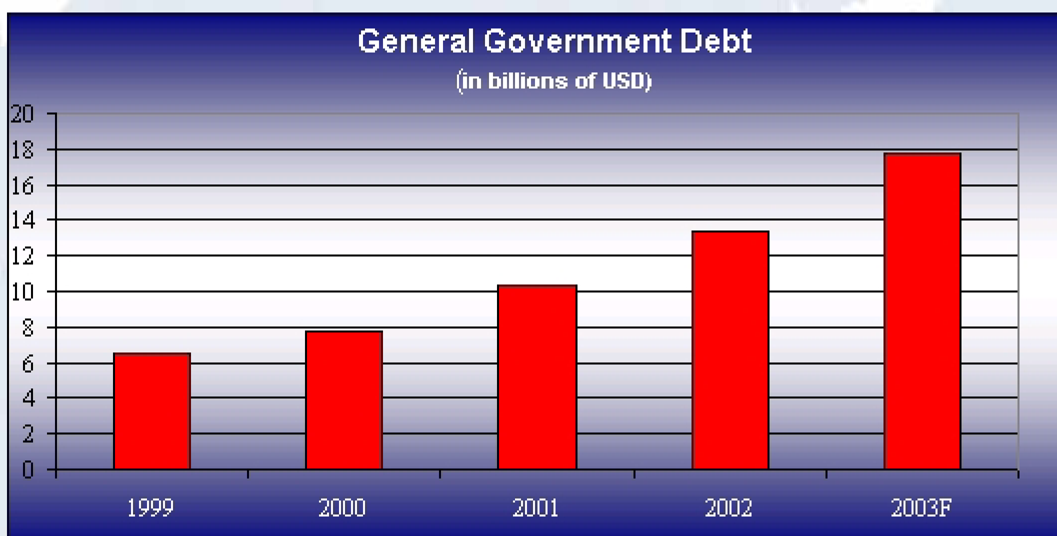
The fiscal position of the accession countries before the EU enlargement shows sizeable differences. While the Baltic countries perform much better, the Central European countries are facing high and increasing deficits and are relatively more indebted. The trend of the figures were more or less in line with the expectations in both groups until 2000. But 2001 was the turning point, when deficits in Central Europe started to rebound. The growing imbalances from then onwards could only partly attributed to the exogenous shocks in the form of a slowdown in the global economy. The deteriorating fiscal position cannot be explained by higher government investment either, the explanation rather lies in primary current outlays. In Central Europe government wage bills and transfers to households have increased continuously and they are significantly higher than in the Baltic States.

In the following years the accession countries will be facing hardships concerning their fiscal position. The compliance with the environmental standards and infrastructure requirements of the EU entail a further heavy fiscal burden in the coming years, due to the neglect of these areas during the socialist era. Utilization of the different EU funds means severe costs for the budget as well. Achieving the fragile balance between the EMU criteria and the necessary growth is a challenging task. Among the Maastricht criteria, the public debt ratio to GDP has proved to be the easiest to achieve for the accession countries so far. However the relatively low indebtedness, which characterized these countries is changing probably because there is no reason to hold back up till the 60 percent reference value. The most radical change concerning the debt stock is taking place in the Czech Republic.

The general government deficit (excluding privatization receipts) has increased over the past five years and reached 9 percent of GDP in 2002. Although a significant part of the expansion has reflected bank restructuring costs, even excluding those the general government deficit still increased by 4 percentage points to 5.3% of the GDP in 2002. The increase of the deficit could not be attributed to a counter-cyclical fiscal policy because it grew both in years of strong and weak economic growth. The structural nature of the problem is also reflected in the gradually increasing government expenditures, which stem from the rising mandatory public spending and the compensation of transformation institutions' costs. The increasingly fragmented general government sector has also contributed to the spending pressures. The extra budgetary funds for transport infrastructure and housing, and the setting up of new regional governments has exacerbated the situation. Ratio of expenditures excluding net lending was estimated to be around 48% of the GDP in 2002, which is 3.1 percentage points higher than in 2001. Regarding the revenue side the privatization receipts, which amounted to 5.6% of the GDP in 2002 are going to decrease in 2003 due to a shifting of some privatization items to the next year. Expected revenues by the National Property Fund (NPF) have been reduced by more than CZK 45 bn.. The expenditures side adjusted to it partly but the NPF deficit is estimated to amount to CZK 33.7 bn..

Addressing the growing problems in public finances seems to be postponed by the Czech authorities. The 5.6% general government deficit (excluding privatization, transfers to transformation institutions, and the effects of the flood), which is implied by the state budget for 2003 indicates that fiscal adjustment is not on their way yet. High dynamics of public debt growth will increase further in 2003, reaching the highest increase since 1993. Public debt is expected to be around CZK 578.2 bn.. This record increase is mainly due to the extremely high CZK 111.3 bn. budget deficit. Share of the state debt in the total public indebtedness will increase by 1.6 percentage points to 89.3 percent compared with 2002.

Chart 1.



The lack of intention for any changes in fiscal policy can be partly explained by low funding costs for government debt management. The funding is relatively cheap because the public debt, in spite of its rapidly growing trend, is still low (25 percent of the GDP). The other reason of the low cost is the deflationary process that has characterized the country since early 2003. Government interest expenditures could also be kept down because Czech banks are reluctant to extend credit to local companies, preferring instead to buy government securities. However, one of these factors, namely the public debt ratio has started to change dramatically. Because the current interest rates are far below those in other EU accession countries and even lower than in the Eurozone, the market cannot reward the Czech Republic for good fiscal performance, it can only punish it for failing to take adequate measures. It is likely for these reasons that the Czech Republic is going to face higher interest payments, that might necessitate further fiscal cuts in order to reach the fiscal reference values. The downgrading of the local currency Czech debt in late 2002 by a credit rating agency was a kind of warning.

The recent flurry of international arbitration lawsuits the Czech Republic is involved in at the moment might boost the public debt ratio radically in the near future. According to Patria Online analyst David Marek public debt may increase by 50 percent this year, amounting to 683 billion Crowns, which would be equal to 45 percent of the GDP.

According to a decision handed down by an international arbitration court on the 14th of March, the Czech Republic was ordered to pay 353.4 million dollars to Central European Media Enterprises (CME) for failing to protect the CME's investment in Czech private TV channel Nova. The government considered depositing the amount into a bank account to avoid the 2 million crown daily interest payment penalty. Some Czech politicians blamed the Council for Radio and Television Broadcasting for the situation. The government made some efforts to involve Nova in the payment. However, the company refused to participate and stressed that the dispute is only between the US investor and the Czech Republic. According to Christian Democratic deputies a kind of special tax should be implemented to cover the bonds that would be issued to raise money for the payment of the penalty. The Czech Republic has already filed an appeal, the ruling will be handed down in Stockholm June 15. Finance Minister Bohuslav Sobotka said that Czech Republic's public debt including the compensation to be paid to CME could amount to 30 percent of the GDP this year.

Another big hit could emerge from Nomura Bank, that also filed for international arbitration. The bank invested in IPB bank in 1997, which collapsed later and its assets were folded into CSOB, currently the country's largest bank. Nomura is suing the Czech Republic for more than 30.5 billion crowns (1 billion dollars) citing discriminatory activities.

There are some six more foreign companies threatening the Czech Republic with an arbitration court lawsuit, the amount at stake exceeds 52 billion crown. The reason for the upheaval of the lawsuits might be that international agreements favor investors, and there is a certain imbalance in international contracts between the foreign investors rights and obligations.

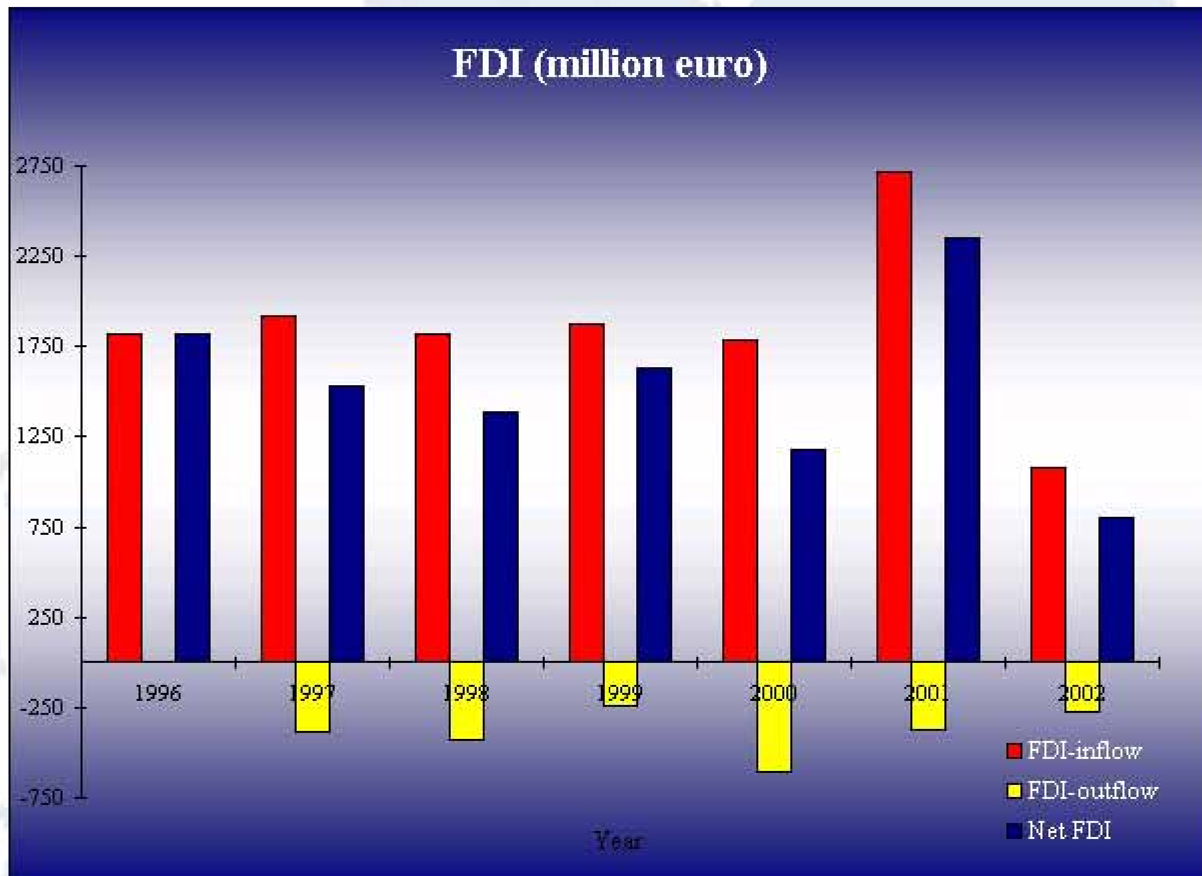
At the moment the problem is not the amount of the public debt, but rather the rapid pace of the build-up, that could easily lead to lower credit ratings. Some politicians argue however, that at least this could put pressure on the government to speed up public finance reform, which is currently stalled. In its Coalition Agreement, the government announced that the general government deficit target for 2006 would not exceed 4.9-5.4 percent of GDP. Even the bottom of this target is in breach with the Maastricht treaty reference values. This kind of slow fiscal adjustment might necessitate a more severe retrenchment afterwards that might limit the room of fiscal policy in those years. The delay of a radical pension reform despite the rapidly aging population will also exacerbate the fiscal problems later on.

Prepared by: Dániel Bebesy

II. FALLING FDI IN HUNGARY: WHAT ARE THE PROBLEMS?

The competitiveness of the Hungarian economy had constantly improved from the latter half of the 1990s until the middle of 2002. In accordance, Foreign Direct Investment (FDI) was rising with a positive effect on the whole economy. By now the process has changed: FDI started declining and some of the foreign investors have left the country.

Chart 2.



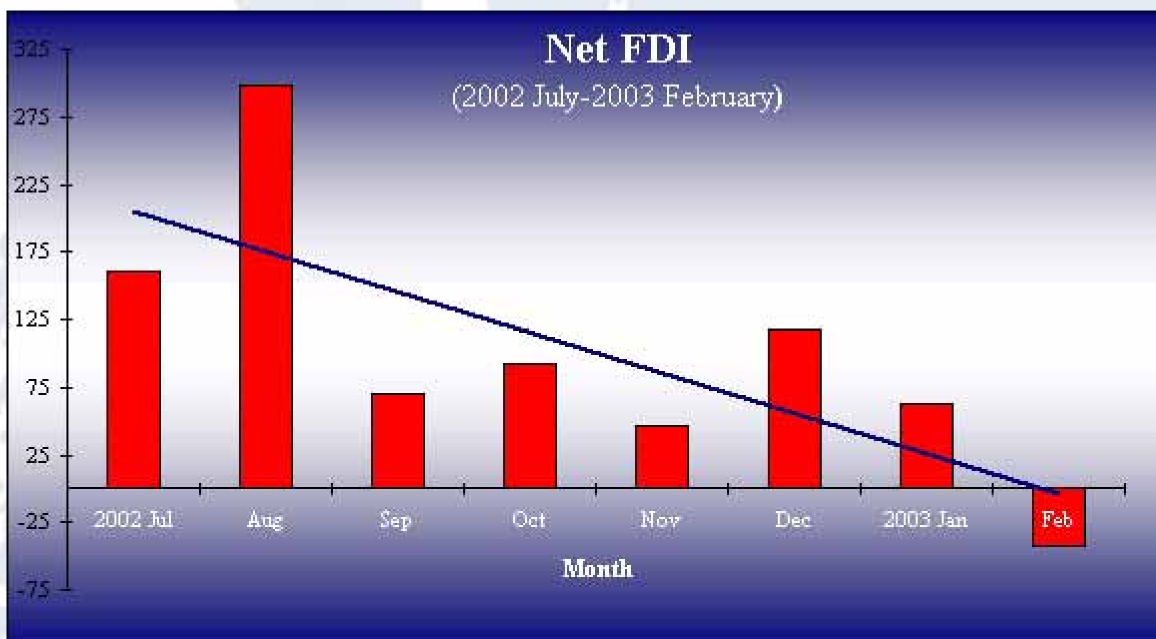
Although the Hungarian economy produced robust growth rates and falling inflation rate last year, capital inflow has been constantly falling since the second half of 2002. The quick and significant rise in wages, the strengthening Forint and loose fiscal policy are in the background of the decreasing ability to draw foreign capital.

Although the relatively strong economic growth last year may seem to reflect a favorable macroeconomic situation, there are some deep-lying problems. Political factors, like rising wages in real terms and loose fiscal policy, constrained the playing field of the monetary policy. Imports grew due to the effect of better household purchasing power, the strengthening Forint and the loose fiscal stance. This process led to worsening deficits of the current account. Meanwhile FDI has fallen significantly and this downward course is predicted to continue according to the IMF and the Economist Intelligence Unit of The Economist.

INTERNAL SHOCKS

The recently rising average wage level is often blamed in itself for the falling interest of foreign investors. Although it is one of the problems but its significance is much less than the emphasis attached to it. A general research of the Economist Intelligence Unit on FDI flows supports this view, because it puts the cheap workforce on the sixth place in the order of the most important factors, which generate cross-border capital flows. In most of the cases low wage level does not generate FDI-flow in itself. For instance, low wages cannot compensate for underdeveloped infrastructure or unskilled workforce. However, we cannot say that this type of constraining factors are present in Hungary and we can state that the international companies present in Hungary had calculated with rising wages in their strategies. Yet they were badly affected by these rising wages.

Chart 3.



The speed of wage increases shocked these companies: average real wages were 13.6 per cent higher last year than a year before, which meant in the competitive sector a 13.3 per cent rise. Economic actors built higher expected inflation in the wage-contracts than the 4.5 per cent central bank forecast, and fiscal policy generated rise in wages in the public sector had put a pressure on the wage level of the competitive sector as well.

Second, and this may be an even more worrisome effect, it became clear to foreign investors that loose fiscal policy would result in worsening budget deficit. The Hungarian budget gap significantly worsened last year and the risk of overspending still exists. The Finance Ministry has repeatedly made vows to bring the deficit below 3 per cent of GDP by 2005, but the verbal communication is not convincing enough. There is no doubt that last year an unfavorable policy mix was created with a loose

fiscal and tight monetary policy. Instead of the earlier foreign capital friendly policy of tax advantages, infrastructure developments and education reforms they were confronted with rising costs. The price of natural gas and electricity, and because of this, the prices of services related to infrastructure, are on the rise. This process of price convergence is expected to take years until the world market prices are reached. This factor gives another push to the corporate sector costs.

The quick growth in wages slowed down disinflation in Hungary. It is now a widely shared consensus that presently there isn't an acceptable scenario, which would make the accomplishment of this year's inflation target possible. Even the central bank has given up its inflation target for 2003 and is concentrating on the inflation level of 2004. A higher and more volatile inflation means less stable economic environment, discouraging foreign investment.

Further, the uncertainty over government subsidies worsens our perspectives for FDI. It was widely known that the Hungarian tax advantages were not compatible with the EU standards and that this would lead to their elimination. However, some of the international companies working in Hungary had expected some substituting governmental help wrapped into a 'legal' frame.

The role of exchange rate volatility, which is probably a more important factor than the political or market uncertainties, must also be mentioned. In Hungary most of international companies export their products and two thirds of them come from the EU: therefore the Forint exchange rate against the Euro determines largely their market access. Companies selling their products in foreign markets have been facing rising costs in Euro on the side of local suppliers and declining incomes in Forint on the foreign markets. This problem occurs mainly because given the small size of the Hungarian market, most of international companies operating in Hungary aim at wider regional markets.

However, it must also not be overlooked that most of these companies work in the processing industry with high import content. Their basic materials come mainly from their parent companies. This means that a stronger Forint results in cheaper imports and lower costs in Forint have partly compensated them for their falling Forint incomes.

In the middle of January the strengthening trend of the national currency was broken by the National Bank of Hungary. High volumes of speculative capital flooded the Hungarian financial markets betting on the dislocation of the exchange rate band, whose stronger edge was hit by the strengthening Forint. The shock was accommodated by open market operations by the central bank. The national currency weakened and this situation led to enhanced competitiveness, although excess liquidity raises concerns over disinflation, which, in turn, undermines competitiveness gained through currency depreciation.

It is strongly expected that exchange rate volatility will be higher at least in the medium term with a negative effect on investments. While foreign investors expect a long period of strong exchange rate movements, the Hungarian Economic Research Institute expects that after a bit more volatile period the exchange rate will return to trend appreciation in the second half of the year.

The IMF emphasizes that although the speculative attack was settled there is still a conflict between competitiveness and the disinflation, at least if disinflation is to be achieved via stronger exchange rate. This situation bears some uncertainty with a negative effect on FDI inflows. The national bank cut back on interest rates in January with the aim of discouraging speculative capital inflows. Lower interest rates may generate investment, although this cannot be observed yet.

EXTERNAL SHOCKS

The unfavorable global conditions are a general problem all over the world. Global FDI flows fell year-on-year by 45 per cent in 2001 and by 22 per cent in 2002, according to the Economist Intelligence Unit. During the 1990's a robust wave of mergers and acquisitions passed across the world. In 2000 the volume of FDI flows was 6.5 times greater than 10 years earlier. This growth was much quicker than the growth of international trade. In first year of the 21st century political and economic problems were accompanied by less M&A activity and the lower international investment with an adverse effect on FDI flows. The US and the UK were hit most by the changing situation, meanwhile, especially in China, but also in France and in Italy, FDI increased.

Recently the war in Iraq has got the key negative effect on the investment climate. On the positive side the war did not last too long, but it is not clear what problems it has solved. The stabilization and reconstruction might improve the situation, while falling oil prices can decrease costs and inflation pressures. On the other hand, if the dollar appreciates, this may compensate for the whole effect of falling oil prices.

The increased attractiveness of China to FDI is an important factor behind the decrease of FDI inflows into Hungary and other CEE countries. China shows an incredible speed in growth, and it is not only cheap workforce but also the huge market that attracts foreign investors. The growth in demand, absorbing products in almost endless quantities provides them with an unequalled advantage to other countries.

A slight improvement is generally expected in the flow of FDI. In the CEE region the Economist Intelligence Unit expects the greatest foreign investment inflow into Poland and the Czech Republic (USD 7 and 6.3 billion in the next four years), and 3.7 billion is forecasted for Hungary. The economic environment in Hungary is not expected to improve as fast as in other Central European countries in the next four

years, so Hungary's position in the contest for foreign investment might relatively worsen.

prepared by: Árpád György Mórotz

III. POLAND : DEVELOPMENTS AND ISSUES IN EARLY 2003

Background at the end of 2002 The Polish economy has been showing signs of modest recovery at the end of 2002. Poland's economy expanded 2.1% y/y in Q4/2002. The whole year's real GDP growth was 1.3%, compared to 1% in 2001. The modest recovery is expected to be sustained throughout 2003, but there is still no base for a longer-term acceleration, because investments fell for the second year in a row, and are still on the fall.

At the end of 2002, the unemployment rate was 18.1%, which means that over 3.2 million people were unemployed. Unemployment has grown among older and university educated people. In 2002 strong disinflation has been experienced in the Polish economy, which was mainly determined by the lack of demand pressure, high unemployment, large supply of foodstuffs and significant reduction of inflationary expectations. The consumer price index has increased by 1.9%, while producer prices grew by 1.0%. Poland has met the Maastricht Treaty's inflation criterion in 2002.

For the first time since the beginning of the economic transformation in Poland, the average annual stock of broad money aggregate M3 was lower (by 2.1%) than in a previous year. The Monetary Policy Council has cut interest rates 8 times and as a result the reference rate decreased by 475 basis points during the year. The Polish Zloty has gone through a very deep one-year nominal and real depreciation, mainly driven by the appreciation of the Euro on the global currency market. The average nominal PLN/EUR exchange rate was weaker by 5.1% than in 2001.

There has been an increase in foreign trade in 2002. Exports (32,998 million USD) and imports (43,292 million USD) reached a historically high level. Exports (benefiting from the strong depreciation of the Zloty) increased by 9.0% y/y, while imports have risen by 3.2% y/y in dollar terms. In 2002 FDI decreased dramatically in Poland. At the same time portfolio investment has increased, and as a result of these two factors there has been a structural change in CA deficit financing. The FDI/CAB cover ratio fell from 97.6% in December 2001 to 59.8% in December 2002.

The troubles in the construction sector continued from 2001 to 2002. The value added has been dropping in this sector in both years. The largest employment decrease (12.3 % in 2002 in comparison to 8% in 2001) has been recorded in the construction sector. The sector with the second largest decrease in employment in 2002 was the transport, storage and communication sector (6.5% in 2002 in comparison to 5.2% in 2001).

Developments in early 2003 Economic recovery continued in the beginning of 2003. The annual growth of industrial output reached 4.1% in February. This was mainly driven by the upheaval in export-oriented branches, such as the office machinery and appliances, furniture and rubber products sectors. The 4.7% annual rise in retail sales

in February was also a contributing factor in the recovery. However the construction industry remains in a dismal position, with a 24% y/y drop in this sector.

The central budget deficit reached PLN 11.72 billion by the end of February, which is 30.2% of the annual plan and means a 14% fall y/y in real terms. The budget deficit was financed mainly with T-bill and T-bond issues, as privatization revenues were reaching only PLN 194 million, just 2.6% of the annual plan. The privatization revenue target of PLN 9.1 billion for the whole year seems more and more unrealistic and is likely to be officially revised downwards.

Inflation remained low in the beginning of 2003, the 12-month CPI reaching only 0.5% in January and in February. The key potential risk factors in the near future could be fuel prices, the Zloty's weakening, and political risk. At the same time PPI inflation accelerated to 2.8% y/y in February, mostly due to rising oil prices. As domestic demand recovers, higher producer costs may be transferred to consumers in the near future, raising the CPI.

The Monetary Policy Council cut all policy interest rates by 25 basis points in March. This indicates that the MPC was not concerned about supply-side inflation factors, most importantly oil prices that are putting upward pressure on the PPI.

The CA deficit fell to EUR 517 million in February, which is better than earlier expected. The CA deficit was EUR 704 million in January 2003 and EUR 950 million in February 2002. The trade deficit shrank considerably to EUR 580 million in February 2003, compared to its EUR 939 million level in February 2002. This was the result of the exceptionally good export performance, reaching EUR 2.6 billion, with a 7.5% y/y growth, even though Poland's most important trading partner, Germany is experiencing a considerable economic slowdown. The high rate of export growth was recorded in both Euro and dollar terms. At the same time imports fell 5.1% y/y to EUR 3.2 billion, indicating that import demand is still weak. Analysts expect investment and investment import to recover throughout 2003.

Table 1: Balance of Payments (USD mn.)

	Jan '03	Feb '03	Feb '02
CURRENT ACCOUNT	-704	-517	-950
Exports of Goods	2769	2637	2452
Imports of Goods	3891	3217	3391
Trade Balance	580	-1122	-939
Services Balance	-149	-268	-169
Income Balance	-18	-123	-97
Net Current Transfers	168	131	158
Unclassified Net Transactions	417	323	97
CAPITAL AND FINANCIAL ACC.	**674**	**2526**	**325**
Net FDI	435	352	376
Net Portfolio Investment	349	2650	43
Net Other Investment	-146	-277	503
Errors and omissions	**177**	**-497**	**621**
OVERALL BALANCE	**147**	**1512**	**-4**

Source:NBP

The competitiveness of Polish exports might rise even more in the coming months as a result of the further weakening of the Zloty. In dollar terms, Poland's exports have risen by 33.2% y/y to USD 2.8 billion, while imports increased 17.5% y/y to USD 3.46 billion, leading to a USD 625 million trade deficit in February. The CA gap in dollar terms amounted to USD 561 million, down from USD 824 million in February 2002. A surge of portfolio investment caused the EUR 2.526 billion (EUR 325 million in the same month last year) surplus in the capital and financial accounts in February 2003.

Kolodko's controversial public finance reform. In March the government provisionally accepted Finance Minister Kolodko's fiscal reform package. This was probably the result of Kolodko's warning that he would resign if his fiscal reform package was not accepted by the government. The full program has not been officially adopted, only the frame of the package was accepted, thus sending an unclear signal to financial markets. The government is not willing to unanimously back the proposals, as they contain such socially unpopular ideas as abolishing the indexation of wages, pensions and benefits

Apart form earlier proposals such as abolishing all tax breaks and lowering social expenditures, the program also calls for implementation of a 20% tax on all capital income; introducing a tax on real estate that would depend on its market value and not size; implementation of a personal income tax for farmers; abolition of some state agencies and offices; allowing open pension funds to invest in infrastructure undertakings; use of the central bank's revaluation reserve, amounting to some PLN 27 billion.

According to the fiscal reform package, PLN 9 billion worth of it would be used to pay Poland's contribution to the EU budget and further PLN 9 billion would be used for co-financing of EU projects. According to expectations the central bank will have a negative opinion of the proposal, as dissolving the reserve would effect money expansion, because the reserve is in fact virtual money existing only on the bank's balance sheet, and using it would lead to printing out additional money. However it is still expected that the government will keep this solution, as it seems to be one of the key points of Kolodko's fiscal strategy.

Other ideas in the package (such as abolishing the indexation of wages, pensions and social benefits) are socially unpopular and there is a lack of political will to implement them. However these reforms are badly needed for preparing Poland's public finances for early Eurozone entry. As the minority cabinet is also internally weak, early adaptation of the Euro seams less and less possible.

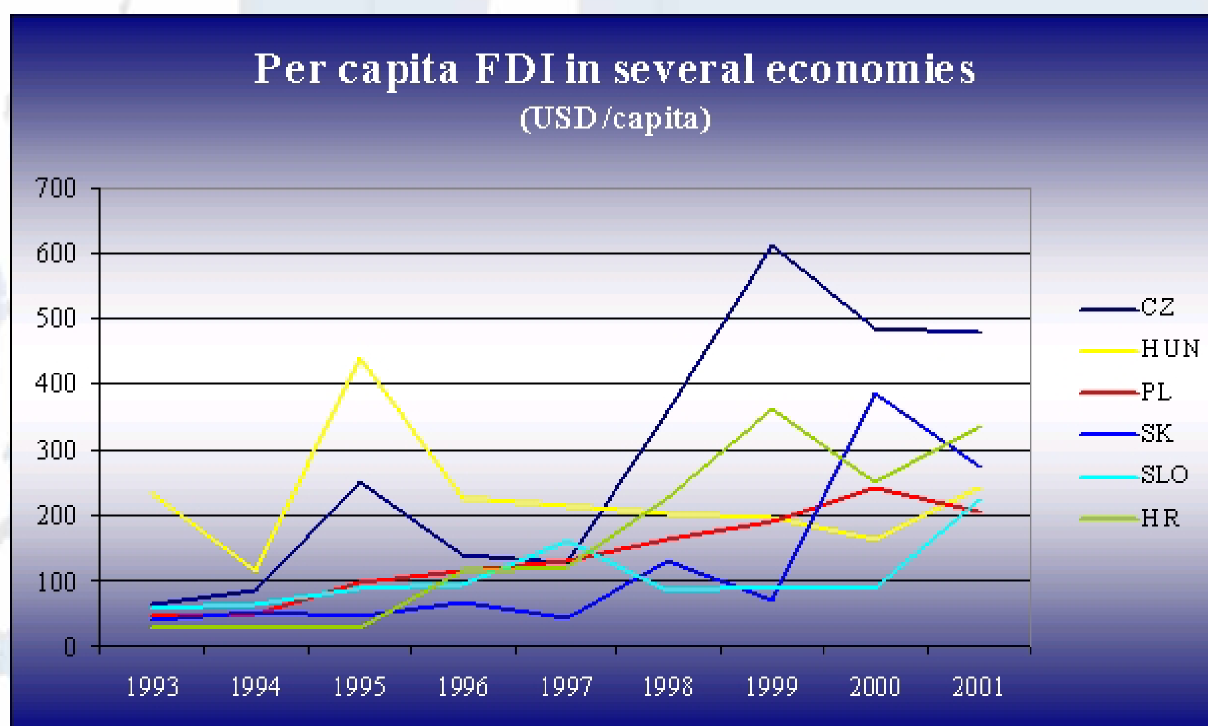
Prepared by: Veronika Czakó

IV. FOREIGN DIRECT INVESTMENT IN CROATIA

In Croatia the macroeconomic environment has been improving. Inflation is decelerating, the government has successfully privatised some key sectors, Croatia has become a member of the WTO and in late 2002 the country submitted its application to join the European Union.

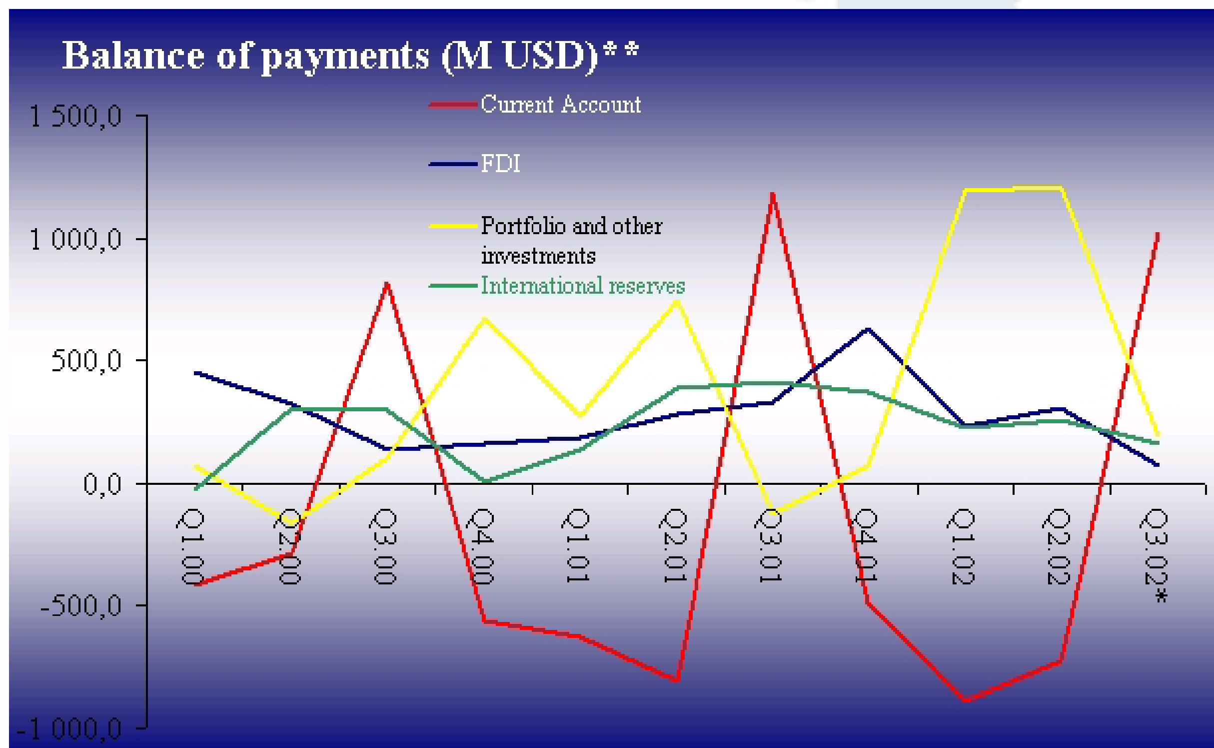
The GDP decreased by 8 per cent in 1993. After that it increased by an average of 4,3% per year, and in the last three quarters of 2002 by 5% in accordance with the estimations. On the other hand the inflow of foreign direct investments was not as stable as the growth of GDP. Under the Croatian independence war, which was officially ended on December 14 in 1995 by signing the Dayton peace treaty, there was no considerable FDI inflow. Even Slovenia - an other former Yugoslavian country - attracted more FDI. In the periods of consolidation the FDI inflows started to accelerate and reached its highest level in 1999.

Chart 4.



The role of the FDI in the Balance of Payments is significant in financing the deficit of the current account (CA). Owing to the seasonal effects of tourism revenues the CA shows high volatility while FDI inflows are quite stable. The Croatian National Bank (CNB) has to adjust its emissions of foreign currency or kuna denominated CNB bills to this difference in order to maintain the exchange rate stability, which is the leading criteria of price stability, the primary goal of CNB. To preserve the confidence this process goes along with the unbroken growth of international reserves.

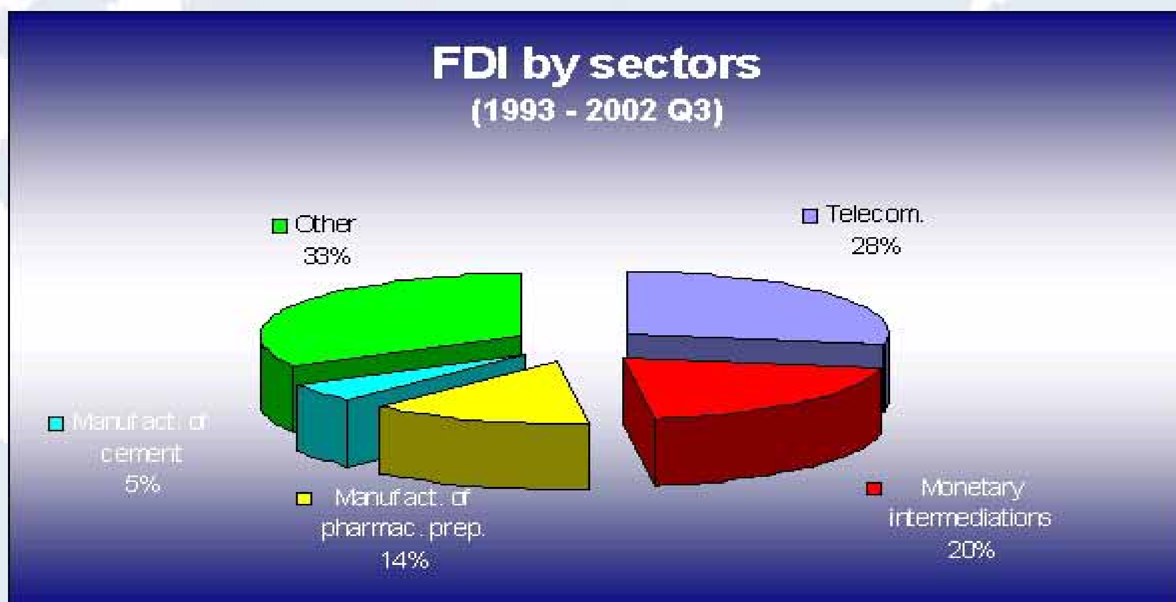
Chart 5.



** Preliminary data*
*** Excluding capital account and net errors and omissions*

Mr. Ivica Racan's administration that took office in early 2000 speeded up the privatisation, which strongly determines the FDI inflows, and several sectors were privatised succesfully like telecommunications, monetary intermediations and the manufacturing of pharmaceutical preparations. From 1993 to the third quarter of 2002, most of the FDI arrived from EU countries (74%), the rest could be shared into other (not EU-member) developed countries (20%), and other countries (6%)..

Chart 6.



In 2002, the reform process slowed down. As a result of the appearence of major differences on policy issues among the coalition members, the government stepped down in the middle of 2002, and a new government was formed by Ivica Racan in order to maintain the reforms. The consequence is that the operational plan for the privatisation of the state portfolio is currently under revision.

Table 2. The enterprise portfolio of the Croatian Privatisation Fund in HRK.

Sectors	No. companies	of Equity (HRK)	State portfolio (HRK)
Agriculture, hunting and forestry	85	3.929.234.256	2.234.897.427
Fishing	7	107.405.932	23.765.191
Mining and extraction	5	67.439.823	22.528.655
Processing industry	342	26.553.611.867	9.335.919.677
Electricity, gas and water supply	1	482.989	1.159
Construction	95	1.993.650.272	222.332.409
Trade	176	3.480.736.561	666.397.325
Tourism	145	14.768.647.149	4.959.753.639
Transport, warehousing and communications	56	6.484.429.688	2.573.831.459
Financial mediation	5	1.115.058.100	368.554.812
Real estate, rental and business services	84	3.578.280.135	2.024.865.705
Education	4	11.859.937	887.035
Health protection and social welfare	2	8.154.464	932.869
Other public, social and individual service activities	28	235.672.906	51.583.960
Total	**1035**	**62.334.467.654**	**22.486.251.320**

The next parliamentary elections will be held in the end of this year, so low privatisation activity is expected in the following months. On the other hand if the negotiations with the EU begin after the coming elections, and if it becomes clear that Croatia could join to the EU in the second round of Eastern enlargement whit countries like Romania and Bulgaria in 2007, it will attract all time high amounts of foreign investments. Even if the new government lays the EBRD's suggestions to heart like the acceleration of privatisation or the creation of clear and transparent legislative environment for green-field investments and concession financing.

Prepared by: Péter Sulán

V. CHANGES IN THE HUNGRIAN BALANCE OF PAYMENTS STATISTICS

Hungary has been making significant efforts since 1993 to adjust its balance of payments statistics, methodology and publication order to the international standards. Since 1995 the balance of payments is published by the National Bank of Hungary (NBH) according to the 5th edition of the IMF Balance of Payments Manual. Since then the balance of payments methodology has experienced some serious changes. The last one occured at the beginning of March, when the NBH – responsible for the balance of payments statistics and publication – in cooperation with the Central Statistical Office (CSO) modified the methodology, and the publication and revision order of the Hungarian balance of payments.

The modifications of the methodology refer to two accounts of the balance of payments: to the goods and the travel account. It is important to state that these modifications do not affect real economic and income developments or the external equilibrium of Hungary, only the method of statistical recording. The NBH intends to improve the quality and analytical power of these data, and make a better international comparability possible.

FOREIGN TRADE

Until 2003 three kinds of statistics provided information to foreign trade data: customs statistics; the national accounts and the balance of payments statistics based on the reports of credit institutions and enterprises. The problem was that the data provided by the customs statistics and that released in the balance of payments were significantly different both on quarterly and monthly level. The NBH identified three major reasons of this difference. First, trade in goods as showed in the balance of payments on the basis of the reports by credit institutions and enterprises does not contain goods for processing and contributions in kind, in contrast with customs statistics. Second, the two systems evaluate foreign trade on different terms of delivery. And third, the time of recording is different (physical movements of goods recorded by the customs statistics vs. information on payments reported by the credit institutions). The NBH states that since current account and customs statistics were in the past compiled on the basis of different data sources, the difference between them would still be inavoidable even if the same transactions were recorded by the two systems.

The major step on the way to incorporate the customs statistics into the balance of payments was an agreement on cooperation between the CSO – responsible for providing customs statistics – and the NBH in 2002. There are two significant problems concerning data quality.

One of those is that monthly data of the reference year change continuously until the publication of yearly data. However, the expected difference between the final and preliminary data is still not zero, as the data are usually complemented. From 2003, the NBH is going to incorporate data on goods into the balance of payments concerning these data supplements estimated on the basis on the agreed methodology.

The second problem is the recording of goods for processing. Customs statistics show a permanent import surplus among these goods which may amount to 1% of the GDP on a yearly basis. The NBH will now receive complementary data from the CSO, not included in the foreign trade statistics. As the import surplus of the goods for processing is recorded as statistical error (because it is impossible to exactly identify the sources, and whether it's only an accounting problem or a matter of real economic effects), the additional data will diminish the size of the balance of errors and omissions.

To incorporate the customs statistics, former data on the transactions of goods have to be replaced by those provided by customs statistics as the international standards require the accrual basis of accounting in which the time of recording is linked to the change in the ownership of the good. In order to achieve accordance with international methodological standards, further revisions need to be implemented:

- Consistent with international standards and the national accounts, exports and imports are valued f.o.b./f.o.b., but customs statistics record imports at c.i.f. Thus, it should be replaced by f.o.b. values in the balance of payments.

- Goods for processing on a gross basis and repairs on a net basis should be recorded as transactions of goods. Until now, they were taken into account among services, both on a net basis.

- Changes in the current acount will of course also have effects on net financing in the financial account, in accordance with the double entry system. One of the elements of the change is that contributions in kind linked to direct investments will be recorded under goods.

- Also according to the double entry system, the difference between data relying on customs statistics and payment transactions statistics is offset by corresponding entries under other short-term claims and liabilities.This means that the difference between physical exports and imports and payments transactions is financed by economic agents in the form of trade credits.

- Finally it should be mentioned that all transactions in goods are taken into account in customs statistics, thus the relevant data must be further provided by credit institutions.

TRAVEL

The NBH has already implemented significant changes in the travel account prior to 2003. In 1999 it has revised the travel data for the period 1995-1999, and since then it has been compiling data on the basis of the methodology used in the revision of the 1995-1999 data. However, the balance of payments and the national accounts showed different travel numbers, as the CSO – responsible for the national accounts – continued to record data using the old methodology. Further revision was necessary to create adequacy among the various macroeconomic statistics concerning travel data. The NBH and the CSO conducted a survey of travel in 2000 with the participation of almost 2000 customers in 23 branches of 7 commercial banks. Based on the outcome, revenue and expenditure data for the period 1995-2002 have been revised by the help of external experts. Beginning with the data for January 2002, balance of payments travel data is compiled according to the new methodology, which has now been changed in two components:

1. It is now not the balance of the households' foreign currency account that is recorded under travel, but only the travel-related parts of both the revenue and the expenditure side of the account.

2. The treatment of the re-exchange of foreign currency purchased for travel purposes (reverse expenditure) has been also changed. According to the new method the 5% of the travel expenditure in the month preceding the reference month is recorded as reverse expenditure and the portion exceeding it is recorded under travel receipts.

THE EFFECTS OF THE CHANGES

According to the statement of the NBH, the building-in of customs statistics has affected trade in goods, services (transportation, trade-related and construction services), direct investment (equity capital), other investments (trade credits) and the item for net errors and omissions. Travel-related corrections have influenced services (travel), income (compensation of employees), current transfers and direct investment (equity capital). As one can see on the table below, the current account deficit was stated lower in the period 1995-1998, higher 1999-2001, but then again lower in 2002.

The changes in the current account and financing have also affected the internal investment position recorded. The stock of net external debt of Hungary was EUR 676 million higher at the end of 2002 according to the new methodology than had been calculated on the basis of the former one. The following table gives an overview.

(The article is based on the NBH's „Notes to the methodological changes to balance of payments statistics implemented in February 2003 and the new data release and revision methods to be introduced in 2003" from 25 February 2003)

Prepared by: Gábor Antal

Table 3. Initial and revised current account data for 1995-2002

Euro millions	1995*	1996*	1997	1998	1999	2000	2001	2002
	Pre 2003							
Current account	-1 982	-1 398	- 848	-2 020	-1 975	-1 434	-1 248	-3 511
Goods	-1 960	-2 110	-1 733	-2 080	-2 054	-1 916	-2 265	-3 122
Services	1 280	1 917	2 026	1 591	1 315	1 938	2 425	991
Income	-1 410	-1 161	-1 263	-1 662	-1 556	-1 706	-1 681	-1 743
Current transfers	109	- 44	122	130	320	249	273	363
Financial account**	4 691	- 734	602	2 582	4 442	2 407	743	1 276
Equity	3 394	1 703	2 212	1 301	2 457	214	813	794
Assets***	199	-1 014	- 745	- 285	- 461	- 424	-3 425	842
Liabilities***	1 099	-1 423	- 866	1 566	2 445	2 618	3 355	- 360
Net errors and omissions	759	837	16	28	- 256	- 115	88	80
Capital account	46	124	104	170	31	300	358	190
CA/GDP****	-5,7%	-3,9%	-2,1%	-4,8%	-4,4%	-2,8%	-2,2%	-5,2%
Net external debt (year-end)	12 585	11 743	10 699	11 031	11 250	12 146	11 796	15 058
	Revised							
Current account	-1 240	- 916	- 578	-1 977	-2 301	-3 152	-1 967	-2 771
Goods	-1 122	-1 337	-1 165	-1 685	-2 044	-3 180	-2 496	-2 203
Services	1 083	1 506	1 562	1 058	834	1 230	1 643	636
Income	-1 359	-1 084	-1 155	-1 565	-1 464	-1 545	-1 513	-1 679
Current transfers	158	- 2	179	215	372	343	399	475
Financial account**	3 879	-1 263	188	2 577	4 865	4 207	1 804	38
Equity	3 493	1 772	2 255	1 327	2 481	252	810	891
Assets***	- 714	-1 613	-1 202	- 316	84	1 720	-2 614	- 348
Liabilities***	1 099	-1 423	- 866	1 566	2 300	2 235	3 608	- 505
Net errors and omissions	829	884	160	- 11	- 354	- 197	- 255	577
Capital account	46	124	104	170	31	300	358	190
CA/GDP****	-3,6%	-2,5%	-1,4%	-4,7%	-5,1%	-6,2%	-3,4%	-4,1%
Net external debt (year-end)	11 733	10 443	9 073	9 539	10 124	12 837	13 587	15 734
	Difference							
Current account	742	482	269	44	- 326	-1 717	- 719	741
Goods	839	774	567	394	10	-1 263	- 231	919
Services	- 197	- 411	- 463	- 533	- 480	- 708	- 782	- 355
Income	51	77	108	97	92	160	168	65
Current transfers	49	42	57	85	52	94	125	112
Financial account**	- 813	- 529	- 414	- 5	424	1 800	1 062	-1 239
Equity	100	69	43	26	24	39	- 3	97
Assets***	- 912	- 599	- 456	- 31	544	2 144	811	-1 190
Liabilities***	0	0	0	0	- 145	- 383	254	- 145
Net errors and omissions	70	47	144	- 38	- 98	- 83	- 343	498
Capital account	0	0	0	0	0	0	0	0
CA/GDP****	2,2%	1,3%	0,7%	0,1%	-0,7%	-3,4%	-1,2%	1,1%
Net external debt (year-end)	- 852	-1 300	-1 625	-1 492	-1 126	691	1 791	676

* pre 2003 method but in BPM% structure
** reserves are excluded
*** "+": decrease in assets, increase in liabilities;"-": increase in assets, decrease in liabilities
**** 2002 estimate