REPORT ON THE BALANCE OF PAYMENTS

2022
JANUARY

‘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, Zsuzsa Nagy-Kékesi, Balázs Sisak, Daniella Tóth and Márton Varga. The Report was approved for publication by Barnabás Virág, Deputy Governor.

The Report is based on information pertaining to the period ending 21 December 2021.

Summary

In the third quarter of 2021, ***similarly to the countries in the region, the external balance indicators of the economy declined in Hungary as well:*** *the four-quarter current account deficit amounted to 2 percent of GDP, resulting in the parallel development of moderate net borrowing. The evolution of the external balance was attributable to the* ***presumably temporary decline in the trade surplus****: the* ***global semiconductor shortage*** *and* ***weakening external demand*** *led to a drop in exports. In parallel with this,* ***growing internal demand resulting from the reopening of the economy, the steadily high investment rate*** *and the* ***surge in fuel prices*** *were* ***reflected*** *in* ***rising imports via the deteriorating terms of trade.*** *In addition,* ***the decline in the income of Hungarian employees abroad****, and the* ***decreasing absorption of EU transfers*** *also contributed to the deterioration in external balance indicators. However,* ***Hungary's external balance may gradually improve from the second half of 2022****, as external factors return to normal, accumulated inventories are reduced and the export-increasing effects of investments unfold.*

According to the financial account, ***the inflow of debt*** *and* ***non-debt liabilities contributed equally*** *to the rise in the economy's net borrowing. In addition to the* ***significant****, roughly EUR 0.8 billion,* ***inflow of net foreign direct investment****, the purchase of foreign mutual fund shares by resident sectors continued.* ***The net inflow of debt liabilities was linked to the general government****, with items reducing foreign exchange reserves (higher utilisation of the central bank's euro liquidity-providing swaps versus the previous quarter, declining stock of fine-tuning swap instruments) and the rising forint government securities holdings of non-residents playing a key role.*

At the end of the third quarter, ***the net external debt ratio stabilised at 8.7 percent of GDP****, as the stock-increasing effect of the debt inflow was offset by the revaluation of outstanding debt and robust nominal GDP growth.* ***Gross external debt rose to almost 62 percent of GDP****, which is mainly attributable to financing developments connected to the general government (issuance of foreign currency bonds and the IMF SDR allocation), which also increased foreign receivables and thus did* ***not influence the net indicator****, along with the rise in non-residents' holdings of forint government securities.* ***In September****, due to the significant increase attributable to the aforementioned factors, international reserves* ***exceeded the level expected*** *and deemed safe* ***by investors by EUR 13 billion****.*

Examining the balance positions according to ***the sectors' savings*** *approach, the rise in the economy's net borrowing was linked to the private sector, while the net borrowing of the general government declined slightly. The* ***pick-up in domestic demand resulting from economic reopening improved the net position of the general government*** *via higher tax revenues, while the private sector's net financial saving had a negative impact, primarily via the decline in financial assets.* ***Households' savings in government securities decelerated slightly*** *in connection with the larger volume of maturities during the quarter, but* ***still contributed strongly to the low external vulnerability of the economy****.*

In our special topic we examine ***the factors behind the changes in the trade balance, which is a key determinant of current account developments****. Hungary is an energy importer, and thus* ***rising fuel prices temporarily reduce the balance of goods directly via the terms of trade*** *and* ***indirectly by curbing foreign demand****. In the third quarter of 2021, in addition to the deterioration in the terms of trade, the global semiconductor shortage also caused the goods balance to decline. However, as these impacts fade, the external balance indicators of the Hungarian economy may gradually improve in 2022.* ***In addition to the acceleration of investment activity, net exports were reduced also by the accumulation of inventories as a percentage of GDP****, and these factors may have a favourable impact on the trade balance* ***in the longer run*** *via the development of export capacities and the reduction of inventories. The* ***deterioration in the goods balance in the third quarter of 2021 affected all of the countries in the region****, in addition to Hungary,* ***in a similar manner and to a similar degree****.*

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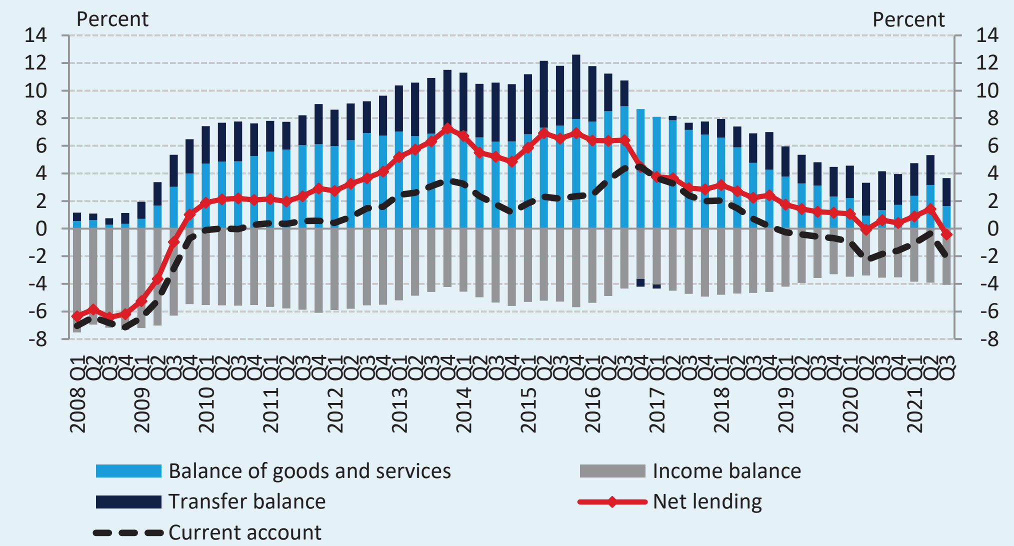
1 Real economy approach

According to the real economy approach, Hungary's four-quarter net borrowing amounted to 0.4 percent of GDP in 2021 Q3, while the current account deficit stood at 2 percent of GDP. The decline in the external balance indicators was mostly attributable to the fall in the four-quarter trade surplus, while income balance deficit also rose moderately. The decline in the trade balance was largely attributable to unfavourable developments in volume changes and the deterioration in the terms of trade. Overall, the contribution of net exports to economic growth was negative. External balance indicators deteriorated in most of the countries in the region in the third quarter.

According to the real economy approach, in 2021 Q3 Hungary's four-quarter net borrowing amounted to 0.4 percent of GDP, while the previous current account deficit of 0.6 percent, rose to 2 percent of GDP (Chart 1). According to *unadjusted quarterly data*, net borrowing amounted to around EUR 1,670 million in the third quarter, as a result of a current account deficit of EUR 2,265 million, which was partially offset by a capital account surplus of EUR 595 million. The decline in four-quarter net lending was mostly attributable to the trade balance. However, developments in the income and transfer balance also had a similar effect.

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

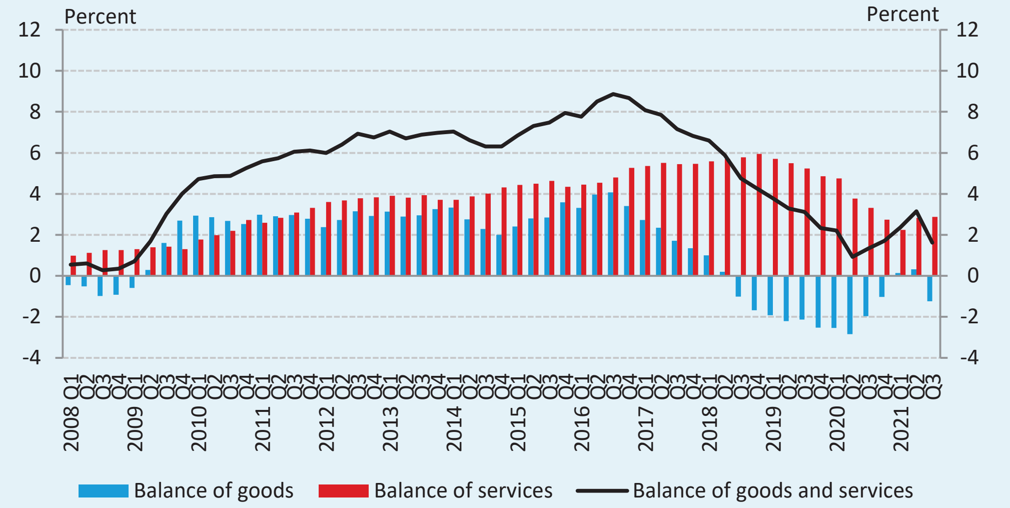


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

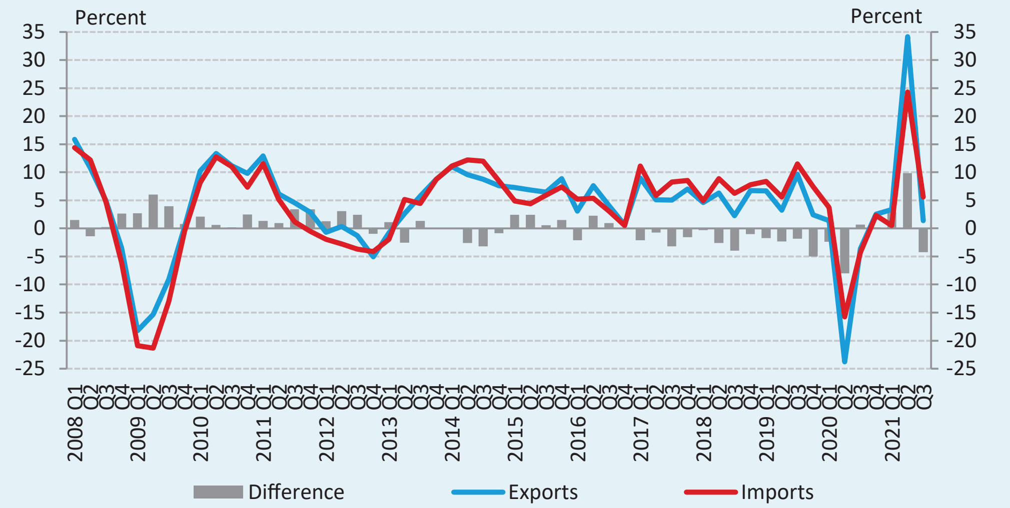
The four-quarter trade surplus started to decline in the third quarter of 2021, due to the fall in the goods balance: the underlying reasons for this included the new, fourth wave of the pandemic and a deceleration in industrial production driven by the global semiconductor shortage, while the services balance surplus continued to rise moderately in quarter-on-quarter terms (Chart 2). The increase in trade balance after the second quarter of 2020 was initially driven by the rebound in the goods balance and then by the renewed rise in the services balance surplus. However, this trend faltered in the third quarter of 2021, and the trade balance started to decline again. After an increasing negative balance registered in previous years, the *goods balance* as a percentage of GDP turned into a surplus from the beginning of 2021, thus making a positive contribution to the level of the trade balance. However, in the third quarter, the goods balance was once again significantly negative. The *services balance surplus*, which plays a key role in the trade surplus, fell to nearly 2 percent by the first quarter of 2021 from the level of 5-6 percent level observed in previous years. However, in the second and third quarters, it was close to 3 percent, in parallel with the lifting of restrictions, and particularly in connection with the recovery commencing in tourism and transportation, both of which have a significant weight within the sector. Accordingly, the rise in the services balance was able to partially offset the decline in the goods balance in the third quarter.

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



In the third quarter of 2021, the export dynamics of goods and services declined, while import performance also decreased significantly (Chart 3). Annual growth in exports fell sharply from the previous quarter's record high, partly due to the global semiconductor shortage and the higher base. Although real growth in imports also fell as a result of the higher base, the indicator still rose by nearly 6 percent. The substantial import growth is in line with the rapid increase in investments and higher household consumption following reopening. As a result of moderate exports and steadily strong growth in imports, the difference between the growth rates of the two indicators reversed and once again shows higher growth for imports.

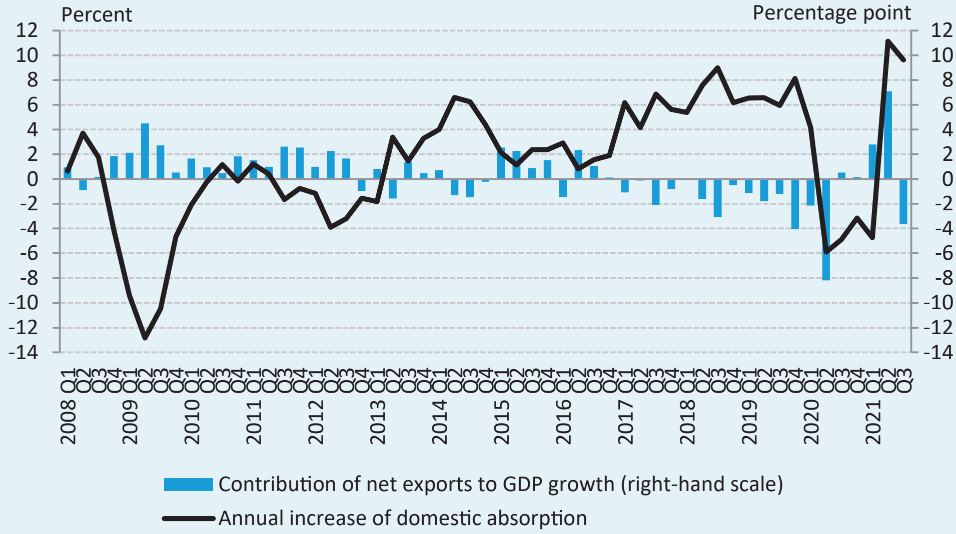
Chart 3: Annual real growth in exports and imports



Source: HCSO, MNB.

The growth contribution of net exports became negative in the third quarter, while the annual growth rate of domestic absorption – similarly to the previous quarter – rose dynamically (Chart 4). The sharp increase in domestic absorption was strongly supported by all three factors. In parallel with the lifting of the pandemic control measures there was significant growth in household consumption. Following the slowdown in previous quarter, growth in public consumption also boosted domestic absorption again in the third quarter, while year-on-year growth in investments stabilised at a high level as well. In contrast to domestic absorption, net exports made a negative contribution to GDP growth, in line with the global market situation resulting from the semiconductor shortage.

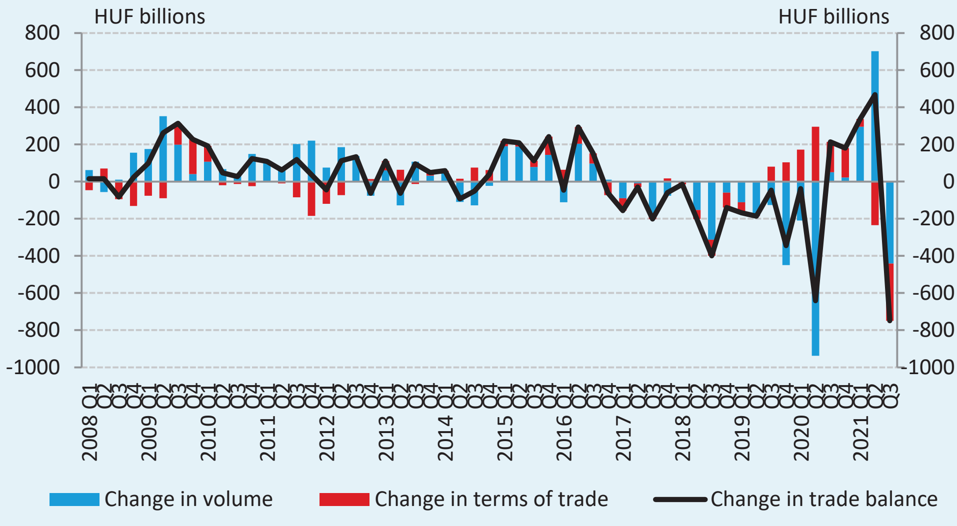
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The unfavourable development in the trade balance in the third quarter of 2021 was the combined effect of the fall in the volume of net exports and the deterioration in the terms of trade. In the third quarter, the declining volume of exports resulting from the global semiconductor shortage and the increase in imports attributable to rising domestic absorption both undermined the trade balance. In parallel with this, the rise in fuel prices was reflected in the deterioration of the terms of trade, which also had a negative impact on net exports (Chart 5). If external factors return to normal in 2022, the negative impacts on the Hungarian economy may fade, and thus Hungary's external balance indicators may gradually improve in 2022.

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

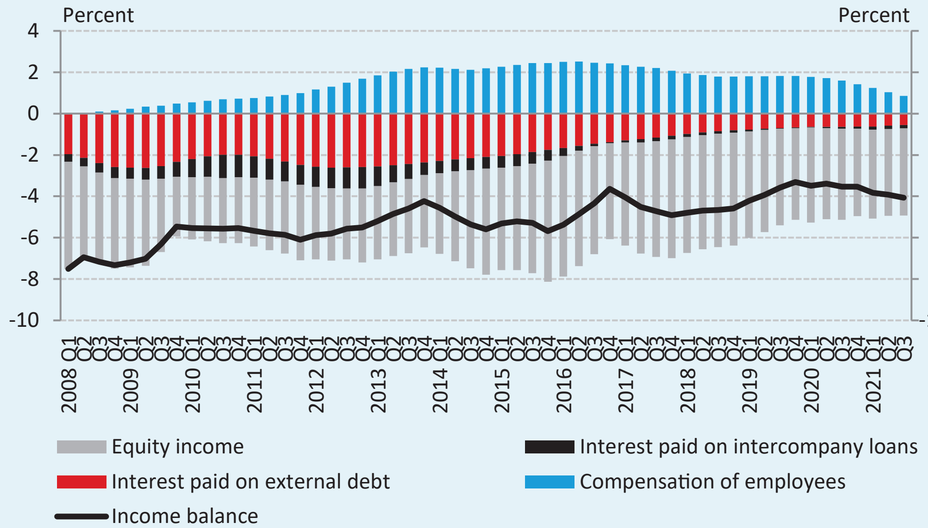


Source: HCSO.

1.2 Income balance

The income balance deficit as a percentage of GDP continued to rise moderately in 2021 Q3, which was primarily linked to the decline in the income of Hungarian employees abroad, while the interest balance of foreign loans prevented stronger growth in the deficit (Chart 6). In 2021, the four-quarter income balance deficit rose from the relatively stable level of around 3.5 percent to exceed 4 per cent of GDP by the third quarter, essentially reflecting the combined result of two factors. On the one hand, employees' income from abroad declined further due to the curbs during the pandemic: this income amounted to only 0.8 percent of GDP in the third quarter (compared to 1.8 percent before the pandemic), contributing to the higher income balance deficit. Contrary to the expectations, the reopening of the economy in the second quarter did not have a positive impact on the balance of employees' income from abroad, and due to the strengthening of the new wave of the pandemic in the autumn, this effect is expected to appear only to a small degree or not at all. On the other hand, the interest paid on foreign loans decreased slightly in the second and third quarters compared to 2020, somewhat mitigating the stronger growth in the income balance deficit.

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

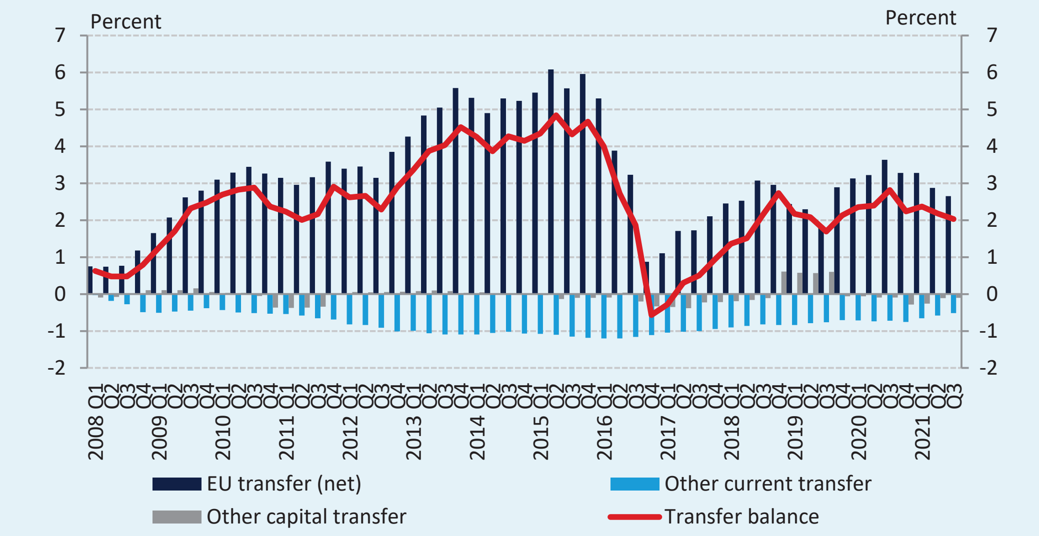


** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

In 2021 Q3, the transfer balance as a percentage of GDP amounted to 2 percent, which is lower than the level observed in previous quarters. Nevertheless, the transfer balance surplus continues to contribute strongly to maintaining Hungary's external balance position (Chart 7). Based on the four-quarter data, the net inflow of EU funds amounted to 2.6 percent of GDP in 2021 Q3, which fell short of the average of the previous quarters. However, in parallel with this, other current and capital transfers reduced the transfer balance to a lesser degree than before. The income of those employed abroad for a short term declined due to the pandemic, 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.

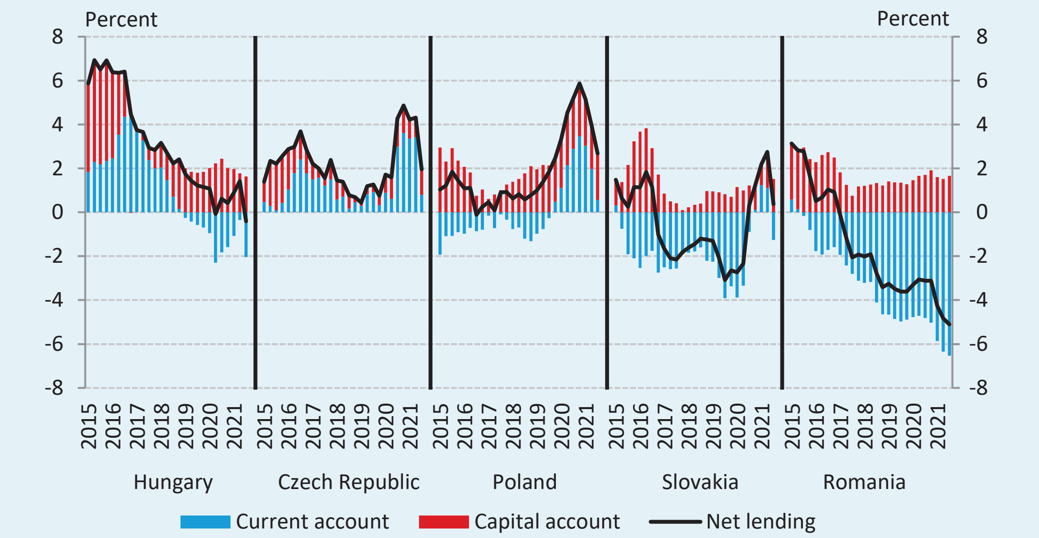
Chart 7: Four-quarter developments in the items of the transfer balance (four-quarter values as a percentage of GDP)



1.4 Regional comparison

A turnaround in external balance trends was seen in the other countries in the region as well, while significant net borrowing may still be observed only in Romania (Chart 8). As balance of payments figures are not yet available for the third quarter for the countries in the region, we substituted these by aggregating the preliminary monthly data for the quarter. On this basis, the favourable trends until the second quarter were followed by a major deterioration in the external balance indicators of all countries in the region: in conjunction with stable growth in the capital account, the four-quarter current account balance fell substantially in the Visegrád countries, while in Romania the decrease continued (for more details on the factors underlying this decline, see the Special Topic). The levels nonetheless varied significantly: while the net lending of the economy was around 2-3 percent of GDP, in conjunction with a current account surplus, in the Czech Republic and Poland, the current account of Hungary and Slovakia turned into a deficit with close to zero net lending, and Romania's net borrowing approached 5 percent of GDP.

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



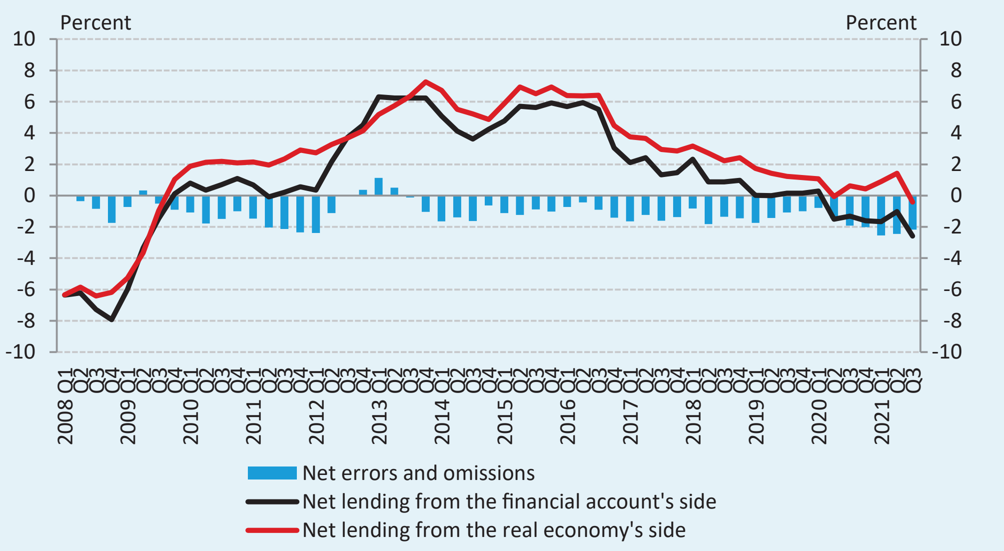
Source: MNB, Eurostat. In the case of the countries of the region, based on preliminary monthly data for the third quarter.

2 Financing approach

The four-quarter net borrowing of the financial account increased significantly in the third quarter. The net inflow of both debt and non-debt liabilities contributed to the historically high net quarterly borrowing. Owing to the rise in reinvested earnings, net FDI funds increased substantially, while the purchase of foreign equities and mutual fund shares by resident sectors continued. The net inflow of debt liabilities was connected to the general government, which was attributable to the foreign exchange reserve-reducing items linked to developments in central bank swaps and to non-residents' increasing holdings of forint government securities. Banks' decreasing net external liabilities were mostly connected to the repayment of their long-term debts.

According to the financing side data, the economy's four-quarter net borrowing rose significantly in the third quarter of 2021 (Chart 9). The four-quarter external balance position calculated using the real economy approach turned into moderate net borrowing, and in parallel with that the inflow of funds rose substantially according to the financing items. The amount of the difference between the four-quarter external balance indicators ("Net errors and omissions"[1]) fell to 2.2 percent of GDP and thus still moderately exceeds the average from previous years.

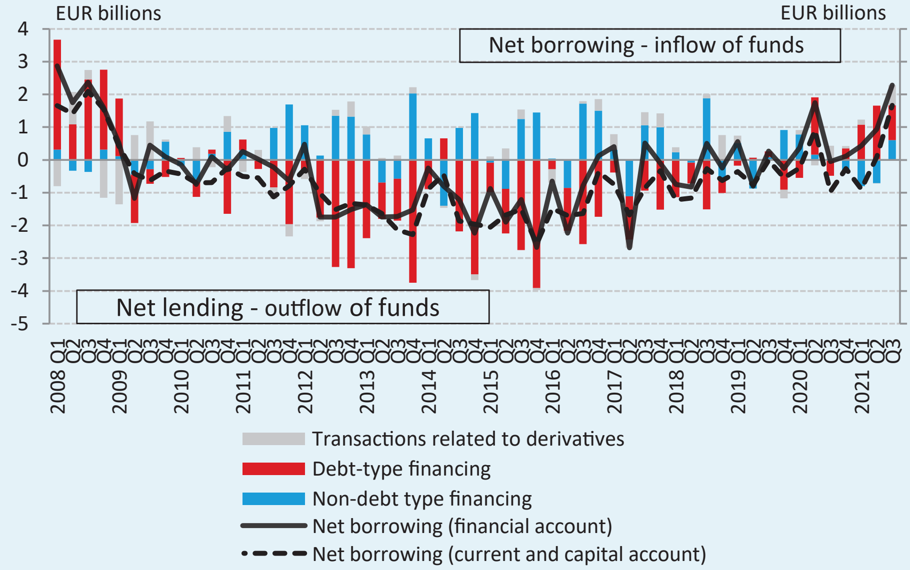
Chart 9: The two types of net lending (four-quarter data as a percentage of GDP)



Based on the quarterly data, the economy's net borrowing rose to over EUR 2 billion in the third quarter, significantly increasing Hungary's net liabilities (Chart 10). The growth in both the inflow of net foreign direct investment and net external debt contributed to the historically high net borrowing. Net outstanding debt rose by EUR 1.1 billion due to transactions, representing a moderate slowdown compared to the previous quarters. The rise in net FDI occurred in conjunction with a simultaneous increase in the gross legs, i.e. non-residents' investments in Hungary and investments by Hungarian companies abroad. Meanwhile, due to purchases of foreign equities and mutual fund shares, the fall in net portfolio dividend receivables continued, which curbed the growth in external liabilities. The combined result of the foregoing is the development of significant net borrowing based on the financial account in the third quarter.

[1] Developments in the balance of payments can also be described in terms of the financing of real economy transactions. Namely, 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)

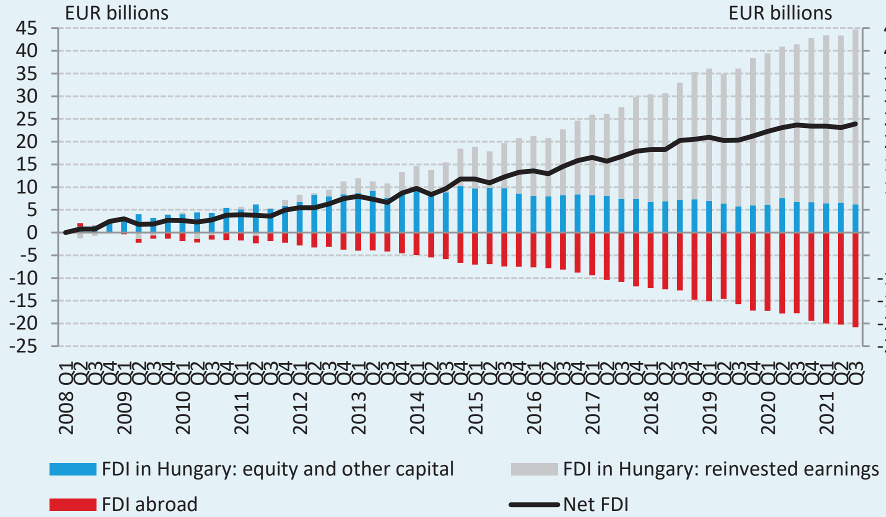


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and thus this technical effect has been eliminated.

2.1 Non-debt liabilities

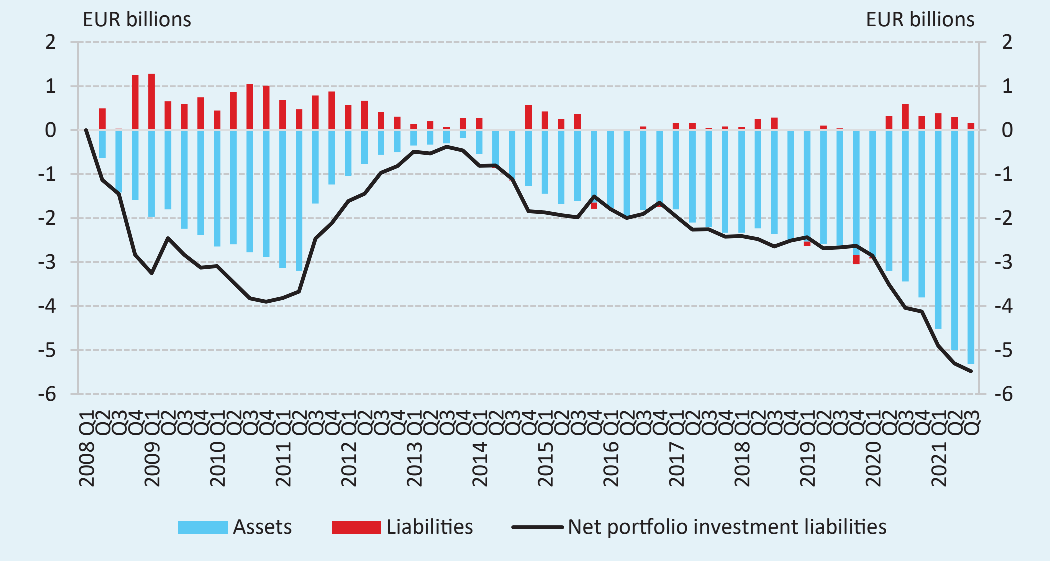
The stock of net foreign direct investment expanded significantly in 2021 Q3 (Chart 11). Net FDI inflow rose to EUR 0.8 billion in the third quarter. Based on data excluding capital-in-transit transactions and portfolio restructuring, the rise in non-resident companies' equity investments in Hungary can mainly be ascribed to higher reinvested earnings. Although Hungarian direct investments abroad also grew in parallel with this, net direct investment increased substantially overall.

Chart 11: Developments in FDI excluding capital-in-transit transactions (cumulative transactions)



Hungarian direct investment abroad decelerated further in the third quarter, accompanied by a steady decline in net portfolio equity investment (Chart 12). In the third quarter, net portfolio equity investments reduced the net balance of non-debt liabilities by EUR 0.2 billion due to transactions. Non-residents increased their Hungarian equity and mutual fund share holdings by EUR 143 million. However, in parallel with this, residents increased their foreign portfolio equity by roughly EUR 323 million during the quarter under review. Accordingly, in the third quarter, the purchase of foreign investment fund and equity by resident actors continued, albeit at a declining rate.

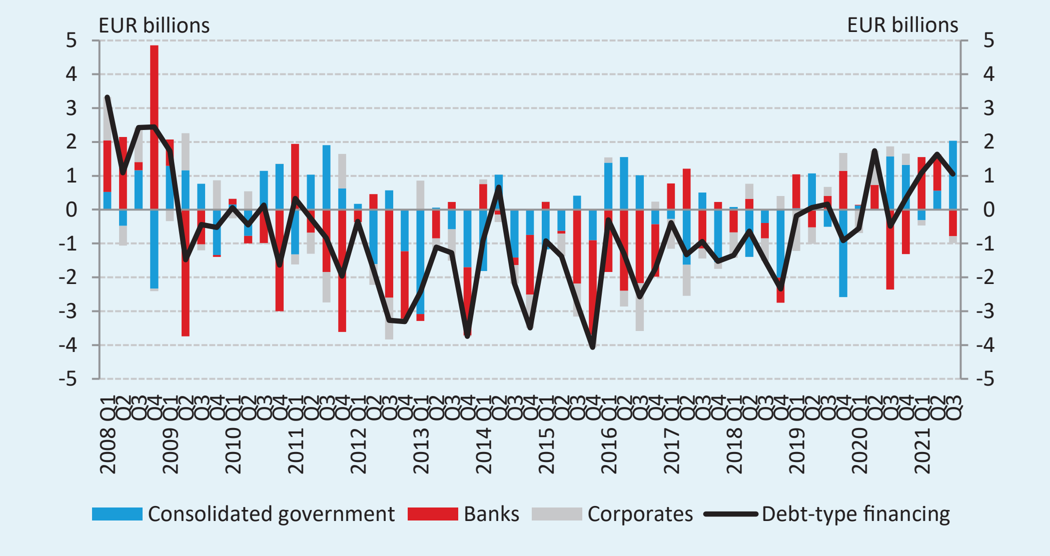
Chart 12: Developments in net portfolio equity and mutual fund share liabilities (cumulative transactions)



2.2 Debt liabilities

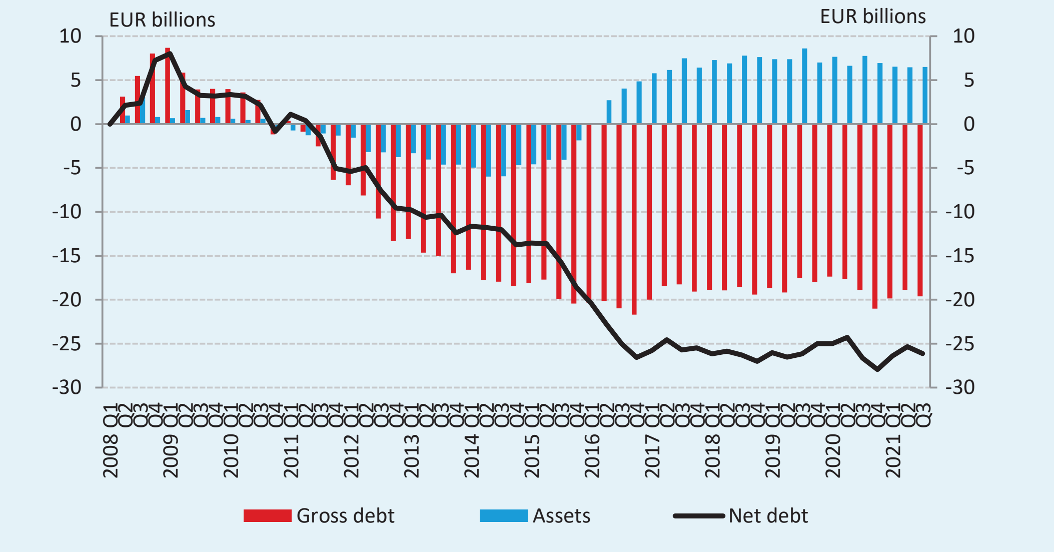
In the third quarter, growth in net external debt due to transactions slowed down substantially versus the previous quarter (Chart 13). The rise of almost EUR 1.1 billion in the indicator was linked to the general government, while the net external debt of the banking sector and corporations declined. The growth in the general government's net external debt was mostly connected to non-residents' rising forint government securities holding. The net external debt of the banking sector fell by EUR 0.8 billion, while the indicator for the corporate sector declined moderately, dropping by roughly EUR 0.2 billion.

Chart 13: Developments in net debt-type financing by sector



The banking sector's net external debt decreased substantially in third quarter, primarily linked to a fall in liabilities (Chart 14). The fall of EUR 0.8 billion in the net ratio was attributable to a decline of a similar degree in banks' liabilities. Banks mostly reduced their long-term debt, while their short-term debt also declined.

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

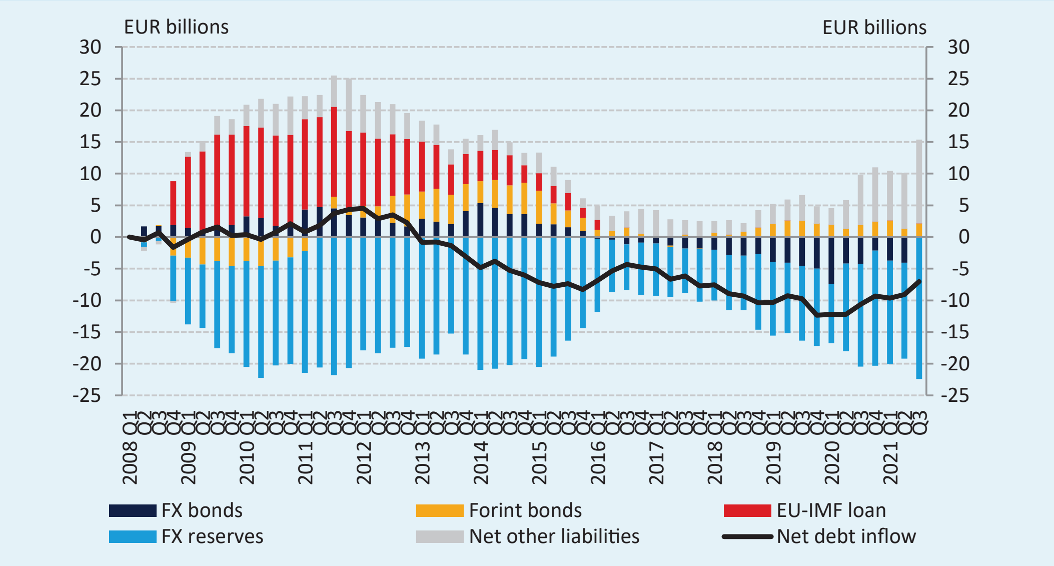


The net external debt liabilities of the consolidated general government including the MNB rose significantly, increasing by roughly EUR 2 billion in Q3 (Chart 15). The foreign currency bond issue, the SDR allocation and the international repo drawdowns increased both the foreign exchange reserves and gross liabilities, and thus had no effect on the net indicator. In parallel with the foregoing, the absorption of EU funds increased foreign reserves in the third quarter, but this was offset by several factors, which increased government's net external debt overall.

- The fall in the central bank's forint liquidity-providing swap contracts was reflected in a decline in foreign exchange reserves, which increased the general government's net external debt.
- The fact that the central bank's foreign currency liquidity-providing swap portfolio at the end of September exceeded the level registered in the previous quarter also reduced foreign exchange reserves.

It should be noted that the changes in the central bank's outstanding swap contracts had a neutral effect on the net external debt at the national economy level, as the foreign currency liquidity obtained from the central bank improved the banks' indicator. In addition to the foregoing, the rise of almost EUR 0.8 billion in non-residents' forint government securities holdings also contributed to the growth in the general government's net external debt. On the other hand, the absorption of EU transfers reduced net external debt via the growth in foreign exchange reserves.

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



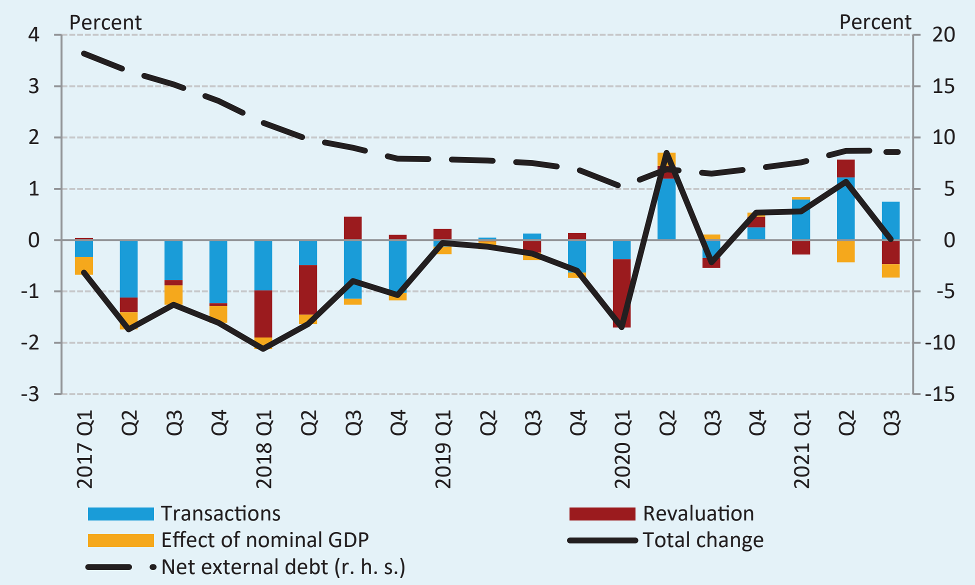
3 Developments in debt ratios

According to the underlying trends, Hungary's net external debt amounted to 8.7 percent of GDP at the end of September 2021. The stability of the debt ratio was attributable to the fact that the fall in the private sector's debt ratio and the rise observed for the consolidated general government including the MNB were of a similar degree. The effect of the debt inflow in the third quarter was offset by the revaluation of outstanding debt and the strong growth in nominal GDP, which thus mitigated the rise in the ratio as a percentage of GDP. In the third quarter of 2021, gross external debt rose to almost 62 percent of GDP, supported by the growth in non-residents' forint government securities holding, the issuance of foreign currency bonds during the quarter, the IMF SDR allocation and the higher utilisation of the central bank's euro liquidity-providing swap instruments. Hungary's short-term external debt amounted to roughly EUR 25.3 billion, while the stock of international reserves stood at EUR 38.3 billion at the end of the quarter. Accordingly, international reserves exceeded the level expected and deemed safe by investors by EUR 13 billion, representing an outstandingly safe reserve adequacy.

3.1 Developments in debt indicators

Based on the underlying trends, net external debt stabilised at 8.7 percent of GDP in the third quarter.[2] The inflow of debt liabilities caused the indicator to rise, which was offset by the combined effect of the growth in nominal GDP and the revaluation reducing the net outstanding debt (Chart 16). Revaluation was partly 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. On the other hand, at the national economy level, foreign currency assets exceed foreign currency liabilities, and thus the depreciation of the forint exchange rate reduced the net debt ratio. The rise in nominal GDP, following the strong growth in the previous quarter, reduced net external debt as a percentage of GDP in the third quarter as well.

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

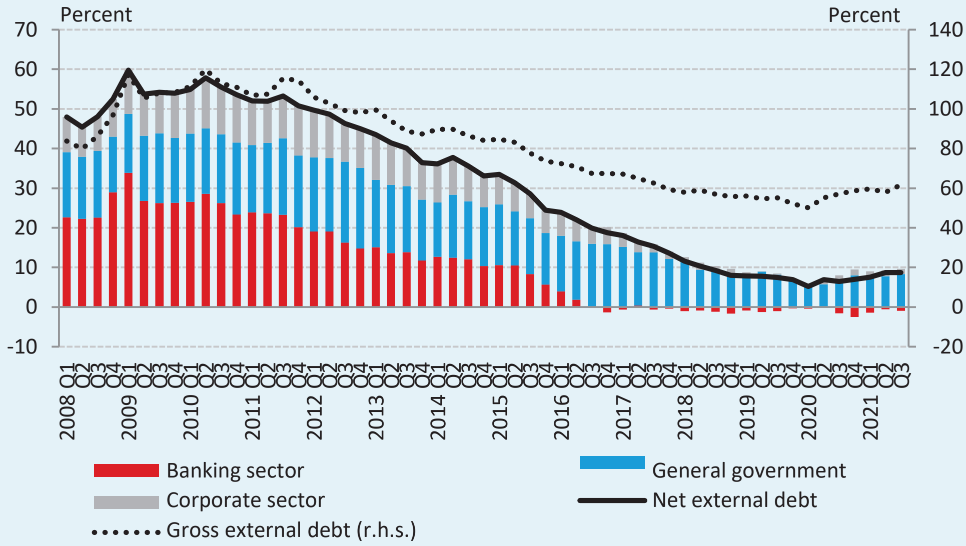


The stable development of net external debt is the combined effect of the fall in the private sector's debt ratio and the rise observed for the consolidated general government including the MNB (Chart 17). The improvement in the private sector's indicator was mostly attributable to the fact that the fall in banks' external liabilities exceeded the decline in external assets. The net external debt of the consolidated government including the MNB rose by 0.6 percent of GDP, which was primarily attributable to the rise in non-residents' forint government securities holdings and the central bank's

[2] From an economic viewpoint, the fundamental development of the debt is not influenced by the conversion between unallocated gold accounts and bullion balances, and thus this effect has been excluded from the time series.

swap instruments, which reduced international reserves. The latter is connected to the fact, on the one hand, that – in line with the decision on the phase-out of the instrument – the volume of outstanding forint liquidity-providing swap declined, and on the other hand, the outstanding euro liquidity-providing swap instrument exceeded the level registered in the previous quarter. By contrast, the changes in the central bank's outstanding swap instrument had a neutral effect on net external debt at the level of the national economy, since – simultaneously with the foreign exchange reserve-reducing effect – it improved the banking sector's ratio. The banking sector's external debt ratio rose by 0.4 percent of GDP, but still remained negative, i.e. banks' stock of external assets exceeds their external liabilities. Corporations' net external debt as a percentage of GDP improved slightly, by 0.1 percent of GDP, as a result of the growth in external assets exceeding that in liabilities, attributable to commercial loans.

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 third quarter, Hungary's gross external debt increased to 61.7 percent of GDP. The rise in the debt ratio was linked to a significant increase in the general government's gross external borrowing, while the ratio for the private sector declined. The factors underlying the rise in the gross external debt of *the consolidated general government including the MNB* include the increase in non-residents' forint government securities holdings and the issuance of foreign currency bonds by the general government in the amount of roughly EUR 4.6 billion – which has a neutral effect on the net ratio, but increases gross liabilities – as well as the higher utilisation of the central bank's euro liquidity-providing swap instrument compared to the second quarter of 2021. In addition, the general SDR allocation by the IMF – which increased both foreign exchange reserves and the central bank's external liabilities by EUR 2.25 billion – also caused the gross debt ratio to rise. Apart from the transactions, the revaluation resulting from the depreciation of forint against the major currencies also caused external liabilities to rise. On the other hand, the price change resulting from the rise in yields reduced outstanding debt, which – together with the significant growth in GDP – curbed the rise in the gross external debt ratio.

The fall in the private sector's gross external debt was mostly linked to the decline in banks' external liabilities. The improvement in the *banking sector's* debt ratio was primarily attributable to the fall in outstanding long-term debt, accompanied by a moderate decrease in short-term debt. The foreign currency obtained through the central bank's euro liquidity-providing swaps also contributed to the decline in the sector's gross external debt. The moderate decline in *corporations'* gross external debt reflects the rise in liabilities due to transactions and revaluation, which was more than offset by the impact of GDP growth.

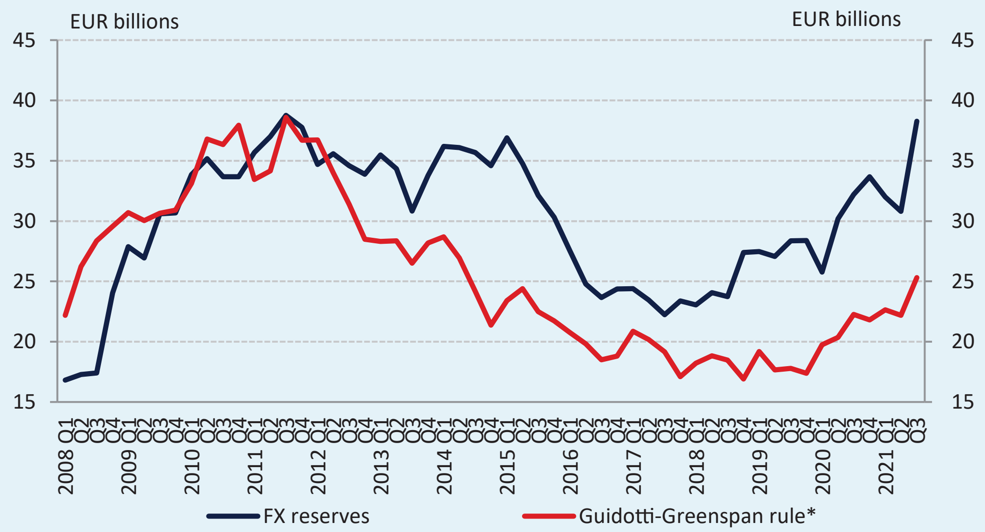
3.2 Foreign exchange reserves and reserve adequacy

Compared to June 2021, the level of FX reserves increased by EUR 7.5 billion in 2021 Q3, amounting to EUR 38.3 billion at the end of September 2021. The development of reserves was affected by various factors, the most important of which were the following:

- The *net FX financing of the Government Debt Management Agency (ÁKK)* raised the reserves by EUR 4.2 billion in total. In September, 10- and 30-year USD and 7-year euro bonds were issued in the total amount of roughly EUR 4.6 billion.
- As result of the *SDR allocation* by the IMF, foreign exchange reserves rose by SDR 1.9 billion (EUR 2.25 billion) in August; Hungary automatically received a share from the SDR allocation.
- The reserve-reducing effect of the *Hungarian State Treasury's foreign currency* transactions amounted to almost EUR 0.3 billion.
- The change in the stock of the forint liquidity-providing FX swap instrument reduced the reserve level by EUR 0.7 billion.
- *The reserve-increasing effect of EU funds was more than EUR 0.8 billion,* resulting primarily from the payment of performance-based invoices of the 2014-2020 EU programming period.
- The balance of the *euro liquidity providing swap instrument* and the international *repo drawdowns* increased reserves compared to the end of June 2021.

At the end of 2021 Q3, the MNB's international reserves exceeded the level of short-term external debt, which is closely watched by investors, by EUR 13 billion. At end-September 2021, international reserves and short-term external debt amounted to EUR 38.3 billion and EUR 25.3 billion, respectively. The growth in short-term external debt, observed in the third quarter, was primarily attributable to the rise in the short-term debt of the consolidated general government including the MNB, and to a smaller degree the debt ratio of the private sector also increased, linked to corporations. The distribution of the change in short-term external debt between sectors – the shift between banks and general government – was influenced by the central bank's euro liquidity-providing swap instrument. Accordingly, the leeway above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, stood at EUR 13 billion at the end of the third quarter, which represents a particularly sound reserve adequacy (Chart 18).

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



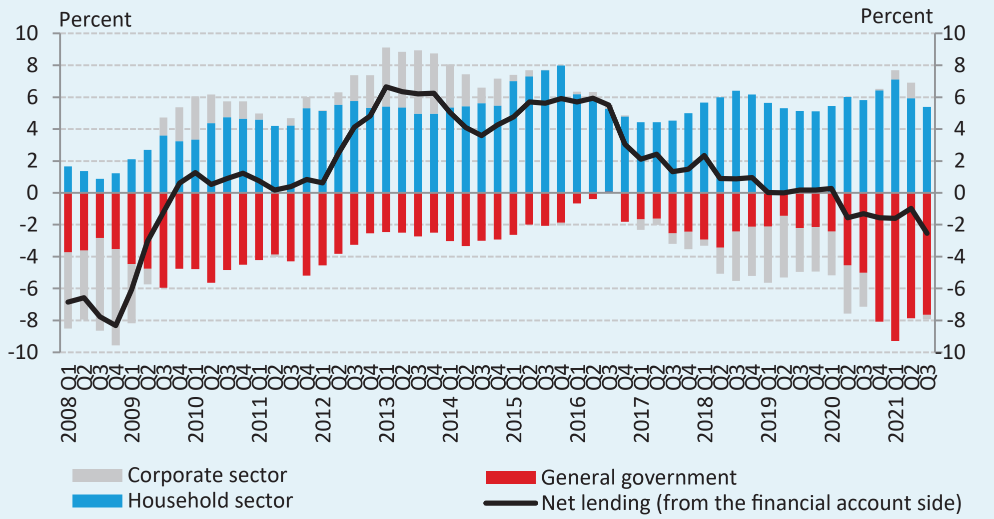
* *Guidotti–Greenspan indicator: short-term external debt based on residual maturity.*

4 Sectors' savings approach

Examining the balance positions according the sectors' savings approach, the economy's net borrowing increased, due to the private sector's declining net savings. In conjunction with a persistently high general government deficit, the net position of households and corporations declined, owing to the pick-up in domestic absorption resulting from the lifting of pandemic control measures. Household savings were dominated by demand for deposits and mutual fund shares, while the rise in government securities decelerated.

Based on the sectors' saving approach, the rise in the economy's net borrowing reflected the private sector's declining net lending (Chart 19). The general government's four-quarter net borrowing – after the lifting of the anti-pandemic restrictions – decreased slightly due to the rise in tax revenues resulting from the recovery of the economy. In parallel with this, recovering domestic absorption significantly reduced households' net financial savings: as a result of the contraction in financial assets, households' four-quarter net savings declined to 5.4 percent of GDP. Meanwhile, corporations' balance position turned into net borrowing due to the rise in investment activity.

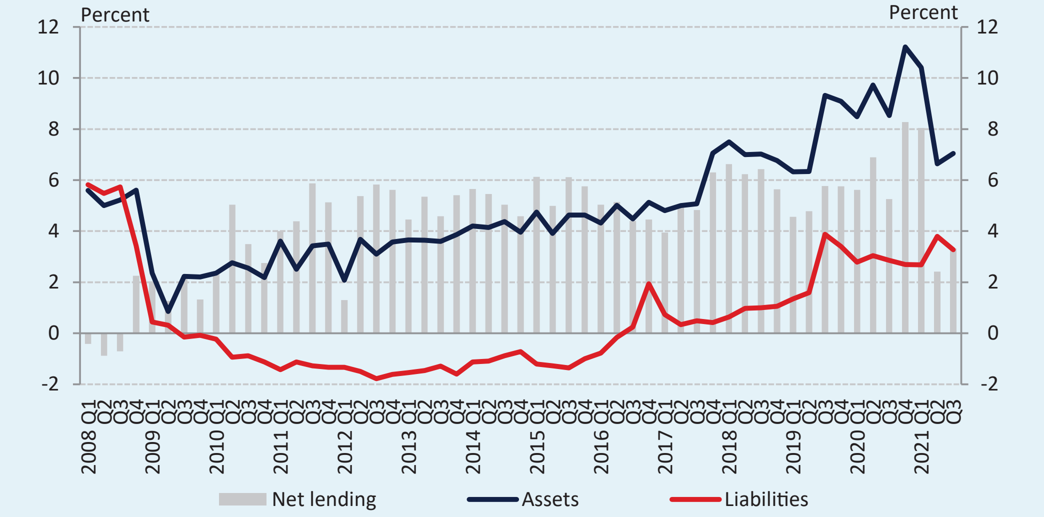
Chart 19: Net lending of specific sectors* (four-quarter values as a percentage of GDP)



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

In the third quarter of 2021, the fall in households' net financial savings was attributable to the significant decline in financial assets compared to a year earlier (Chart 20). The underlying reasons for the fall in households' accumulation of financial assets included the pick-up in household consumption, in line with the reopening of the economy and investment activity, which was also fostered by the home improvement programme. After the gradual lifting of the anti-pandemic restrictions, household reduced their forced savings, which was reflected in a major contraction in financial assets, in annual terms. Households' net new borrowing as a percentage of GDP fell moderately in the third quarter, but still exceeded the level registered a year ago. In addition to the prenatal baby support loans, the new housing subsidies available from 2021 also substantially boosted growth in households' credit demand.

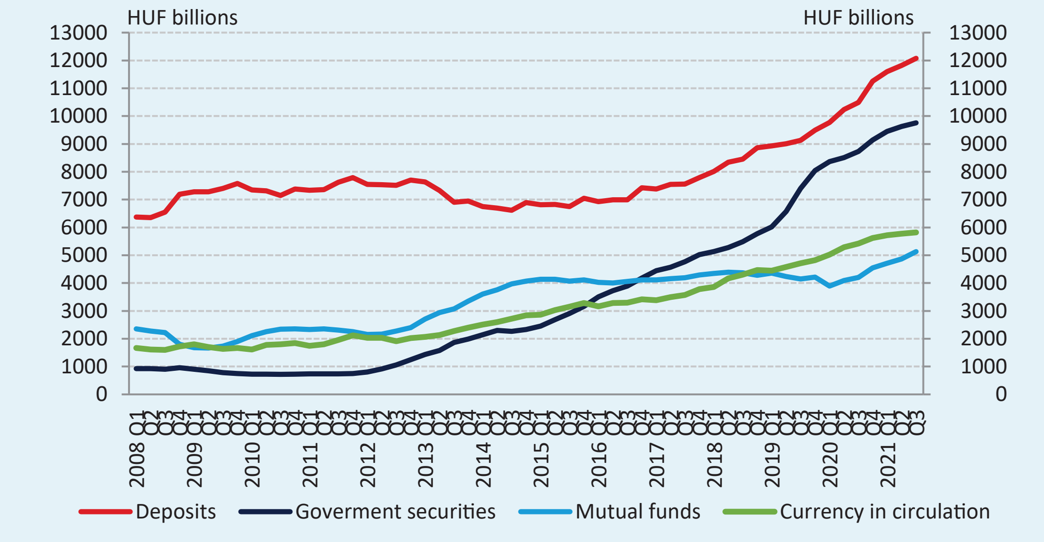
Chart 20: Net lending of households (seasonally-adjusted, revised* values, as a percentage of GDP)



** Figures showing underlying trends, adjusted for the impact of pension savings, the early repayment scheme and the real yield payment, the indemnification of the depositors of liquidated mutual savings banks as well as the forint conversion and settlement. Time series adjusted separately.*

The more moderate accumulation of financial assets was reflected – in addition to the fall in demand for government securities – in slowing cash accumulation (Chart 21). Current account deposits rose steadily, expanding by almost HUF 300 billion, in the third quarter, which implies that households still give preference to liquid assets in their investment decisions. Nevertheless, demand for cash remained moderate in the third quarter, partly due to rising inflation and the penetration of electronic payment instruments, linked to the extension of the obligation to use online cash registers and POS terminals. The increase in households' financial assets held in investment funds continued to accelerate moderately, with rising demand for foreign funds making a significant contribution. As investment opportunities have broadened, households steadily increased their foreign mutual fund share and equity portfolios over the past year. Although household demand for government securities declined further, net government securities purchases still amounted to around HUF 120 billion last quarter. Holdings in Hungarian Government Securities Plus (MÁP+) increased by more than HUF 300 billion, while the PMÁP stock declined along with the short-term government securities. The latter was mainly due to a larger volume of maturity in August. Overall, the growth in households' government securities holdings continued to support the financing of the government from internal funds.

Chart 21: Developments in households' key financial assets



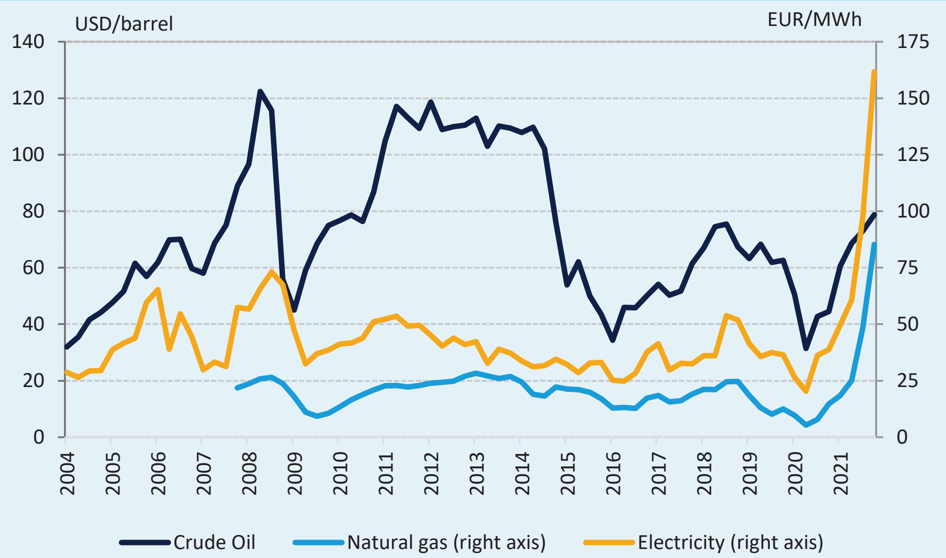
5 Factors underlying the decline in the balance of goods and services

In our special topic we examine – in domestic and international contexts – the factors behind the changes in the balance of goods and services, which is a major determinant of developments in the current account. As Hungary is a net energy importer country, significantly rising energy prices reduce the balance of goods and thus the current account as well directly via the terms of trade and indirectly by restraining external demand as well. These effects were already observed in 2021 Q3 as well: in addition to a slowdown in the growth of net exports, the worsening global shortage of semiconductors and the deterioration in the terms of trade in view of the high commodity prices also negatively affected the balance of goods. With the normalisation of external factors, external balance indicators may gradually improve in 2022. The increase in investment and changes in inventories as a share of GDP also contributed to the decline in net exports, although later, upon the implementation of the new export capacities and the reduction of the accumulated inventories they may have a positive impact on the balance of goods and services. At the same time, deterioration in the balance of goods is typical not only of Hungary: net exports decreased significantly in all of the countries in the region in Q3, which is attributable to the surge in energy prices as well as a downturn in vehicle manufacturing.

5.1 Significant rise in energy prices

World market energy prices already began to rise in the second half of 2020, but price increases accelerated considerably in 2021. During 2021, prices of gas and electric energy rose by more than 350 and 200 percent, respectively, compared to the beginning of 2021, and oil prices were also significantly up, advancing by 30 percent. The price of Brent crude increased from USD 60 per barrel early in the year to nearly USD 80 by October, corresponding to a rise of some 40 percent in the first 10 months of the year (Chart 22). There are various underlying reasons for the upturn in the price of electricity: the surge in the prices of coal and natural gas used for power generation, carbon emission permit price increases, structural changes (in Germany, a significant part of power plant capacities is being gradually closed and reduced in a pre-announced manner) and unplanned downtime in the European market. The price of natural gas also reached historical highs in the autumn of 2021, with burgeoning demand in the Asian region and disputes regarding the Nord Stream 2 pipeline as contributing factors, and lower levels in European gas storage facilities compared to the past also exerted upward pressure on the market price of gas. Although a price correction has been seen since October 2021, the relatively high level of energy prices may affect the coming year as well, possibly impacting global developments in exports and industrial production.

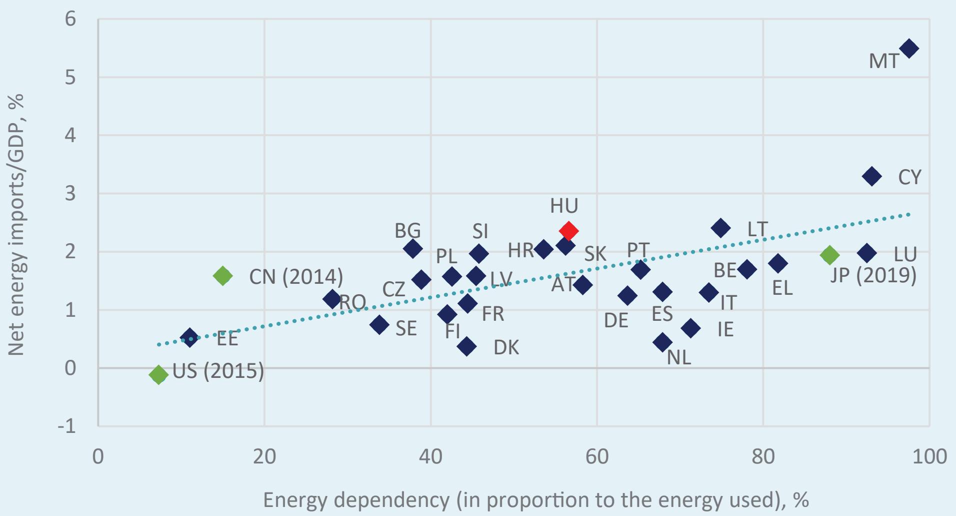
Chart 22: Changes in world market energy prices



Source: Bloomberg, BP.

The sudden and drastic increase in energy prices is a problem, as the developed economies and most European countries are typically net energy importers. The energy dependency rate is around 60 percent on average in the EU, which means that according to the dependence measured on a quantitative basis these countries cover half or even two thirds of their energy consumption from external sources. Hungary's energy dependency was close to 57 percent in 2020, which is around the EU average (Chart 23). The energy dependence of the domestic economy is basically determined by the energy intensity,[3] which is significantly higher (about 70 percent) than the EU average, i.e. the extremely energy-intensive domestic economic operation. Nevertheless, the relatively favourable domestic indicator for 2020 was also supported by the fact that the level of natural gas storage facilities, which had previously risen to an exceptionally high level due to energy security, decreased in 2020, which had the effect of reducing import dependence. However, in the uncertain economic environment caused by the coronavirus pandemic, soaring energy prices and, in addition, slowing production and exports due to semiconductor shortages are leading to deterioration in the balance of goods and services. The countries most exposed to the negative impacts are those where the high import ratio within energy consumption is significant as a percentage of GDP as well (e.g. Malta and Cyprus). In the case of Hungary, in 2020 this accounted for 2.4 percent of gross domestic product.

Chart 23: AEnergy dependency of each countries and the share of net energy imports as a percentage of GDP



Note: Regarding energy dependency, data available from IEA and World Bank databases are indicated for China (2014), the USA (2015) and Japan (2019).
Source: Eurostat (2020), World Bank, IEA, Unctad (2020)

5.2 Rising energy prices increase imports and cut external demand for exports

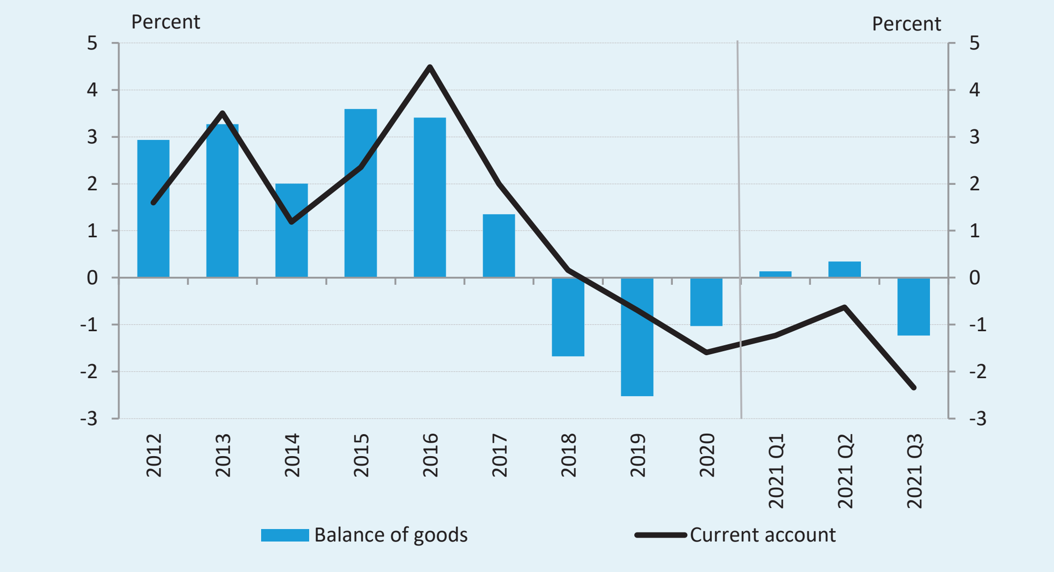
The sharp increase in energy prices affects the financial savings of individual sectors and thus the external balance through various channels. As a result of the utility costs fixed by the government and valid since 2013, households in Hungary are not directly affected by the higher energy prices. Indirectly, however, the higher commodity and energy prices are expected to be reflected in consumer prices through the rise in corporate costs, as companies may shift some of the higher costs to consumers, which entails an increase in inflation and thus a decline in families' real disposable income. Accordingly, maintaining the former level of consumption may result in a decrease in households' financial savings (for example, by reducing the forced savings accumulated during the previous waves of the pandemic). In addition, higher corporate costs due to the surge in energy prices (and the rising minimum wage) may also result in lower corporate incomes, pointing to an increase in corporate net borrowing. The losses of universal service providers as well as the energy costs of the individual budgetary institutions and local governments impose an additional burden on the balance of the general government.

The significantly rising energy prices reduce the balance of goods and thus the current account as well directly, and also indirectly by restraining external demand. Hungary is a net energy importing country, and thus the higher energy

[3] For more details, see the November 2021 Competitiveness Report.

prices entail a rise in imports of goods as a percentage of GDP. Deterioration in the terms of trade reduces the balance of goods directly as well, thus leading to a rise in the current account deficit. In addition, the higher world market energy prices restrain external demand and reduce Hungarian companies' exports, which also contributes to the decline in the balance of goods and thus in the current account. Accordingly, it was observed in the past as well that changes in the balance of goods and services determine the developments in the current account (Chart 24).

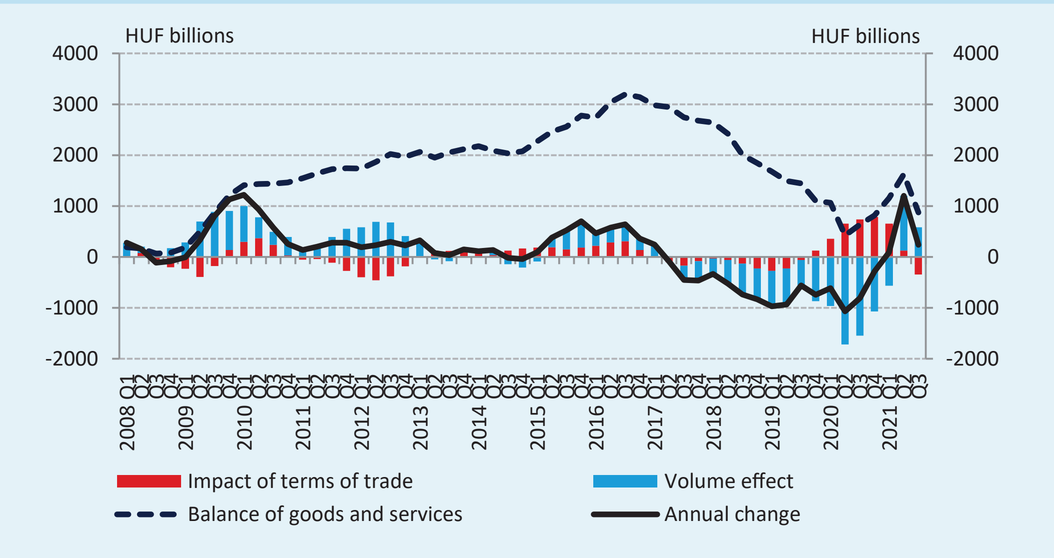
Chart 24: Developments in the current account and the balance of goods (as a percentage of GDP)



5.3 Changes in both prices and quantities contributed to the deterioration of the balance

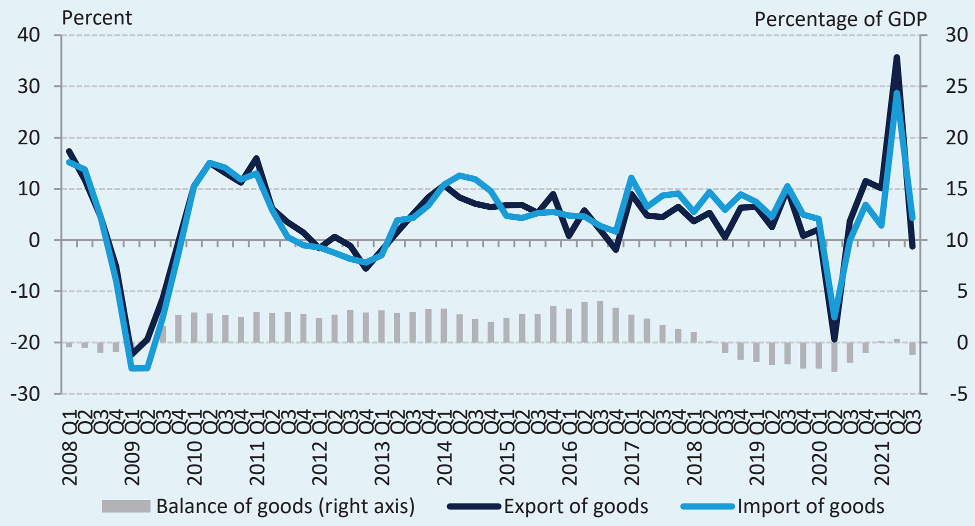
In addition to slower net export growth, the deterioration in the terms of trade due to the worsening global semiconductor shortage and high commodity prices had a further negative impact on the development of net exports in 2021 Q3, and thus on the balance of goods as well. Compared to the rapid expansion seen in the previous quarter, the slowdown in the volume growth of the balance of goods was partly related to the downturn in domestic industrial production due to the global shortage of chips, and thus to a sudden interruption of export performance. In addition, during the quarter the impact of the deterioration in the terms of trade due to the higher energy costs and large increases in the import prices of commodities also contributed to the decline in the four-quarter balance of goods and services (Chart 25).

Chart 25: Impact of terms of trade and volume change on the balance of goods and services (four-quarterly balance)



Growth in exports and imports of goods also decelerated significantly in 2021 Q3, and contrary to previous quarters, the expansion in imports exceeded that of exports. From 2017 until mid-2020 the ratio of exports of goods to imports was continuously negative, i.e. the annual increase in imports of goods exceeded that of exports (Chart 26). Following the outbreak of the pandemic, from 2020 Q3 – in line with the more subdued expansion in consumption and investment – annual growth in exports of goods was more dynamic than that of imports. In 2021 Q3, however, a major change took place in foreign trade turnover. Firstly, compared to the previous quarter's 35 percent growth rate, which was primarily attributable to the low base from one year earlier, the downturn was drastic, which may have been the result of the upswing in the fourth wave of the pandemic and the impact of deceleration in industrial production due to the global semiconductor shortage and the surge in commodity prices. Secondly, real growth in goods imports also fell in Q3, but to a lesser degree than that of exports, and as opposed to the annual decline in exports, imports continued to show a slight increase of around 4 percent. Accordingly, in addition to the higher prices and more restrained exports, the import component also contributed significantly to the fact that the four-quarter balance of goods showed a deficit again in 2021 Q3.

Chart 26: Annual real growth in exports and imports of goods



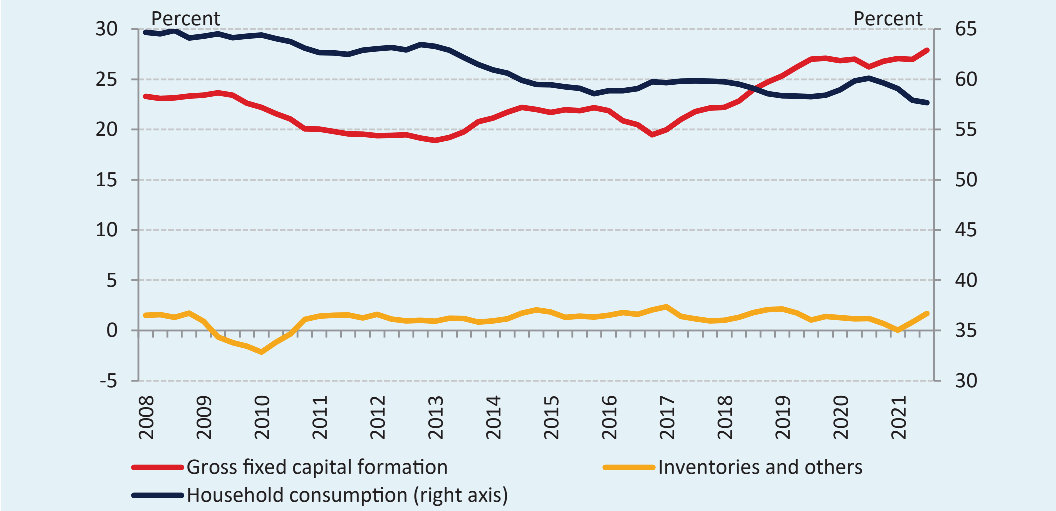
5.4 Investment and inventory changes as the main contributors to import growth

Import growth weakened less than exports, mainly due to the buoyant investment activity and changes in inventories. Investment and changes in inventories as a percentage of GDP continued to expand in Q3, while consumption declined slightly (Chart 27). The protracted recovery of household consumption decelerates import growth, while the import demand of investment contributes to the decline in the balance of goods and services.

- The rising investment rate is linked primarily to the buoyant investment activity in the corporate sector, including contributions from new corporate investment projects launched after last year's low of the pandemic. Investment increased considerably in the tradable sectors as well as in sectors producing for the domestic market and in the services sector. Investment performance also expanded in the real estate transactions sector, which is used as an indicator for household investment, mainly as a result of commercial real estate development projects for rent. In addition to favourable income developments, the government's housing subsidy schemes also support households' home building and renovation activities.

- Moreover, inventory accumulation may also have risen considerably in Q3: in addition to GDP absorption side changes in inventories, sectoral inventories also indicate that the expansion in imports in parallel with a decline in exports is partly attributable to an increase in inventories. Inventories as a share of GDP rose in computer technology and road vehicle manufacturing as well as in the sector of electric equipment manufacturing in Q3, which is presumably related to the global shortage of semiconductors. All of this also means that some of the deterioration seen in the balance of goods and services may only be temporary, and following the easing of base material supply difficulties, contrary to the previous quarter, the current account may be positively affected during the reduction of inventories.

Chart 27: Developments in gross fixed capital formation, consumption and changes in inventories (as a share of GDP)

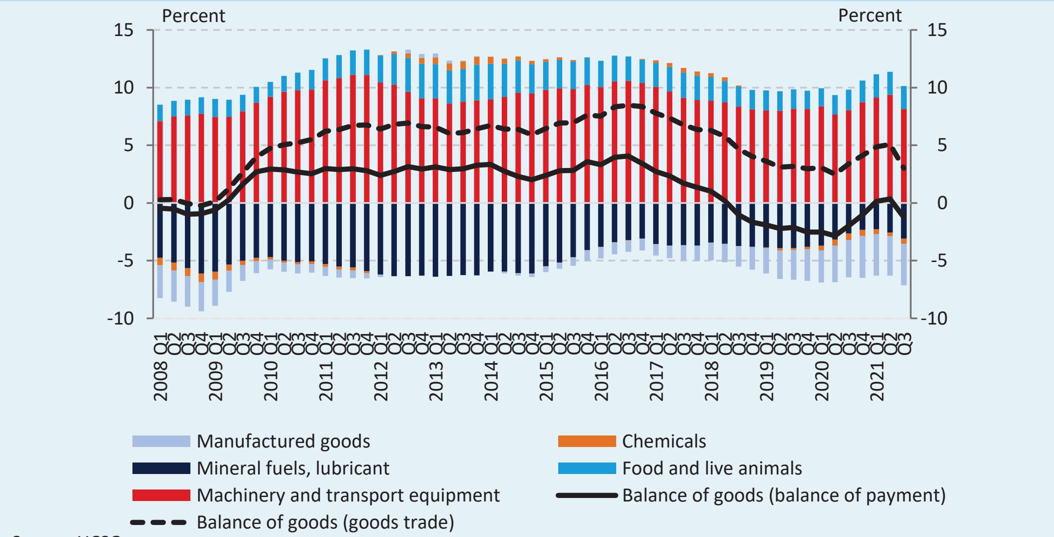


Source: HCSO, MNB.

5.5 Lower net exports of machine production, including vehicle manufacturing

The decline in the balance of goods in 2021 Q3 was primarily related to the fall in net exports of machinery and transport equipment. Based on the sectoral developments in external trade in goods, the nearly 2-percentage point decrease in the balance of goods as a percentage of GDP was mainly attributable to the downturn in net exports of machinery and transport equipment in Q3 (Chart 28). In addition, to a lesser degree, lower food and live animal exports and higher net energy imports also contributed to the decline in the balance of goods. According to sectoral data, only net exports of manufactured goods increased, slightly mitigating the deterioration in the balance of goods.

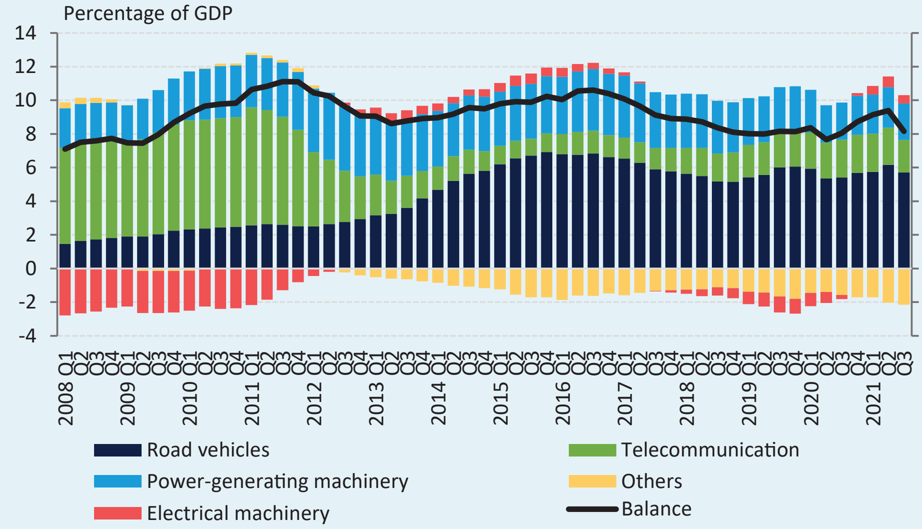
Chart 28: External trade of goods by main commodity groups (four-quarter values as a percentage of GDP)



Source: HCSO.

The drop in net exports of machinery and transport equipment was mainly due to disruptions in supply chains and subdued external demand. Developments in Hungary's exports of goods are negatively affected by the restrained performance of German industry as well as by the global shortage of semiconductors, which is hindering industrial production. Within the sector of machinery and transport equipment, the sharpest downturn was seen in the exports of road vehicles (Chart 29), owing to the effect of the slower recovery of vehicle manufacturing due to the global shortage of chips; presumably this factor also undermined production in the telecommunications sector as well. At the same time, the upswing in electric motor and battery manufacturing is becoming an increasingly important determinant of industrial production, as also reflected in the gradual rise in the exports of the electrical machinery sector.

Chart 29: Changes in components of net exports of machinery (as a percentage of GDP)

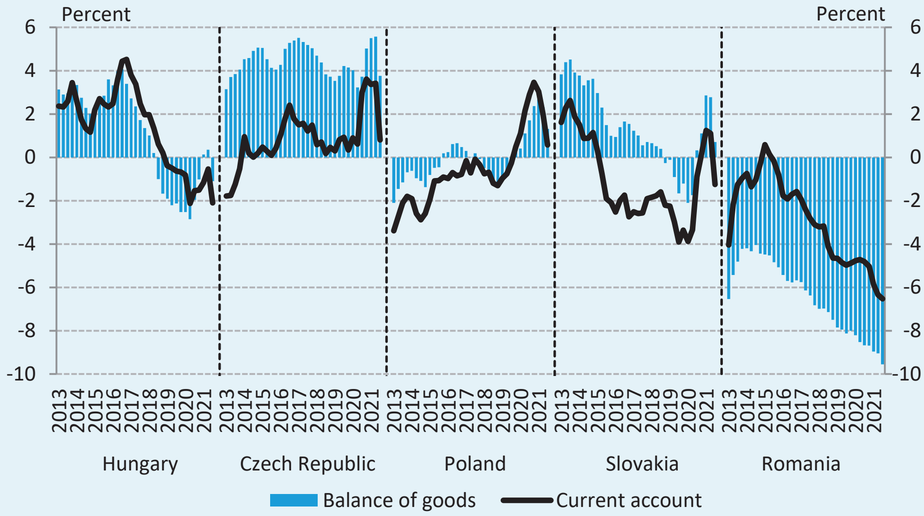


Source: HCSO.

5.6 Developments in foreign trade are similar in the countries of the region as well

As in the Hungarian economy, the balance of goods plays a major role in the development of the current accounts of the countries of the region as well (Chart 30). Although the weight of the balance of goods is different in the levels of the external balance indicators of the Visegrád countries and Romania, its dynamics shows close co-movement with the changes in the external balance position: in the past years, changes in the balance of goods significantly influenced the current account everywhere. Between 2017 and 2019, the larger decline in Hungary's balance of goods and services compared to the other countries was primarily related to the fixed capital formation indispensable for the development of future export and growth capacities: the Hungarian investment rate, which was the lowest in a regional comparison at the beginning of the period, rose to the top position by 2019. Following last year, which was severely impacted by the pandemic, current accounts in the region generally improved, which was mainly attributable to the balance of goods. Subsequently, the decline in net exports in 2021 Q3 was also observed in the region, which also entailed worsening current accounts as well everywhere: in the Czech Republic and Poland, the current account remained positive (but fell nearly to zero), in Slovakia the current account dropped into negative territory, while the current account deficit was close to 2 percent of GDP in Hungary, and rose to above 6 percent of GDP in Romania.

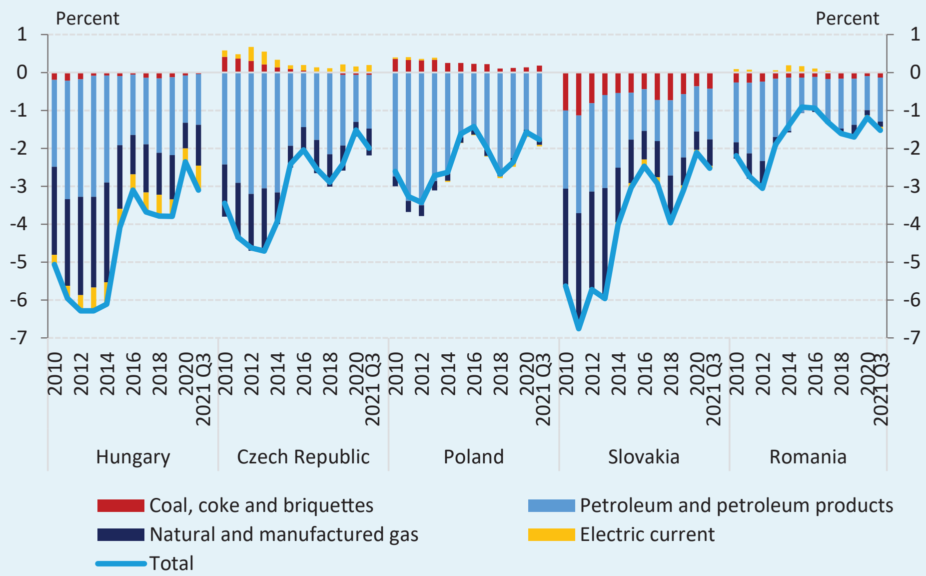
Chart 30: Current account and balance of goods in the region (as a percentage of GDP)



Source: Eurostat.

Changes in energy prices drove declines in external balance indicators in every country of the region (Chart 31). Following a decline in net energy imports in 2020, which was also attributable to changes in volume and an improvement in the terms of trade, net energy imports typically increased in the region in 2021 Q3. As the countries of the region are net energy importers, this was due to the fact that the Q3 surge in energy prices impaired the current account via the negative impact of the worsening terms of trade on the balance of goods and services. Within the region, the balance of net energy imports as a proportion of GDP is the lowest in Romania, while the Czech, Polish and Slovak net imports exceed the Romanian level, but are slightly below the Hungarian one. Oil and gas imports account for most of the net energy imports everywhere, and thus their price changes affect the value of net imports to the greatest degree. Within the region, Hungary's electricity imports are the highest, and thus changes in the price of electricity have a stronger impact on Hungary's current account compared to other countries in the region, while in the Czech Republic – which is a net electricity exporter – rising energy prices may improve the external balance position. Gas price increases mainly have unfavourable impacts on the external balance indicators of Hungary, the Czech Republic and Slovakia, which are relatively more dependent on imports.

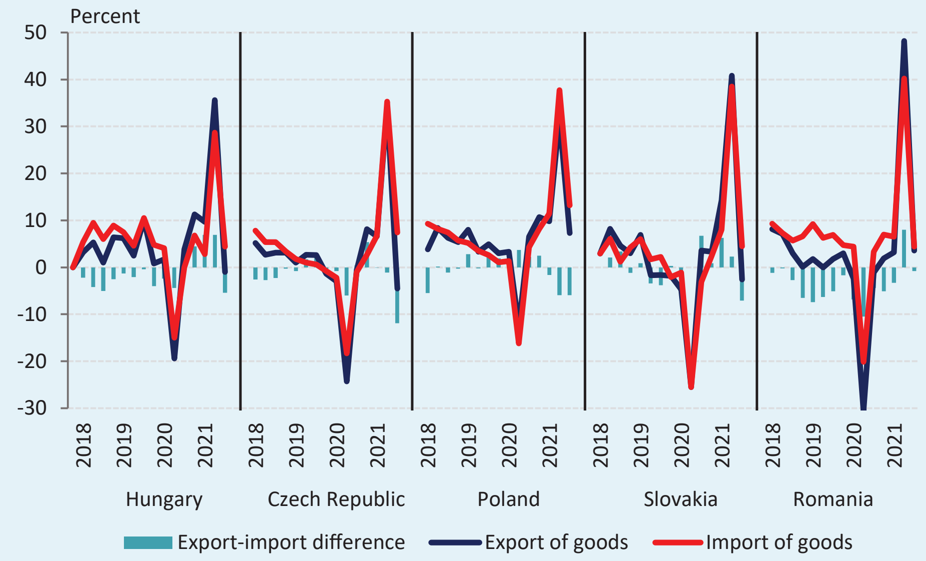
Chart 31: Net energy imports in the region (as a percentage of GDP)



Note: 2021 Q3 denotes the four-quarterly values of the data up to the third quarter.
Source: Eurostat.

The dynamics of gross exports and imports of goods in the countries of the region was similar to that seen in Hungary: the decline in the volume of import of goods was typically exceeded by the fall in the growth in exports (Chart 32). The outbreak of the pandemic resulted in major outliers in changes in export and import volumes, which had previously moved within a relatively narrow band. Following the sharp declines linked to the lockdowns in 2020 Q2, exports of goods expanded faster than imports in the region from 2020 Q3, as was the case in Hungary, although with some difference in timing. The expansion in 2021 Q2, which was outstanding due to base effects, was followed by declines in the gross components everywhere in 2021 Q3. Real growth in export of goods fell to a greater degree than imports of goods, i.e. together with the decline in the expansion in exports, the relatively more stable imports of goods also contributed to the deterioration in the balance of goods.

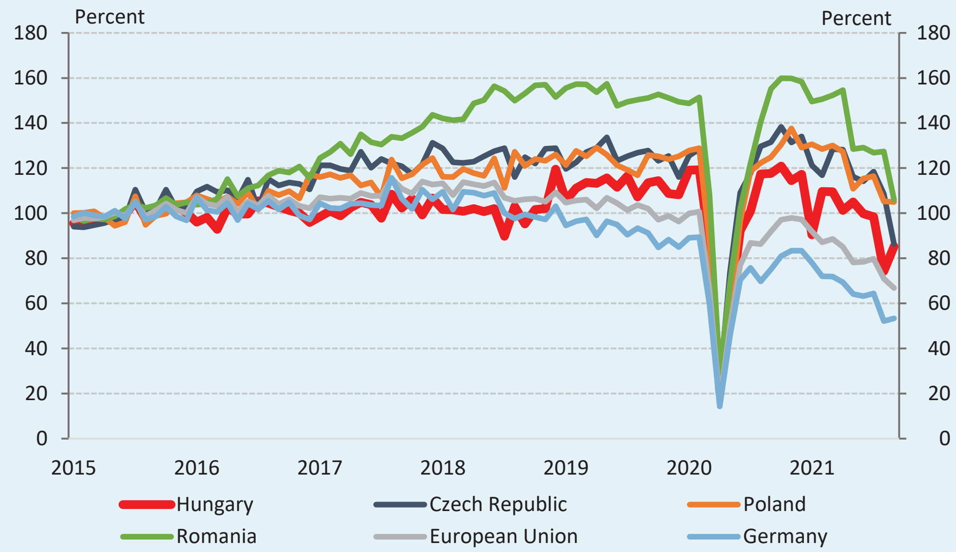
Chart 32: Changes in the volume of exports and imports of goods in the region (percentage change compared to the same period of the previous year)



Source: Eurostat.

The downturn in vehicle manufacturing was a major contributor to weak exports in Q3 in all the countries of the region. For some years before the beginning of 2020 (presumably as a result of high capacity utilisation), vehicle manufacturing in the regional economies was on a relatively stable, slightly rising path, while production in the sector gradually decelerated in the European Union as a whole. This trend was brought to an end by the impact of the lockdowns due to the coronavirus pandemic, resulting in drastic downturns across Europe. Nevertheless, production in the vehicle manufacturing sector in the EU then rapidly rebounded, and at end-2020 it reached or in some places even exceeded the pre-pandemic level. After that, however, a general, steady decline was observed in 2021, which turned into a steep drop in Q3 (Chart 33). Early on, these developments were presumably due to turbulences after the pandemic, disruptions in global supply chains caused by globally different dynamics of lockdowns and the ensuing shortage of containers, which was exacerbated by the temporary blockage of the Suez Canal. ultimately, the resulting deceleration turned into a downswing in Q3, when production was hampered by the shortage of semiconductors and chips as well as of gas and energy, and also by the surge in prices.

Chart 33: Industrial production in the vehicle manufacturing sector (volume index, 2015=100)



Note: Seasonally and calendar adjusted data.
Source: Eurostat.

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Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

REPORT ON THE BALANCE OF PAYMENTS

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