Hungarian Central Statistical Office
President

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Director

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Subject: Statistical classification of Eximbank

Dear Mr Barredo Capelot,

Thank you for your analysis and preliminary views on the classification of Eximbank. After analysing your assessment the Hungarian statistical authorities think there is a need for a deeper clarification of the issue before introducing any change in the classification advised by you. Hungarian statistical authorities consider that our sector classification practice is sound, consistent, well established and is in line with the international methodological guidelines. Applying a completely different approach without deeper understanding of economic rationale would cause further difficulties and make damage to the system of national accounts.

We would like to summarise briefly the considerations and rules applied in the course of the sector classification of Eximbank.

The bank meets all conditions required for the independent institutional existence defined in ESA2010 (owns assets and incurs liabilities on its own rights, has independent decision making bodies, responsible and accountable by law for its decisions and activities, keeps its own records and prepares its own reports), thus its treatment as an independent institutional unit cannot be questioned. As your analysis properly stated it is a public unit.

Eximbank is a financial corporation whose principal activity is production of financial services. It performs transactions exclusively with financial assets and liabilities and such financial instruments are predominant in its balance sheet. Its revenues are decisively property incomes (interests) related to the financial assets kept in its balance sheet.

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Eximbank is a financial intermediary. In this context we would like to call your attention that your analysis contains a misinterpretation while referring to 2.56 and 2.57 of ESA2010: *'Financial intermediation is the activity in which an institutional unit acquires financial assets and incurs liabilities on its own account by engaging in financial transactions on the markets. The assets and liabilities of financial intermediaries are transformed or repackaged in relation to, for example, maturity, scale, risk, etc. in the intermediation process.'*
'A financial intermediary does not simply act as an agent for these other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account.'

The purpose of these sections is namely to make a clear distinction between financial intermediaries and financial auxiliaries. The difference between the two institution types is that the former performs intermediation on its own account by recognising the assets and liabilities in its own balance sheet (in this sense at its own risk), while the latter brings together the clients only as an agent without involving its own balance sheet.

Eximbank acquires assets and liabilities on its own behalf and on own account (not as an agent) from the market and transform these, (in maturity, scale, risk) i.e. it performs real intermediation in line with section 2.56 of the ESA2010. If it acquired assets and liabilities not on its own risk, according to the applicable regulation it would not recognise them in its balance sheet. If we apply properly these paragraphs above, we can conclude that Eximbank is a financial intermediary rather than a financial auxiliary - nothing more.

Moreover, Eximbank is a monetary financial institution and as such it should be classified into the S.122 subsector. A monetary financial institution is a financial corporation which transmits the central bank's monetary policy to the other operators of the economy. Since the traditional instrument of monetary transmission used to be deposits, in a simplified manner methodologies distinguished between monetary and other financial intermediaries based on deposit collection. This is an important aspect, but more important is which institutions have direct relations to the central bank and interbank markets. Specialised credit institutions as mortgage banks usually do not collect deposits but issue bonds and take up loans but they are still considered as credit institutions (ESA2010 2.76-2.77). Eximbank is a monetary financial intermediary which takes part in the various central bank instruments and programs, and it is subject to credit institutional rules. It is part of the credit institutional sector, major part of its assets and liabilities stems from the interbank markets.

Your analysis challenges the market nature of the bank's activities. It can only be attributed to the fact that you do not acknowledge its activities as financial intermediation. In the national accounts, financial intermediation is considered as market activity without further investigation. Financial intermediation by definition takes place in the market, i.e. it always "represents market production" (SNA2008 A3.28). This explains why there are no rules in national accounts for examining the market/non market nature of financial intermediation. It is par excellence market activity.

According to your opinion Eximbank is not a market producer because its output is negative: you consider the interest subsidy provided by the government as subsidy on production received by the bank. While classifying the government subsidy we apply 4.37(c) of ESA2010: *'Grants for interest relief are current transfers designed to lighten producers' operating costs. They are treated in the accounts as subsidies to the producers benefiting from them, even when the difference in the interest is paid directly by the government to the* *credit institution granting the loan.'* Regardless how the amount of subsidy is calculated, technically it should be recorded as a subsidy to the exporter companies. Otherwise our accounts would suggest that the export is not subsidised in Hungary at all – instead the government is keeping alive a permanently loss-making bank without any purpose. This treatment would not reflect the economic reality. Moreover in the Hungarian practice the interest subsidies are in fact determined by clients and by loans and are calculated on a quarterly basis, therefore they cannot be considered as subsidisation of the financial service provider.

Finally your paper considers the bank as captive financial institution on the basis of MGDD chapter I.6.6. When classifying Eximbank we do not consult this chapter of the MGDD. In our understanding all financial institutional units should be classified into the financial corporation sector, they cannot be reclassified elsewhere. Public units having the features of captive financial institutions can be reclassified into the general government only because they are not independent institutional units, so they should be merged with their controlling units. A 'captive financial institution' is a holding or SPE type institution according to SNA/ESA, i.e. a passive money channel with large worth without organisational background, staff and sales revenue. This is not the case with Eximbank. It has considerable organisational background, is an independent institutional unit and cannot be considered as captive. Therefore, according to our assessment, it cannot be subjected to the rules of Chapter I.6.6.

During the Dialogue visit in February 2016 this issue was discussed only in the form of cross examination of the representatives of the banks and no room was devoted to elaborate and discuss our understanding and assessment of this issue. Therefore we are at your disposal for and feel necessary to have further discussions and consultations on this issue. We also would like to emphasize that this topic has a wider perspective from a national accounts point of view and should not be considered as a general government (EDP) issue only.

We highly appreciate your intention to publish your opinion on the classification issue. We do not have any objections if you release it together with our response – now or later in the course of the debate.

Sincerely yours:

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