REPORT ON THE BALANCE OF PAYMENTS

2022
JULY

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

Letters 27
Gábor Bethlen

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In accordance with Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the primary objective of the MNB is to achieve and maintain price stability and, without prejudice to its primary objective, the central bank is also responsible for maintaining the stability of the financial intermediary system. Developments in the external balance are key to financial stability, as processes relating to the balance of payments allow for conclusions to be drawn concerning the sustainability of economic growth and the relevant risks. Moreover, the analysis of the balance of payments 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 processes which are of critical importance for Hungary's vulnerability.

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

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

The Report is based on information for the period ending 22 June 2022.

Summary

***Hungary's external balance indicators continued to decline** in 2022 Q1: the four-quarter deficit of the current account corresponded to 4.8 percent of GDP, while net borrowing rose to 1.6 percent of GDP. Developments in external balance indicators were **primarily driven by the continued decline in the trade balance**: exports are still restrained by the global shortage of semiconductors, the war between Russia and Ukraine, supply chain disruptions and weakening external demand, while **the deterioration in the terms of trade due to the surge in energy prices** as well as strong domestic demand **support an increase in imports.** At the same time, **the decline in foreign-owned companies' profits** and **the increase in the absorption of EU transfers** moderated the decline in the external balance indicators. **Hungary's external balance will improve from 2023**, as external factors normalise, geopolitical tensions ease and the export-increasing effect of the implemented investment projects comes to the fore.*

*In terms of the financing side, the rise in the net lending of the economy was related to inflows of **debt** liabilities. The **net outflows of foreign direct investment** were partly attributable to Hungarian investments abroad, owing to expansion as well as to foreign-owned firms' acquisitions by Hungarian buyers. Non-debt liabilities were also reduced by the fact that **non-residents cut their Hungarian equity and mutual fund share holdings**, while domestic sectors continued to purchase foreign portfolio equities and mutual fund shares. **The significant net inflows of debt liabilities in the first quarter were primarily related to the banking sector**, partly as the correction of the previous quarter's deleveraging in parallel with banks' balance sheet tightening, which is usual at the end of the year. The external liabilities of the general government expanded to a lesser extent: the effect of non-residents' government securities purchases and the foreign exchange expenditures of the state treasury was partly offset by the rising absorption of EU transfers.*

*At the end of the first quarter, **the net external debt ratio increased slightly to 8.6 percent of GDP**, as the stock-increasing effect of the debt inflow was mostly offset by the revaluation of outstanding debt (as a result of yield increases) and nominal GDP growth. **Gross external debt climbed to nearly 61 percent of GDP** in relation to the private sector: the banking sector's foreign liabilities increased after the adjustment at the end of the year, while the growth in corporate commercial loan debts may have been attributable to the effect of supply problems due to the war and the surging energy prices. **In March as well, international reserves significantly exceeded the level of short-term external debt***, which is monitored most closely by investors.

*Examining the balance positions according to **sectors' savings**, the rise in the economy's net borrowing was linked to the private sector, while the net borrowing of the general government continued to decline. In relation to the rise in tax revenues, **the pick-up in domestic demand improved the net position of the general government**, but had a negative impact on the net financial savings of the private sector, and particularly of companies within that. **A continued increase in net borrowing** has been observed in **companies'** balance position in relation to the still-buoyant investment activity and inventory accumulation, as well as the effect of higher energy and commodity prices in terms of reducing corporate income.*

*As a special topic, **the changes in Hungarian households' financial savings** were examined in view of the coronavirus pandemic and the outbreak of the war. Hungarian households' **net financial savings at end-2021 significantly exceeded those of the peers in the region**, with contributions from government transfers as well. For the time being, the uncertainty caused by the war between Russia and Ukraine has not resulted in a decline in the consumption of households to a degree that was seen in the case of the successive waves of the coronavirus pandemic; according to the underlying trends, households' savings have remained stable. The change in **households'** savings position was significantly affected by the impact of the recognition of PIT refunds, which boosted 2021 savings in the statistics. According to the MNB's questionnaire survey, **the majority of households spent the PIT refund within a couple of months**. In April, a mere 15 percent of the beneficiaries planned to use it for longer-term savings. The uncertainty related to the outbreak of the war and one-off government transfers contributed to the growth of wealth held in **more liquid forms of savings**, while **investment options providing protection from inflation** became increasingly popular.*

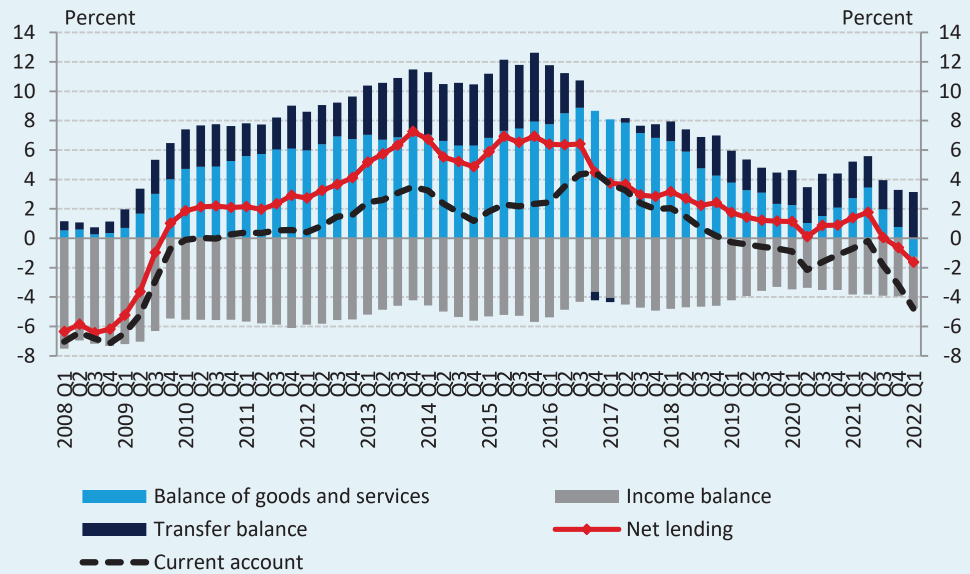
Content

1 Real economy approach

According to the real economy approach, Hungary's four-quarter net borrowing amounted to 1.6 percent of GDP in 2022 Q1, while the current account deficit stood at 4.8 percent of GDP. The decline in external balance indicators was attributable to the fall in the trade surplus, with the latter mainly affected by external factors, while changes in the income and transfer balance had an opposite effect. The decline in the trade balance was primarily related to the deterioration of the terms of trade, with changes in volumes as additional contributors. Similarly to the developments observed in Hungary, external balance indicators continued to deteriorate in the countries of the region as well in the first quarter.

According to the real economy approach, in 2022 Q1 Hungary's four-quarter net borrowing amounted to 1.6 percent of GDP, while the previous current account deficit of 3.2 percent, rose to 4.8 percent of GDP (Chart 1). According to *unadjusted quarterly data*, net borrowing amounted to around EUR 2.6 billion in the first quarter, as a result of a current account deficit of EUR 7.6 billion, which was partially offset by a capital account surplus of EUR 5 billion. The increase in four-quarter net borrowing was mainly due to the trade balance, whereas changes in the income and transfer balance had an opposite effect.

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

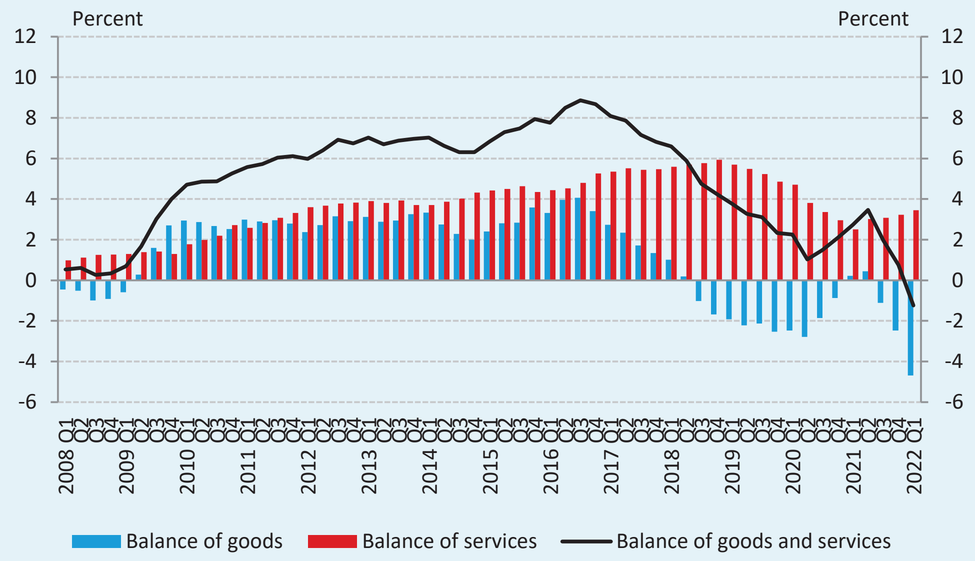


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

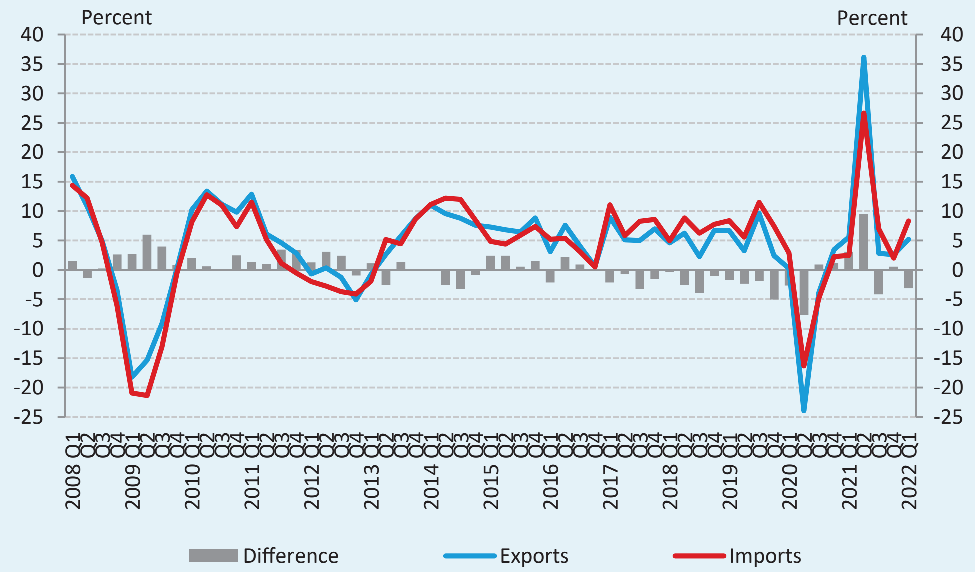
In 2022 Q1, the four-quarter trade surplus turned into a deficit for the first time since 2007. This is attributable to a continued decline in the balance of goods, which is primarily explained on the import side by the rising commodity and energy prices as well as the major expansion in consumption, and on the export side by the global shortage of semiconductors and the frictions in production chains in view of the conflict between Russia and Ukraine (Chart 2). Following the previous years' growing negative balance, the *balance of goods* as a proportion of GDP turned into a temporary surplus in early 2021, but this positive trend broke in 2021 H2, and since then the balance of goods has been showing an increasing deficit. After the downturn due to the outbreak of the pandemic, with the lifting of containment measures, the *balance of services* surplus, which plays an important role in the development of the trade balance, rose to 3.4 percent in 2022 Q1, as a result of the emerging recovery in tourism and transportation services, which represent a major weight within the sector. Accordingly, the balance of services surplus was able to offset the further decline in the balance of goods to some extent, but, on the whole, in the first quarter the trade balance turned into a deficit of around 1 percent of GDP, which had been unprecedented since 2007.

Chart 2: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)



Export growth rose slightly in 2022 Q1, but imports expanded to a greater degree (Chart 3). The global shortage of semiconductors, disruptions in supply chains as a result of the war between Russian and Ukraine and more subdued external demand are all factors that continue to restrain exports. The significant increase in imports is in line with the expansion in investment and inventory accumulation, as well as with the higher household consumption, which was also encouraged by considerable government transfers in Q1 ('arms money', PIT refund, 13th month pension). As a result of moderate exports and the continued strong growth in imports, the difference between the growth rates of the two indicators rose, and the stronger growth in imports is reflected by the fact that the increase in the real indicator was close to 8.5 percent.

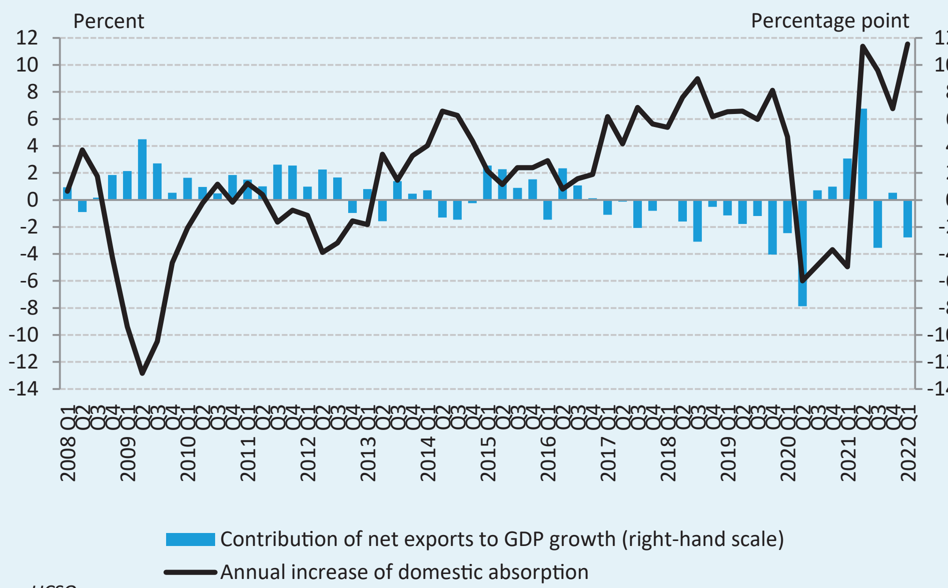
Chart 3: Annual real growth in exports and imports



Source: HCSO, MNB.

The growth contribution of net exports turned negative in the first quarter, while – similarly to the previous quarter – the annual growth rate of domestic absorption rose dynamically (Chart 4). The sharp increase in domestic absorption was strongly supported by all factors. As a result of containment measures being lifted and significant government transfers (PIT refund, 'arms money', 13th month pension), household consumption expanded considerably in Q1. After the previous quarter's slower increase, the expansion in actual final government consumption was a major contributor to domestic absorption in the first quarter, while year-on-year growth in investment and corporate inventory accumulation stabilised at high levels. In line with the rapid growth in domestic absorption, the contribution of net exports to GDP was negative.

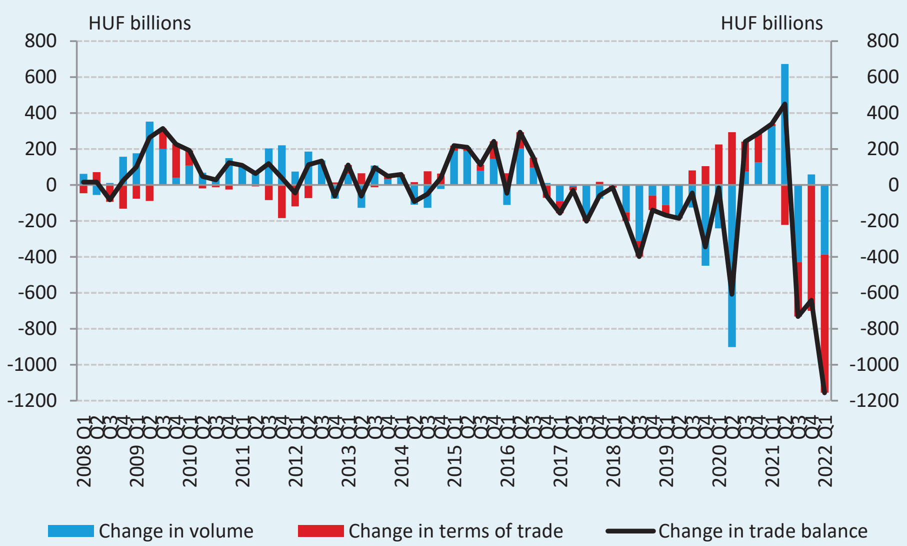
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The unfavourable trend in the trade balance in 2022 Q1 was primarily due to the effect of the deterioration in the terms of trade, but the decline in the volume of net exports was also a contributing factor. In the first quarter, the trade balance was undermined by both the subdued volume of exports resulting from the global semiconductor shortage and the Russia–Ukraine conflict, and the increase in imports due to the large rise in domestic absorption. In parallel with that, the increase in commodity and energy prices was reflected in the deterioration in the terms of trade, which had a major negative impact on net exports: changes in the terms of trade in the past four quarters impaired the current account by around 3.5 percent of GDP.

Chart 5: Developments in trade balance factors according to GDP (year-on-year)

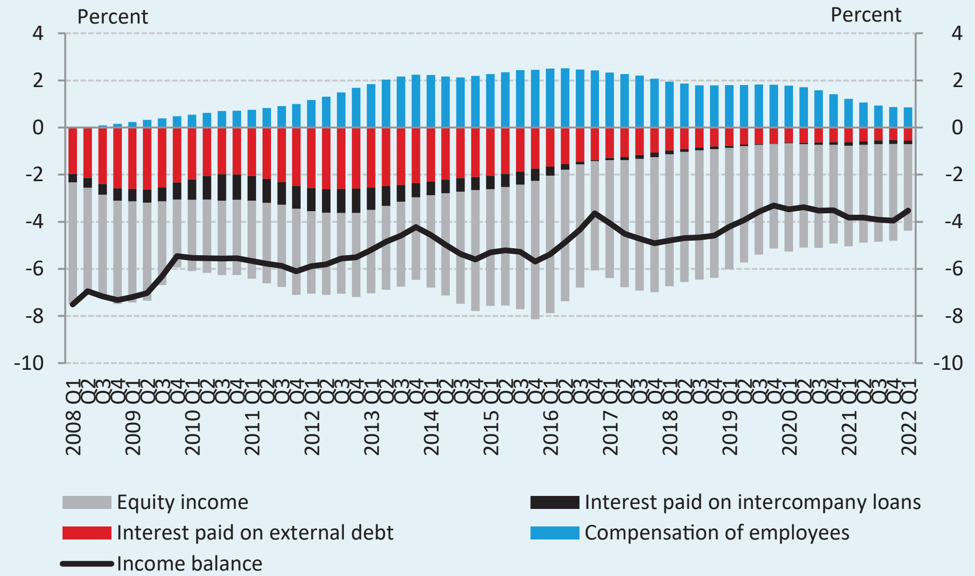


Source: HCSO.

1.2 Income balance

The income balance deficit as a percentage of GDP fell slightly in 2022 Q1, which was related to declines in the profits of foreign-owned companies (Chart 6). While the income of those working temporarily abroad declined, the four-quarter deficit of the income balance advanced to almost 4 percent of GDP in 2021, before dropping to 3.5 percent of GDP in 2022 Q1. The latter development is basically related to the decrease in the profits of foreign-owned companies, attributable to the impact of the deteriorating external environment and high energy prices, which impairs corporate profitability. Even though containment measures started to be lifted, Hungarian employees' income from abroad remained at an unchanged low level of 0.9 percent of GDP (compared to nearly 2 percent prior to the pandemic). An increase in the income of those working abroad, which would contribute to the decline in the deficit on the income balance, did not yet start in parallel with the reopening of the economy that took place in the first quarter.

Chart 6: Development of income balance items* (four-quarter values as a percentage of GDP)

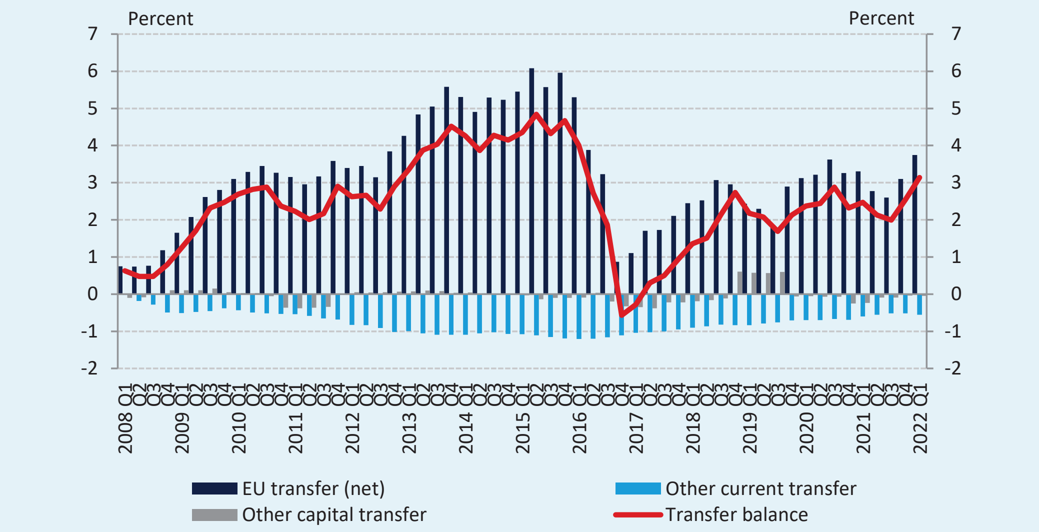


** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

In 2022 Q1, the transfer balance surplus rose to 3.1 percent of GDP, thus softening the impact of the trade balance deterioration (Chart 7). According to four-quarter data, the net inflow of EU funds climbed to 3.7 percent of GDP in 2022 Q1, exceeding the values seen in the previous quarters. Other current transfers only resulted in a mild deterioration in the transfer balance. The income of those employed abroad for a short time declined due to the pandemic and the uncertainty caused by the war between Russia and Ukraine, and thus the amount of taxes and contributions paid abroad also decreased within the other current transfers item, which contributed modestly to the improvement in the transfer balance. The transfer balance surplus, which was higher than in the previous quarter, resulted from the above factors.

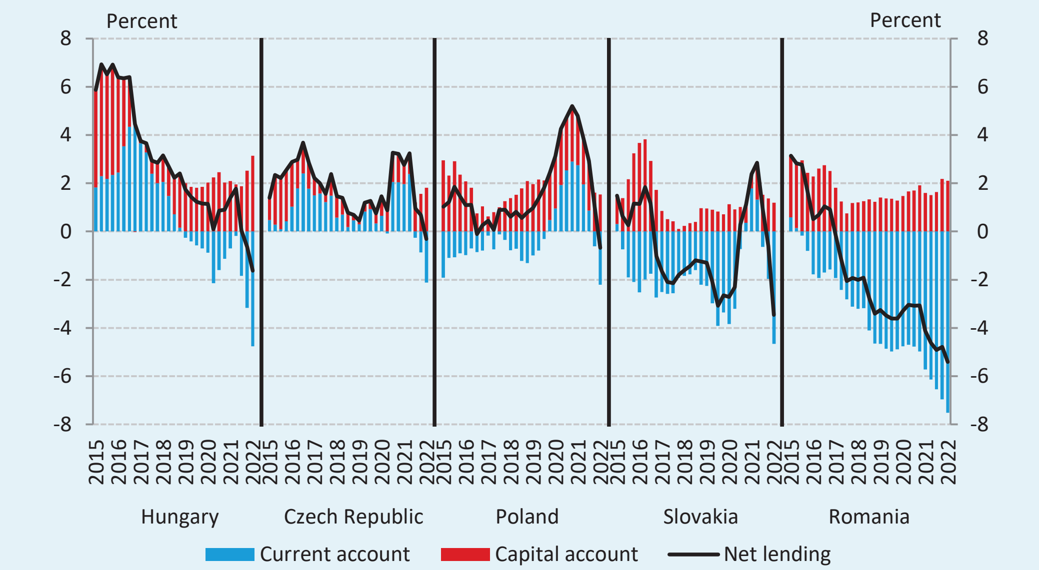
Chart 7: Four-quarter development of transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

In view of the pandemic and the global commodity and energy price increases, as in Hungary, external balance indicators continued to worsen in the countries of the region as well, resulting in net borrowing in all the countries of the region in the first quarter (Chart 8). Starting from 2020 H2, the external balance position of the countries of the region typically improved as a result of the coronavirus pandemic, but from 2021 H2 the trade balance and thus the current account of all the countries in the region worsened, owing to the global increase in commodity and energy prices as well as to disruptions in supply chains. In the Czech Republic and Poland, the previously high net lending turned into net borrowing of nearly 1 percent of GDP in the first quarter. In the case of Hungary, even the capital account surplus, which was higher than in the previous quarter, was unable to offset the 4.8 percent deficit of the current account. In the region, the level of net borrowing was the highest in Slovakia and Romania, at around 3.5 percent and 5.4 percent, respectively, as in the case of these two countries even the relatively low surpluses of the stable capital accounts were unable to offset the significant trade deficits.

Chart 8: Four-quarter net lending in the countries of the region (as a percentage of GDP)



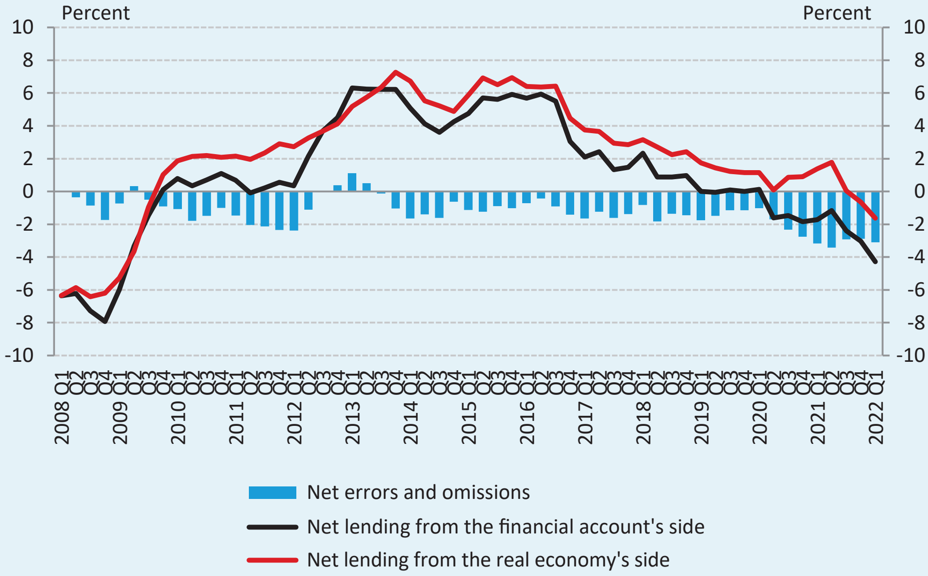
Source: MNB, Eurostat.

2 Financing approach

In parallel with the deterioration of the current account, the four-quarter value of the financing-side net borrowing of the economy also rose significantly in early 2022. The high quarterly net borrowing which had been unseen since 2008 was mainly financed by net inflows of debt liabilities, as the outflow of portfolio equities, which had been typical in previous quarters as well, continued, while net FDI funds also showed outflows, partly as a result of Hungarian investments abroad and acquisitions of foreign-owned companies. The net inflows of debt liabilities were primarily related to the banking sector, and within that mainly to the increase in liabilities, with contributions from the other sectors as well.

According to the financing-side data, the economy's four-quarter net borrowing climbed further to almost 5 percent of GDP in 2022 Q1 (Chart 9). In parallel with the increasing net borrowing of the four-quarter external balance position calculated using the real economy approach, the inflow of funds rose substantially according to the financing items as well. The amount of the difference between the four-quarter external balance indicators ('Net errors and omissions'[1]) was around 3 percent of GDP and thus still moderately exceeds the average from previous years.

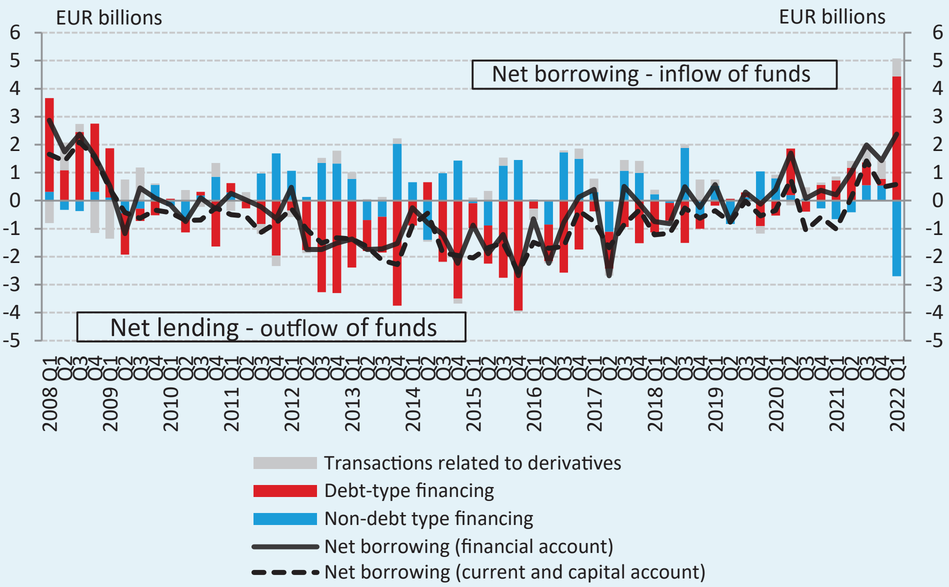
Chart 9: Two types of net lending (four-quarter data as a percentage of GDP)



According to quarterly data, the net borrowing of the economy amounted to EUR 2.4 billion in early 2022, contributing to the increase in Hungary's net external debt (Chart 10). Net borrowing, which was high in a historical comparison as well, was financed by inflows of debt liabilities, while substantial outflows of non-debt liabilities were registered, with contributions from net FDI inflows and developments in portfolio equities as well. Due to transactions, net outstanding debt expanded by more than EUR 4 billion, which represents extremely high growth.

[1] Developments in the balance of payments can also be described in terms of the financing of real economy transactions. The financial account shows what kinds of transactions affecting net financial worth were used by resident economic agents to finance real economy transactions. 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 exchange rates, as indicated by the category "Net errors and omissions".

Chart 10: Structure of net lending (unadjusted transactions)

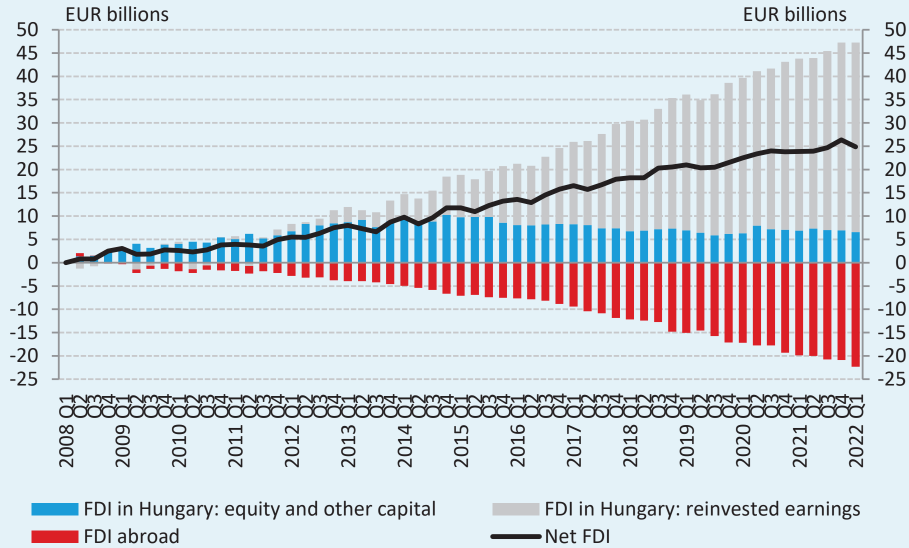


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and thus this technical effect has been eliminated.

2.1 Non-debt liabilities

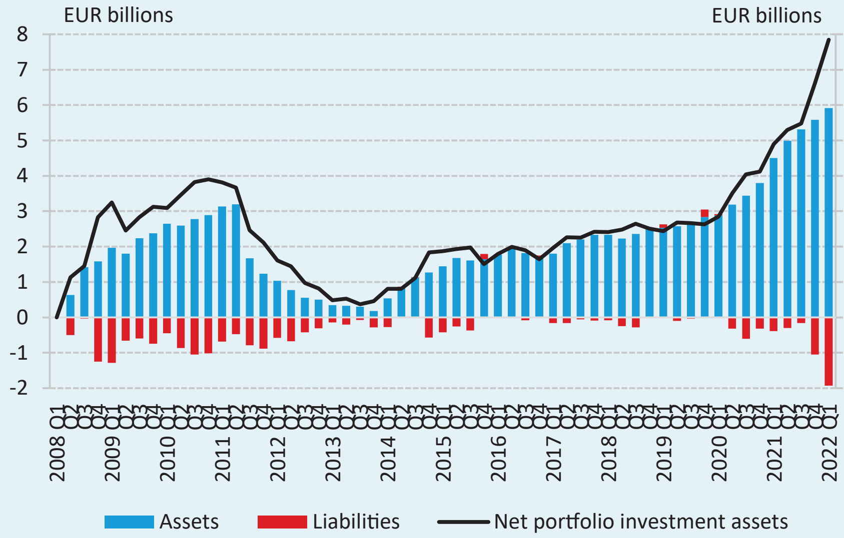
Net FDI outflows were observed in early 2022 (Chart 11). Net FDI outflows amounted to nearly EUR 1.5 billion during the first quarter. According to data net of capital-in-transit transactions and asset portfolio restructuring, following the previous quarters' significant growth, foreign-owned companies' investment in Hungary remained unchanged. The expansion in reinvested earnings was offset by the acquisition of a foreign-owned company in Hungary, which reduced direct investment. In addition, partly as a result of a Hungarian company's expansion abroad, Hungarian investments abroad also increased, and thus, on the whole, net foreign direct investment showed significant outflows in 2022 Q1.

Chart 11: Development of FDI, excluding capital-in-transit transactions (cumulative transactions)



A further significant increase in net portfolio equity assets also contributed to the outflow of non-debt liabilities (Chart 12). In the first quarter, net portfolio equity investments shrank the net balance of non-debt liabilities by more than EUR 1.2 billion due to transactions. On the one hand, non-residents reduced their Hungarian equity and mutual fund share holdings by EUR 900 million. On the other hand, residents further increased their assets held in foreign portfolio equities and mutual fund shares by more than EUR 300 million (in line with the average of the previous two years) during the quarter. Accordingly, domestic agents' steady foreign investment fund and equity purchases lasting since 2018 continued in the first quarter as well.

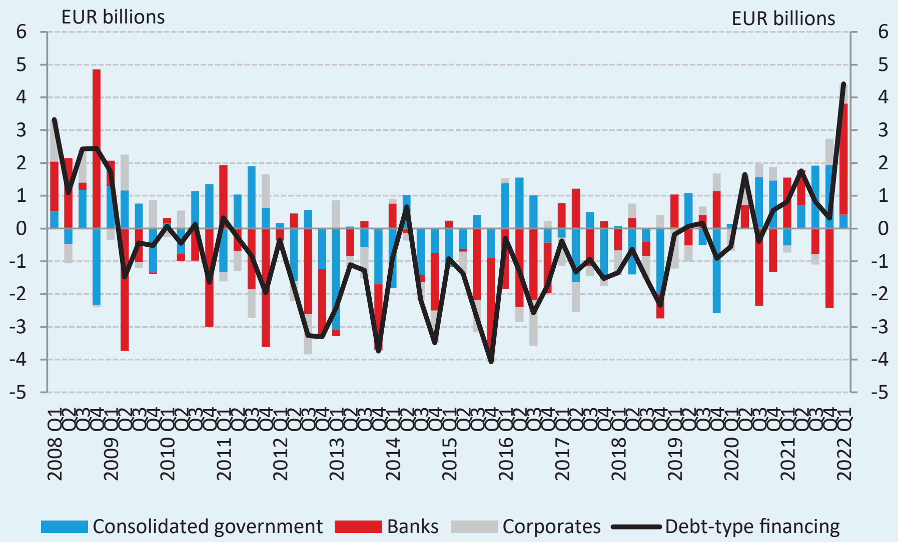
Chart 12: Developments in net portfolio equity and mutual fund share receivables (cumulative transactions)



2.2 Debt liabilities

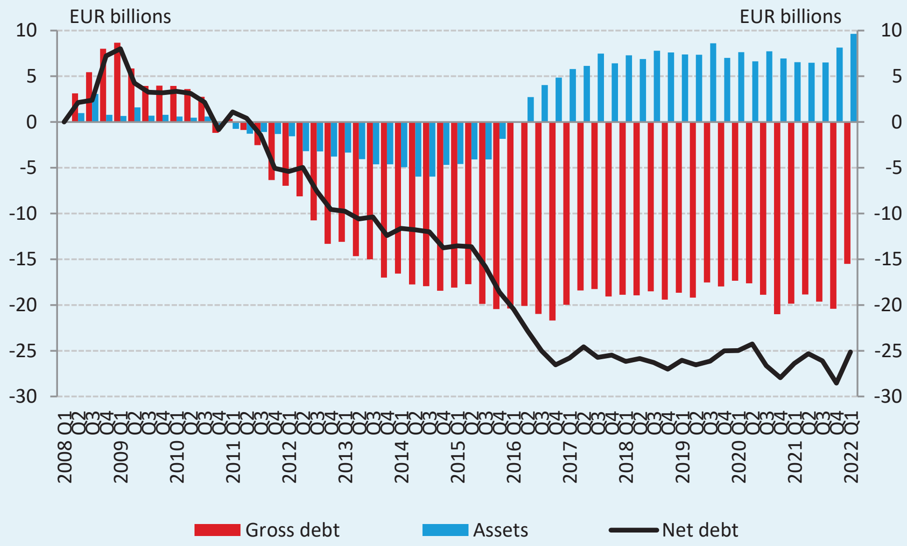
In the first quarter, the growth in net external debt due to transactions was extremely high (Chart 13). The increase of more than EUR 4 billion in the indicator was primarily attributable to the banking sector, and within that to the rise in liabilities. At the same time, moderate growth was also registered in the net external debt of the government and of companies (in relation to the energy price explosion and the increase in commercial loans as well). The former and the latter contributed to debt liability inflows by EUR 0.4 billion and EUR 0.6 billion, respectively.

Chart 13: Development of net debt-type financing by sector



The net external debt of the banking sector rose significantly in Q1 (Chart 14). The increase of EUR 3.4 billion in the net indicator is attributable to the expansion of EUR 4.9 billion in banks' liabilities, the impact of which was mitigated by an increase of EUR 1.5 billion in the sector's foreign receivables. The significant increase in net debt can partly be considered as a correction of the decline in debt related to banks' balance sheet tightening, which usually take place at the end of the year. The magnitude of the debt inflow corresponds to the decline in the previous two quarters, and banks' outstanding net external debt remains negative (see next chapter).

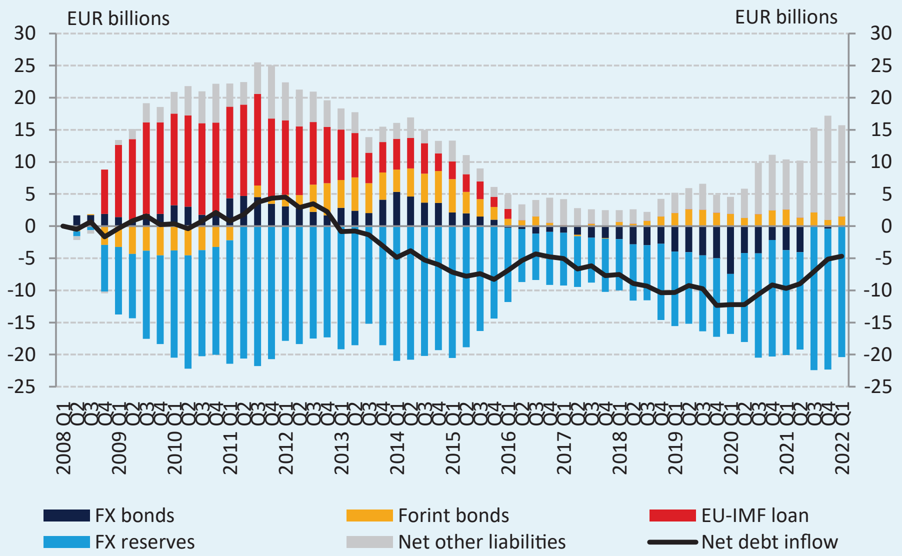
Chart 14: Development of the banking sector's external debt and asset (cumulative transactions)



Compared to the pace observed in the previous quarters, the expansion in the net external debt liabilities of the consolidated general government including the MNB proceeded more slowly in 2022 Q1 (Chart 15). The moderate rise of EUR 0.4 billion in the net external debt of the government was the result of contrasting effects.

- The foreign exchange expenditures of the Hungarian State Treasury and the increase of more than EUR 400 million in non-residents' government securities holdings contributed to the rise in net external debt.
- The absorption of EU transfers reduced the net external liabilities of the government through the increase in FX reserves and receivables from the EU.
- FX reserves increased as recourse to the central bank swaps providing FX liquidity to banks was below the level seen at end-2021. It should be noted that the changes in the central bank's outstanding swap contracts had a neutral effect on net external debt at the national economy level.
- Issuance of the one-off central bank discount bond used to ease swap market tensions was lower than at the end of the year and this reduced the net external debt of the consolidated general government, but had a contrasting effect on the indicator of banks.
- Continuation of the phasing out of the central bank's forint liquidity-providing swaps was reflected in a decline in foreign exchange reserves, which increased the net external debt of the government.
- The FX bond issue in the Japanese market in the quarter under review increased the FX reserves and the gross external debt as well, and thus did not affect the net indicator.
- Gross external debt was increased by the recourse to the MNB's repurchase agreements vis-á-vis international organisations, but FX reserves also increased simultaneously with that, so this transaction itself did not affect the net external debt.

Chart 15: Breakdown of changes in the net external debt of the consolidated general government (cumulative transactions)



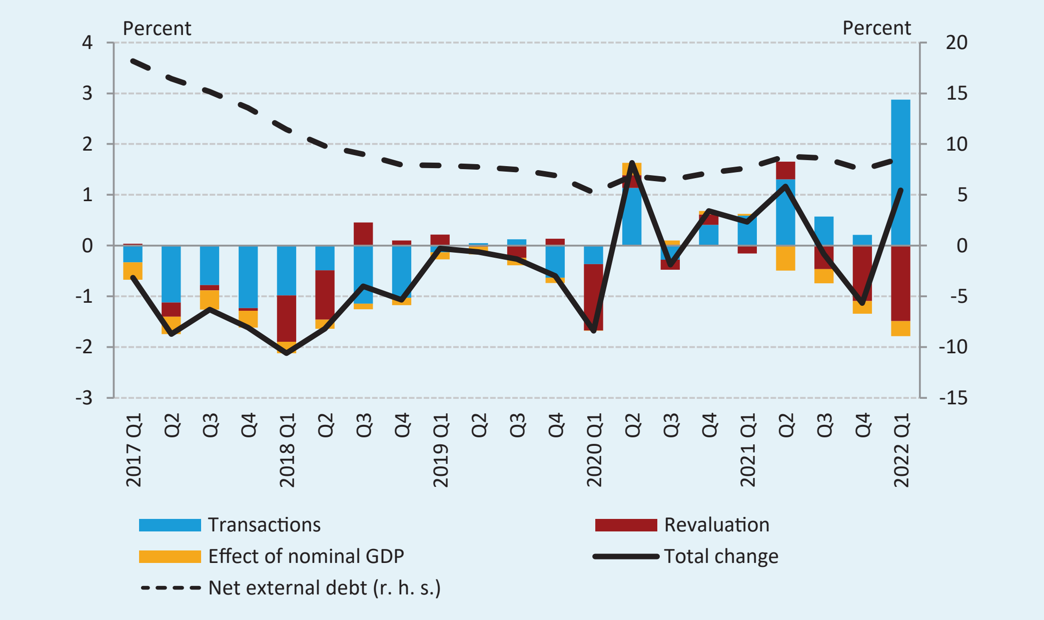
3 Developments in debt ratios

According to the underlying trends, Hungary's net external debt amounted to 8.6 percent of GDP at the end of 2022 Q1. The first-quarter rise of 1.1 percentage point observed in the debt ratio compared to its historical low seen at the end of the year was primarily related to the private sector's debt-generating borrowing. The effect of the debt inflow was offset by the revaluation of outstanding debt and the growth in nominal GDP, which thus mitigated the rise in the ratio as a percentage of GDP. In 2022 Q1, gross external debt rose to nearly 61 percent of GDP, with the expansion in companies' commercial loans and the increase in the liabilities of the banking sector as the main contributors. International reserves amounted to EUR 37 billion at the end of the quarter, still significantly exceeding the level expected by investors.

3.1 Developments in debt indicators

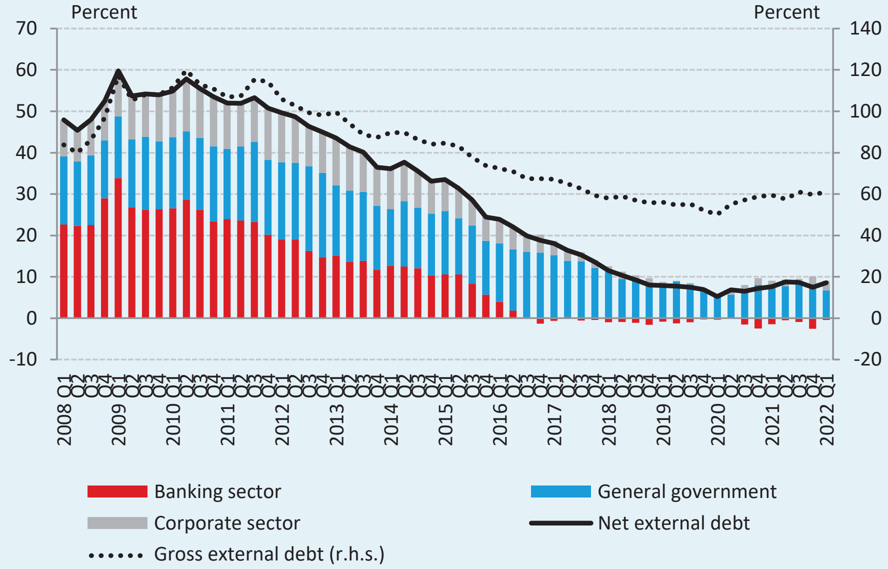
In the first quarter, the net external debt of the economy according to underlying trends rose to 8.6 percent of GDP, from a level close to its historical low at the end of the year. The inflow of debt liabilities caused the indicator to rise, which was partly offset by the effect of the growth in nominal GDP and the revaluation reducing the net outstanding debt (Chart 16). Revaluation was due to the fact that, as a result of rising yields, the price of government securities held by non-residents declined, which reduced the outstanding debt. The rise in nominal GDP, following the growth in the previous quarters, reduced net external debt as a percentage of GDP in the first quarter as well.

Chart 16: Components of the change in net external debt (values excluding intercompany loans as a percentage of GDP)



The increase in net external debt was related to the private sector's debt-generating borrowing, while the debt indicator of the consolidated general government including the MNB declined (Chart 17). The rise in the indicator was primarily attributable to the fact that **banks'** foreign liabilities expanded to a greater degree than foreign assets, and thus the net external debt of banks increased by 2.1 percent of GDP. The debt inflows of banks took place primarily through the borrowing of short-term funds. Despite the increase, the sector's net external debt ratio is still negative, i.e. banks' foreign assets continue to exceed foreign liabilities. **Companies'** net external debt-to-GDP ratio was up slightly, by 0.4 percent of GDP, as the rise in foreign liabilities (related to commercial loans) exceeded the expansion in foreign receivables. The net external debt of the **consolidated general government including the MNB** declined by 1.5 percent of GDP, as the effect of the mild debt inflow was more than offset by the revaluation of the net outstanding debt, which took place as a result of yield increases.

Chart 17: Breakdown of net external debt by sectors and gross external debt (as a percentage of GDP, excluding intercompany loans)



At the end of the first quarter, Hungary's gross external debt rose to nearly 61 percent of GDP. The rise in the debt indicator was attributable to the private sector's significant borrowing from abroad, while the indicator for the general government declined as a result of revaluation effects. The gross foreign liabilities of the *consolidated general government including the MNB* due to transactions were stable, which was a result of contrasting effects. The samurai bond issues in the first quarter and non-residents' HUF-denominated government securities purchases increased the debt indicator of the government, which was offset by the fact that the MNB's foreign liabilities declined in view of the lower one-off discount bond issue as well as the more moderate recourse to the euro liquidity-providing swap compared to December. The decline in the gross external debt of the government was attributable to a revaluation effect: the price change due to an increase in yields reduced the outstanding debt (through the decrease in the price of government securities), which improved the debt indicator together with the expansion in GDP.

The increase in the private sector's gross external debt was mostly related to the rise in banks' external liabilities and to a lesser degree to that of companies. The rise in short-term debt outstanding was the main contributor to the increase in the *banking sector's* debt indicator, while long-term debt also climbed a bit. The increase in the sector's gross external debt reflected the first-quarter correction of banks' balance sheet tightening (which usually takes place at the end of the year), i.e. the effect of the return to the underlying trends. The increase in the gross external debt-to-GDP ratio for *companies* was mainly driven by a major expansion in commercial loan debts, with the effect of supply problems due to the war and surging energy prices also playing a role.

3.2 Foreign exchange reserves and reserve adequacy

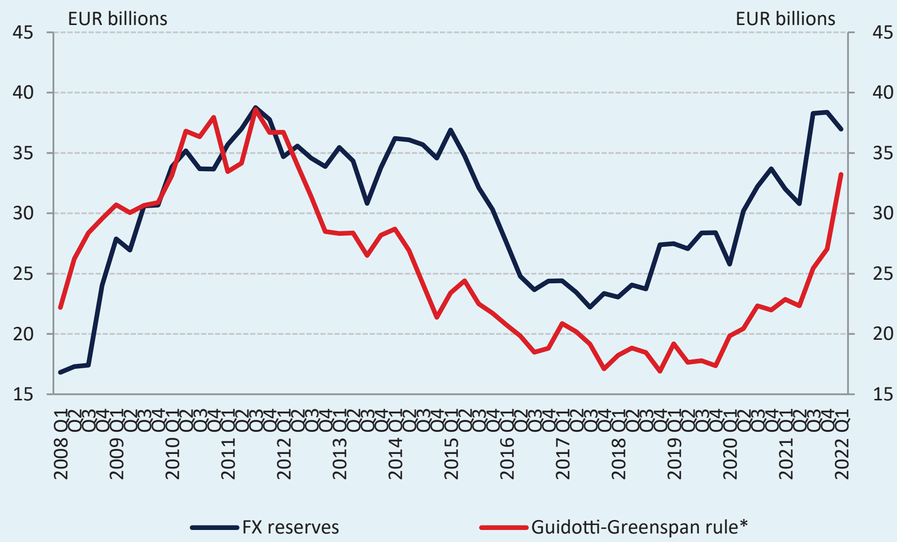
At the end of 2022 Q1, international reserves amounted to EUR 37 billion, reflecting a decline of EUR 1.4 billion versus the end-December 2021 level. The reserves were mostly reduced by the FX expenditures of the State Treasury, whereas the largest growth was seen in EU fund inflows. Following EUR 38.4 billion at end-December 2021, the MNB's international reserves amounted to EUR 37.0 billion at end-March 2022. The development of reserves was affected by various factors, the most important of which were the following:

- *Funds from the European Union* increased the reserves mainly in relation to disbursements connected to agricultural support programmes.
- The *net FX financing operations of the Government Debt Management Agency* (*GDMA)* boosted reserves by EUR 0.5 billion in total. The increase is mainly the result of the four series of Japanese JPY-based government securities issued in February, three of which were issued with green certifications.

- The *revaluation* stemming from other currencies appreciating against the euro and the increase in the price of gold expressed in EUR boosted the reserves.
- The reserve-reducing effect of the *Hungarian State Treasury's foreign currency* transactions amounted to EUR 0.7 billion.
- *The change in the stock of the forint liquidity-providing FX swap instrument reduced the reserve level by EUR 0.5 billion.* In September 2021, the Monetary Council first announced the gradual phasing-out of the swap instrument, but then a decision to completely phase out the swap instrument was made in mid-November 2021. Accordingly, the tenders, which had previously been held every week, were no longer announced.
- The balance of the *euro liquidity-providing swap instrument* and the international *repo drawdowns* decreased reserves compared to the end of December 2021.

At the end of 2022 Q1, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 3.8 billion. At end-March 2022, international reserves and short-term external debt amounted to EUR 37.0 billion and EUR 33.2 billion, respectively. Compliance with the Guidotti–Greenspan indicator declined in the first quarter of the year. The short-term external debt of the consolidated general government including the MNB was reduced by the financing of the central bank forint liquidity-providing swap holdings, which were lower compared to end-2021, while the government dollar bonds maturing within a year pointed to a rise in the indicator. Nevertheless, in view of the FX financing operations of the Government Debt Management Agency, this latter effect can only be considered temporary. The increase in the private sector's short-term external debt was related partly to the corporate sector and partly to the banking sector. The expansion in companies' commercial loan debt was attributable to the increase in foreign trade and the surging energy prices. The increase in energy prices also added to the liabilities recorded on the margin accounts related to companies' hedging transactions. The rise in the banking sector's short-term external debt was primarily related to the borrowing of funds that were short-term according to original maturity. The leeway above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, amounted to EUR 3.8 billion in early 2022, which still represents sound reserve adequacy (Chart 18).

Chart 18: Short-term external debt of the Hungarian economy and foreign exchange reserves



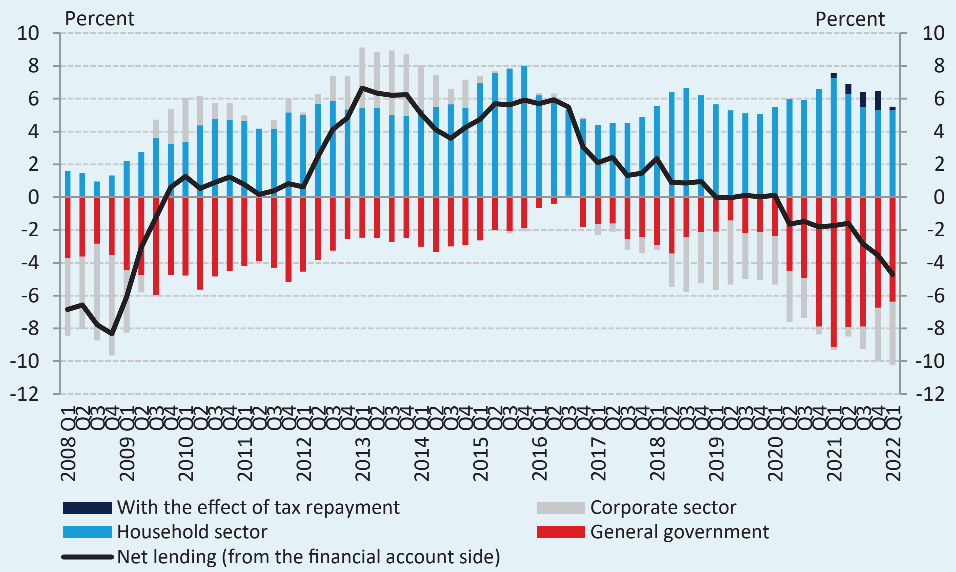
** Guidotti–Greenspan indicator: short-term external debt based on residual maturity.*

4 Sectors' savings approach

The external balance position of the economy according to sectors' savings declined further, which was attributable to the savings of the private sector. The decrease in the general government deficit continued from the previous year's high level in 2022 Q1 as well, which was primarily the result of the effect of rising tax revenues. In parallel with that, the net position of households and corporations was lower, which was partly explained by the pick-up in domestic absorption in view of the lifting of containment measures and partly by the corporate income-reducing effect of the rising energy and commodity prices, as well as by the methodological recognition of the PIT refund. Within households' savings, the weight of deposits and cash demand was the greatest, while government securities holdings temporarily declined, presumably in view of the uncertainty following the outbreak of the war.

In terms of sectors' savings developments, the rise in the net borrowing of the economy reflected the declining net lending of the private sector (Chart 19). The changes in household savings were significantly affected by the sharp expansion in incomes and consumption observed in the first quarter, which was also facilitated by government transfers resulting in one-off expenditures (13th month pension, service benefits of armed forces and police services). Income related to the PIT refunds was generated in 2021, and thus, in line with the methodology of financial accounts, the PIT refund was recognised in the statistics for this period, increasing the 2021 savings of households in parallel with the higher budget deficit, while it did not affect the net savings of 2022 Q1. By contrast, in early 2022, according to underlying trends and excluding the effect of the PIT refund, households' financial savings stabilised above the 5 percent value observed at end-2021 (for details, see Section 5). Meanwhile, a continued increase in net borrowing is observed in companies' balance position, in relation to the still-buoyant investment activity and inventory accumulation as well as presumably to the corporate income-reducing effect of higher energy and commodity prices. In parallel with the pick-up in the economy and as a result of the rise in tax revenues stemming from the rapid nominal increase in wages and consumption following inflation, the four-quarter net borrowing of the government declined in spite of the significant one-off expenditures in the first quarter.

Chart 19: Net lending of specific sectors* (four-quarter values as a percentage of GDP)

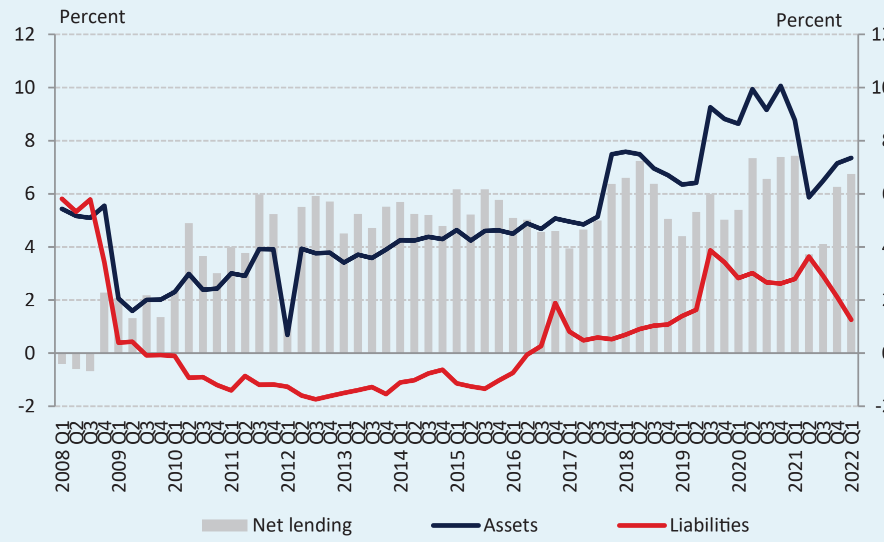


** General government represents the net borrowing according to the financial accounts. Corporations based on the residual principle.*

In 2022 Q1, according to the underlying trends, households' seasonally adjusted net financial savings increased compared to the previous quarter, with contributions from the rise in financial assets and the decline in net borrowing (Chart 20). For economic considerations, the MNB excludes the one-off effects (such as pension fund savings, early repayment, real yield disbursement, indemnification of the depositors of liquidated mutual savings banks, forint conversion and settlement) from the indicator based on underlying trends. The one-off effects influence the net indicator as well through the accumulation of financial assets and the liabilities, and therefore, in addition to presenting the gross legs, we present the underlying trends on seasonally adjusted data.

According to the seasonally adjusted indicator as a proportion of GDP, which captures the underlying developments, the increase in households' financial asset accumulation is partly attributable to the rising wages and the one-off government transfers in the first quarter (13th month pension, service benefits of armed forces and police services) as well as to the still-strong wage dynamics. The dynamics of households' seasonally adjusted net borrowing as a percentage of GDP decelerated in the past quarter, which mainly reflected the effect of the high-amount repayments observed in the securities loans outstanding as well as of cautiousness due to geopolitical tensions, which was partly offset by the increased interest in the closing FGS Green Home Programme and demand brought forward due to the rising interest rate environment. In addition to the prenatal baby support loan, the new housing subsidies available from 2021 play an increasing role in households' credit demand.

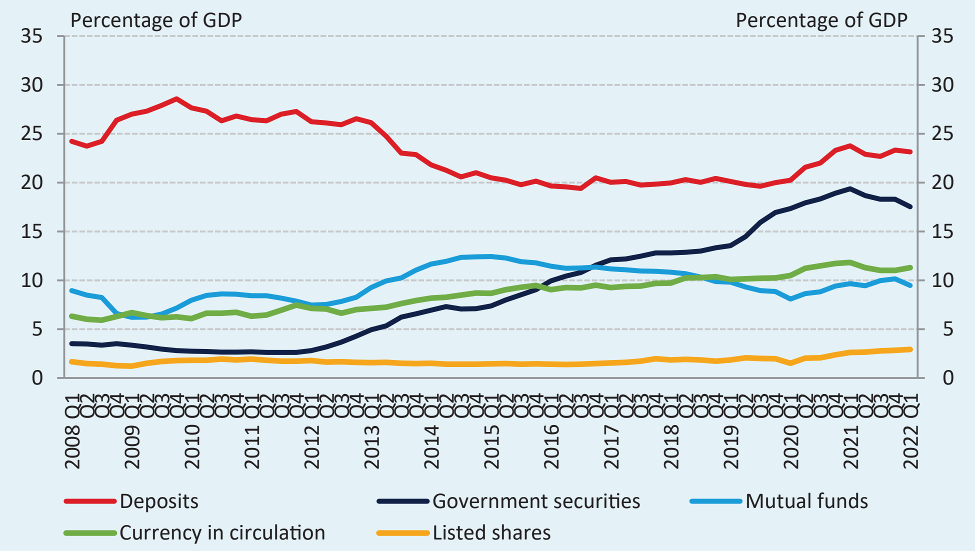
Chart 20: Households' net lending according to underlying trends (seasonally-adjusted, revised values, as a percentage of GDP*)



** 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 the forint conversion and settlement and the PIT refund. Time series adjusted separately.*

Households' financial asset accumulation increased significantly, although to a somewhat lesser degree than the expansion in nominal GDP, and it took place in parallel with a rearrangement within the forms of savings (Chart 21). In the first quarter, as a result of the PIT refund and other government transfers, overnight deposits increased considerably, rising by more than HUF 450 billion, which was offset by the expansion in nominal GDP. Meanwhile, cash accumulation also increased significantly, rising by nearly HUF 400 billion, mainly due to precautionary considerations in view of the Russia–Ukraine conflict and presumably to the demand for cash of refugees arriving in the country. In parallel with that, however, households' demand for government securities declined as a result of the increasing uncertainty. Consequently, a net outflow of government securities took place, which may have partly added to cash savings. Net government securities purchases fell compared to the previous quarter, primarily as a result of MÁP+ redemptions. Starting from the final quarter of 2021, in view of the rising inflation, households shifted from fixed-rate government securities towards inflation-indexed government securities. While in March the MÁP+ holdings declined considerably as a result of transactions, holdings of inflation-indexed PMÁP securities increased dynamically during the period (partly as a result of the first-quarter issue of the new security with more favourable interest). Although with the widening of investment options households steadily increased their financial wealth placed in investment funds (and within that, *inter alia*, their foreign mutual fund share and equity portfolios) during the past one year, there was an outflow from this segment as well in the first quarter. On the whole, in the quarter the uncertainty related to the outbreak of the war and one-off government transfers contributed to the growth of wealth held in more liquid forms of savings, while investment options providing protection from inflation became increasingly popular. In parallel with that, quoted share holdings rose to a historical high, which was partly attributable to rising prices and partly to households' transactions. In the past period, households considered the major falls in prices as a good opportunity to enter, and they increased their holdings of shares considerably.

Chart 21: Development of households' key financial assets



5 Households' savings following the pandemic and the outbreak of the war

As a special topic, the changes in Hungarian households' financial savings were examined in view of the coronavirus pandemic and the outbreak of the war. At end-2021, Hungarian households' net financial savings significantly exceeded those of the regional peers and were later also increased by government transfers. For the time being, the uncertainty caused by the war between Russia and Ukraine has not resulted in changes among households of a degree similar to the change caused by the successive waves of the coronavirus pandemic; according to the underlying trends, households savings have remained stable. The change in households' savings position was significantly affected by the impact of the recognition of PIT refunds, which increased 2021 savings in the statistics. According to the MNB's questionnaire survey, the majority of households spent the PIT refund within a couple of months. In April, a mere 15 percent of the beneficiaries planned to use it for longer-term savings. The uncertainty related to the outbreak of the war and one-off government transfers contributed to the growth of wealth held in more liquid forms of savings, while investment options providing protection from inflation became increasingly popular.

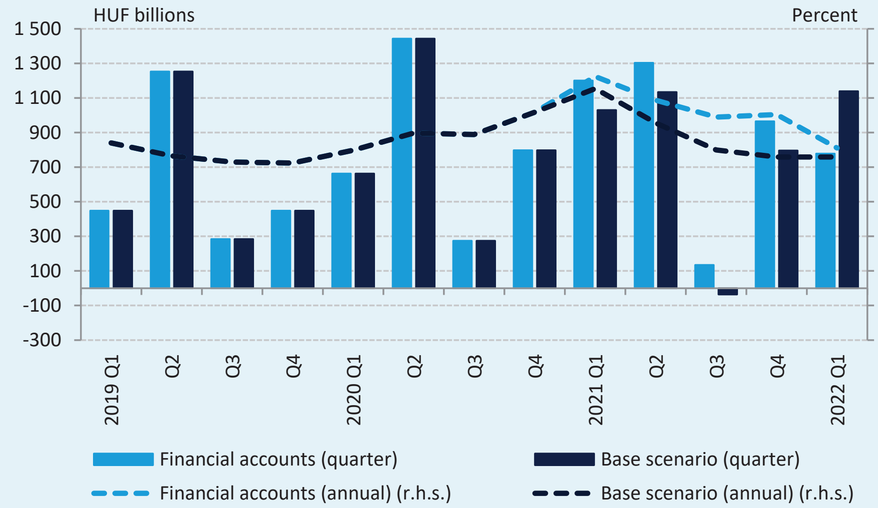
5.1 Underlying trends in Hungarian households' financial savings

During the past two years, the changes in Hungarian households' financial savings were affected by both international and country-specific developments. In 2020, the lockdowns to contain the coronavirus pandemic and the economic effects of the latter entailed a drop in household consumption and an increase in savings, which was followed by contrasting changes with the restarting of the economy and the lifting of restrictions. These developments were perceived at the international level as well: after rising in 2020, households' savings typically moved on a downward path in 2021. Somewhat differently from the countries of the region, Hungarian households' savings increased in 2021 as well, which reflected country-specific factors, such as the statistical effect of the tax refund provided to households raising children.

According to financial accounts data, households' financial savings-to-GDP ratio declined at the beginning of 2022. Adjusting the trend attributable to the PIT refund, however, savings according to the underlying trend show the savings rate stabilising above 5 percent. According to the financial accounts, the PIT refund to families with children added to households' net financial savings in 2021. The PIT refund amounting to HUF 680 billion was based on incomes generated in 2021. Accordingly, it also increased the net borrowing of the general government in the financial accounts for this period. In connection with that, in 2021 other receivables of households came into being vis-à-vis the state, which, according to the financial accounts, increased households' net lending, evenly distributed across quarters (Chart 22). However, the increased other receivables of households did not actually expand households' disposable financial assets, and thus for every quarter net savings according to underlying trends were lower by one fourth of the total PIT refund, i.e. by HUF 170 billion lower, as compared to net savings according to the financial accounts.

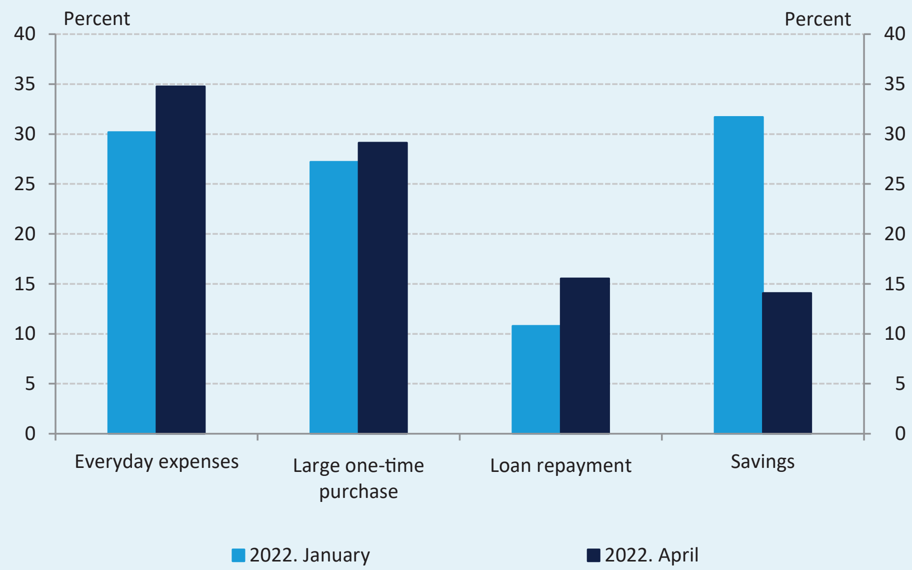
The impact of the disbursement of the PIT refund in 2022 Q1 on households' net savings in the financial accounts was neutral in this quarter. In 2022 Q1, according to the financial accounts, households' other receivables from the government declined in parallel with the disbursement of the PIT refund, e.g. with its crediting to bank accounts, and thus households' net lending did not change as a result of the above. Nevertheless, in order to determine the level of net financial savings that capture the underlying trend and do not take into account the effect of the PIT refund it is necessary in this case as well to adjust the financial account data, as households spent the one-off income, and partly this is the reason why their financial assets declined, otherwise they would have reached a higher level. For the adjustment we used the survey conducted by the MNB, which – in connection with households' savings decisions – assessed the savings attitude related to the PIT refund as well as the amounts that had been spent.

Chart 22: Nominal value of households' quarterly unadjusted net savings and four-quarter net savings as a percentage of GDP



According to the MNB's questionnaire survey, the majority of households spent the PIT refund within a couple of months. In April, a mere 15 percent of the beneficiaries planned to use it for longer-term savings (Chart 23). In 2022, the MNB surveyed households' plans related to the PIT refund on several occasions: in early 2022, the ratio of those who were planning savings was still relatively high, exceeding 30 percent, but this fell to less than half by mid-April, i.e. after actual disbursement. According to our estimate prepared based on the survey, more than half of the PIT refund was spent by mid-March (a small part of it on loan repayment, which increases net financial savings). The spent amount of the PIT refund actually reduced households' financial assets, and therefore we adjusted the indicator based on underlying trends accordingly. As a result of the adjustment, households' four-quarter savings according to underlying trends stabilised at above 5 percent of GDP in 2022 Q1.

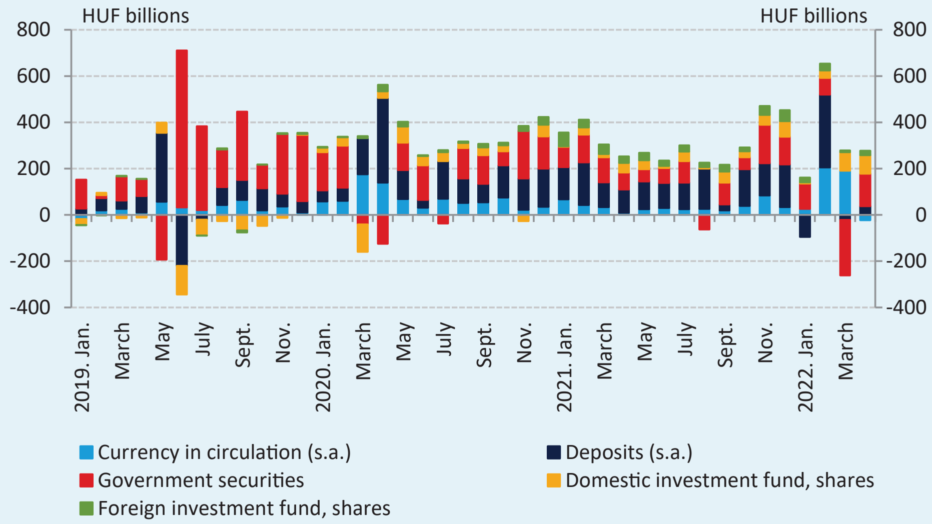
Chart 23: Households' plans regarding the PIT refund on based on the MNB survey (January, April 2022)



5.2 Changes in the structure of financial claims

The consequences of the coronavirus pandemic and the war between Russia and Ukraine affected not only the level of households' savings but also the composition of their financial assets: following the coronavirus pandemic, deposits started to catch up with government securities, whereas a surge in the demand for cash was observed after the outbreak of the war (Chart 24). The upswing in demand for government securities following the introduction of the MÁP+ restrained the growth of both deposits and investment funds. However, the coronavirus pandemic resulted in a growing demand for liquid assets, with a significant deceleration in the expansion of government securities in parallel with that. It is worth emphasising that following a surge in March 2020 demand for cash adjusted, and cash holdings returned to their earlier trend by the end of the year. Starting from early 2021, as a result of the favourable conditions (new investment opportunities, rising stock exchange prices), foreign investment funds and equities increased to a degree unseen before, and the growth of domestic investment funds also caught up with that by the end of the year. Households accumulated significant cash reserves after the outbreak of the war, while they reduced their government securities holdings, but these developments partly adjusted in April.

Chart 24: Household portfolio rearrangement according to underlying trends* (HUF billion)

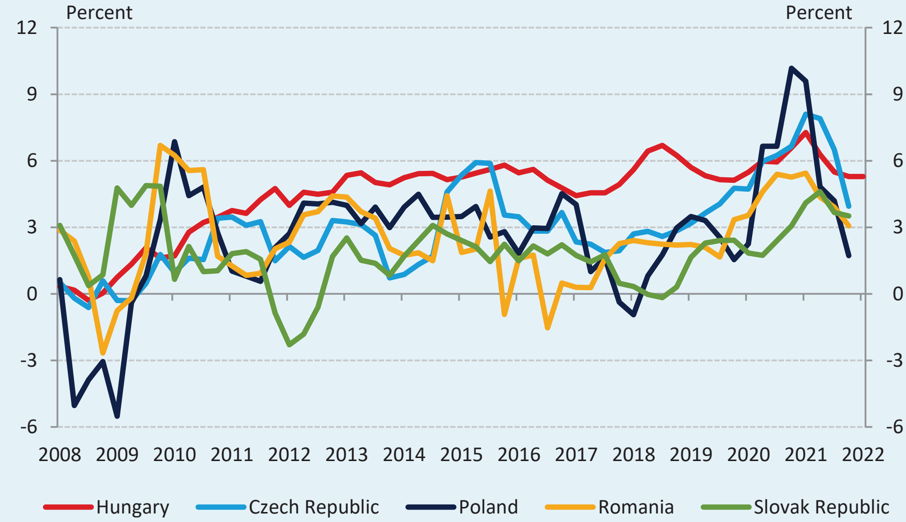


Excluding the effect of the PIT refund.

5.3 Households' financial savings in a regional comparison

The effects of global economic and foreign policy events on the savings developments in the countries of the region were typically similar in terms of direction, but different in terms of their degree (Chart 25). At end-2021, Hungarian households' net financial savings considerably exceeded those of its peers, and then increased further as a result of government transfers. Prior to the pandemic, Hungarian households' net financial savings were above the levels typical in the countries of the region. In the period following the outbreak of the coronavirus pandemic, presumably as a result of the forced savings due to the lockdowns and the precautionary motives typically rising in a crisis situation, household savings rose in all the countries, but the figure for Hungary was still in the upper part of the band for the countries of the region. As in the case of the regional peers, household savings declined considerably with the lifting of the restrictions in mid-2021. In the last quarter of the year, in view of the adjustment, the Hungarian figure rose to above 6 percent of GDP, significantly exceeding the levels observed for households in the region. The domestic savings rate increased further as a result of strong wage dynamics and government transfers.

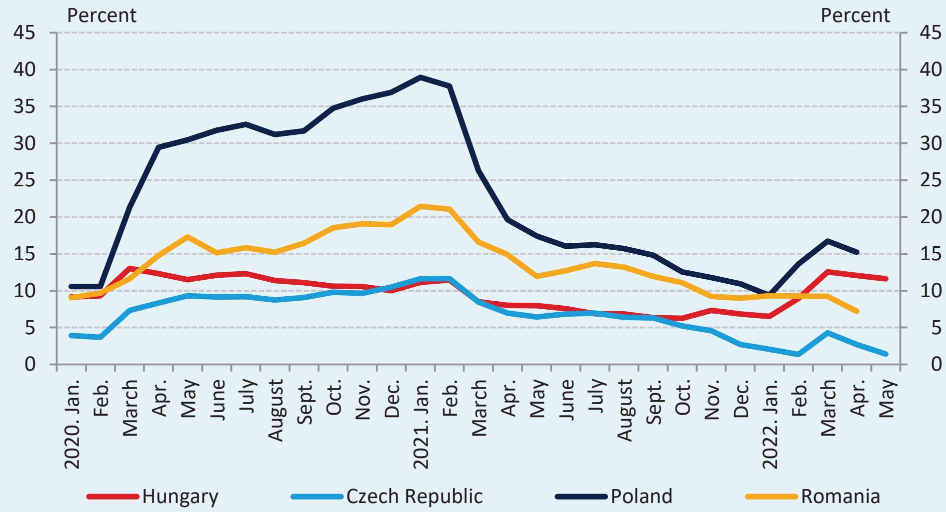
Chart 25: Net savings as a percentage of GDP (four-quarter values)*



** 2022 Q1 data are available only for Hungary; central banks in the region do not publish preliminary data. Excluding the effect of the PIT refund.*

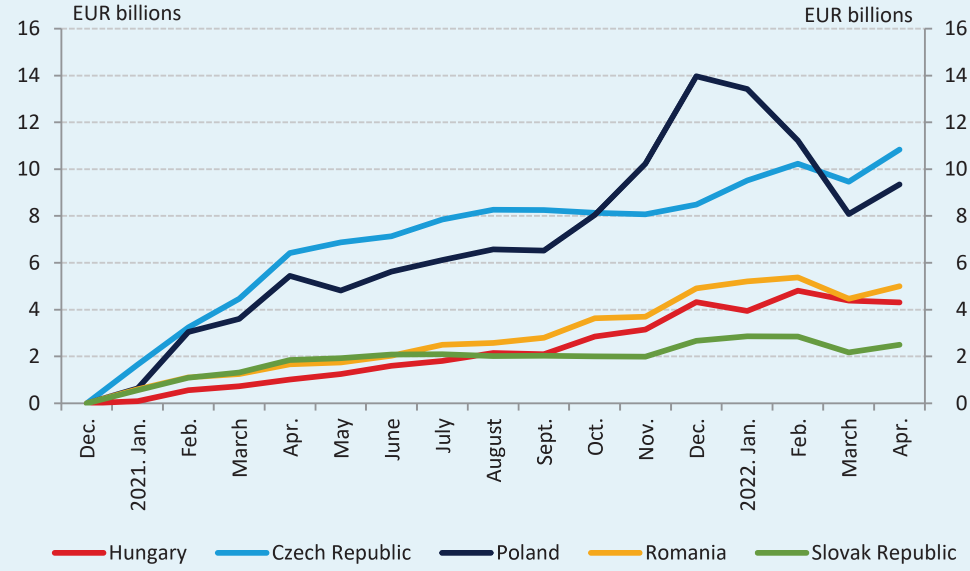
Following the outbreak of the war between Russia and Ukraine, the rise in households' cash holdings accelerated in most of the countries of the region in March (Chart 26). In March, the year-on-year increase in households' demand for cash was the highest in Poland (16.7 percent), which was presumably attributable to the fact that many of those escaping from the war are given shelter and taken care of there. It was followed by the annual increase in cash holdings in Hungary (12.5 percent), Romania (9.2 percent) and Czech Republic (4.3 percent). However, in parallel with the easing of the uncertainty related to the war, cash accumulation fell in all the countries of the region in April (and on based on the May data available) from the outliers recorded in February and March.

Chart 26: Changes in cash holdings (annual growth)



The increase in cash holdings was financed by households partly by reducing their deposits in March 2022 (Chart 27). Just like the earlier appearance of the first wave of the coronavirus pandemic, the uncertainty related to the war temporarily changed the behaviour of households and resulted in a restructuring across the forms of savings in favour of cash. A decline in deposits was less typical in Hungary, which was presumably attributable to the important role of government securities in the portfolio. In April, however, a renewed flow into deposits was already observed in the majority of the countries of the region.

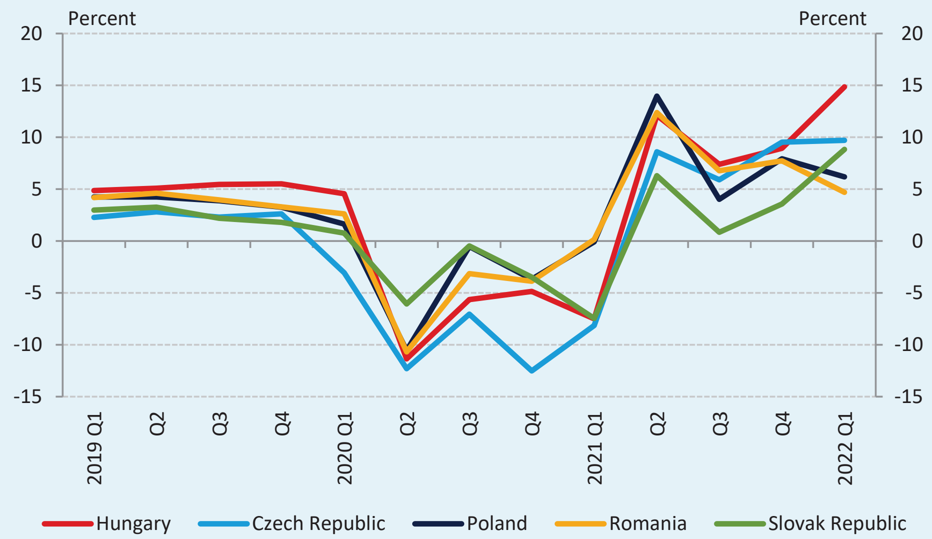
Chart 27: Households' cumulative bank deposit transactions*



**Excluding the effect of the PIT refund.*

For the time being, the uncertainty caused by the war between Russia and Ukraine has not resulted in a decline in the consumption of households of a degree that was seen in the case of the successive waves of the coronavirus pandemic (Chart 28). In real terms, the consumption of households in the region fell considerably in the first phase of the coronavirus crisis due to forced savings and precautionary considerations during the restrictions and only started to recover from 2021 Q2. During 2021, however, a small pause was observed again, and following that, consumption trends varied in the countries of the region at end-2021 and in early 2022. While household consumption declined in Romania and Poland in 2022 Q1, household spending rose in Hungary and Slovakia, presumably in part because of the gradual lifting of containment measures, while one-off income allocations also contributed to the growth in Hungary.

Chart 28: Households' annual real consumption growth



List of charts

Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

REPORT ON THE BALANCE OF PAYMENTS

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