REPORT ON THE BALANCE OF PAYMENTS

2023

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

REPORT ON THE BALANCE OF PAYMENTS

2023

JULY

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1013 Budapest, Krisztina körút 55.

www.mnb.hu

ISSN 2064-8707 (print)

ISSN 2064-8758 (on-line)

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, Balázs Forgó, Gábor Horváth, Péter Koroknai, Balázs Sisak and Daniella Tóth. The Report was approved for publication by Barnabás Virág, Deputy Governor.

The Report is based on information pertaining to the period ending 27 June 2023.

Summary

*There was **a major change in external balance developments** in 2023 Q1: after a steady deterioration from mid-2021, **the four-quarter current account deficit** and net borrowing **declined to 7.2 percent** and 5.8 percent **of GDP**, respectively, while the seasonally adjusted quarterly deficit in the current account balance fell to 3.4 percent of GDP. The improvement in external balance indicators was attributable to the **decrease in the trade balance deficit**, and within that to the improvement of non-energy factors due to the adjustment of domestic sectors, the increase in exports and in the balance of services as well as the improving terms of trade due to the fall in energy prices at the beginning of the year, while the transfer balance declined slightly, and the rise in the income balance deficit also had a contrasting effect. Similarly to the developments observed in Hungary, external balance indicators **started to improve in the countries of the region as well** in early 2023.*

*In 2023 Q1, **the four-quarter value of the economy's net borrowing according to the financial account** also **declined**, in line with the improvement seen in real economy developments. The borrowing requirement during the quarter **was primarily financed by inflows of debt liabilities**, while there was an outflow of net FDI, partly as a result of one-off factors. The **banking sector and the general government were the main contributors** to the continued net debt inflow, while the indicator for companies declined considerably.*

***Net external debt amounted to 12.5 percent of GDP at end-March 2023.** The decline in the debt indicator observed since end-2022 is attributable to the fact that **debt-type financing, which is the primary source of external funding for the country,** has no longer been offset by revaluation effects since end-2022: the adjustment following the former period of major yield increases and exchange rate weakening contributed to the growth in net outstanding debt. The increase in net external debt was related to the rise in the indicators of the banking sector and the general government, while the debt ratio of non-financial corporations declined slightly. **Gross external debt** also continued to grow, **corresponding to 69 percent of GDP** at end-March 2023. **International reserves were close to their historical high, i.e. nearly EUR 40 billion, exceeding the level of short-term external debt, closely monitored by investors**, by EUR 2 billion.*

*The **slight rise in the external balance position according to economic sector savings** was because in 2023 Q1 **the improving net position of the private sector was only partly offset by the growing deficit of the state**. The downturn in the expansion in VAT revenues, the compensation of higher energy prices and the carry-over effect of the phasing out of the home improvement programme at the end of last year and the increase in interest expenditure contributed to the worsening general government indicator. The **net financial position of households and companies improved significantly, which is mainly attributable to the decline in consumption and investment**, but it was also supported by increasing corporate profits. In the high inflation environment, **inflation-indexed government securities holdings continued to increase**, while the demand for fixed- or low-yield forms of investment declined.*

***In our special topic we examine the factors behind the improvement in the current account balance in Q1** in more detail. On an annual basis, the balance **was primarily raised by the energy and non-energy components of goods trading and by the balance of services**. The increase in the surplus on the balance of goods excluding energy is attributable to the **dynamic expansion in exports** as well as to the import-suppressing effect of the **slowing domestic demand**. In addition to the rapid expansion in road vehicle and battery production, the decline in inventories presumably also contributed to the increase in exports. In addition to the previous year's high base of domestic consumption, the decline in demand due to buoyant inflation also explained the slow growth in imports. The gradual pass-through of **lower energy prices** into Hungary's import prices and **the quantitative adjustment that took place in domestic energy consumption** both contributed to the decline in the deficit on the energy balance. **Transportation was the main contributor to the increase in the surplus on the balance of services,** but the performance of toll manufacturing, tourism and other business services also improved in Q1.*

Contents

1 Real economy approach **7**

1.1 Trade balance 7

1.2 Income balance 10

1.3 Transfer balance 10

1.4 Regional comparison 11

2 Financing approach **12**

2.1 Non-debt liabilities 13

2.2 Debt liabilities 14

3 Developments in debt ratios **17**

3.1 Developments in debt indicators 17

3.2 Foreign exchange reserves and reserve adequacy 18

4 Sectors' savings approach **20**

5 Factors behind current account improvement **23**

5.1 Turnaround in the current account balance 23

5.2 Major improvement in balance of goods excluding energy 24

5.3 The energy deficit decreased due both to lower prices and adaptation 26

5.4 Wide-ranging improvement in services 28

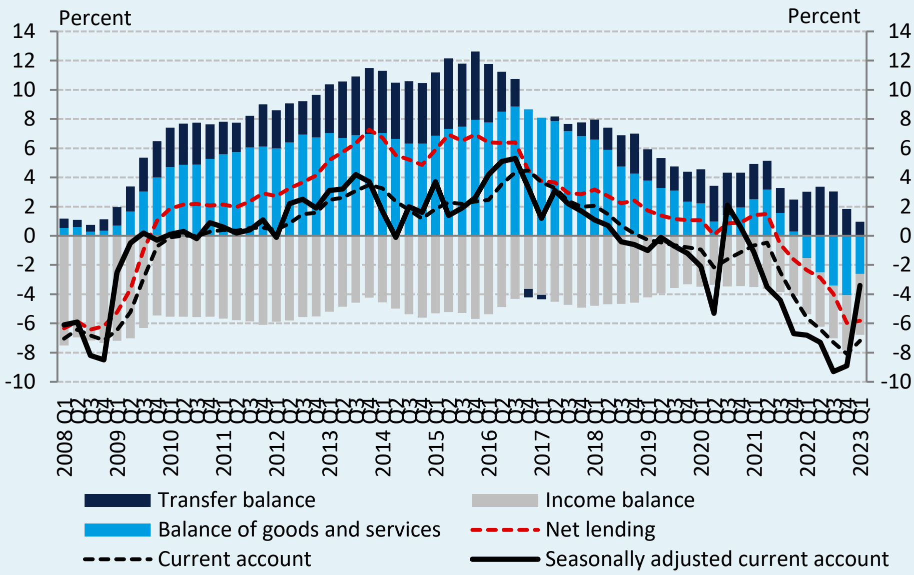
List of charts **29**

1 Real economy approach

According to the real economy approach, Hungary's four-quarter net borrowing amounted to 5.8 percent of GDP in 2023 Q1, while the current account deficit stood at 7.2 percent of GDP. The improvement in external balance indicators was mainly attributable to the decrease in the deficit on the trade balance, and within that the adjustment of domestic sectors, the increase in the balance of services as well as the improving terms of trade due to the fall in energy prices at the beginning of the year, since the transfer balance declined slightly, and the rise in the income balance deficit also had a contrasting effect. Similarly to the developments observed in Hungary, external balance indicators continued to deteriorate in the countries of the region as well in 2023 Q1.

According to the real economy approach, in 2023 Q1 Hungary's four-quarter net borrowing amounted to 5.8 percent of GDP, while the current account deficit declined to 7.2 percent of GDP (Chart 1). The quarterly deficit, which better reflects short-term trends, fell even more significantly to 3.4 percent from 8.9 percent in the fourth quarter of 2022. According to *unadjusted quarterly data*, net borrowing amounted to around EUR 0.4 billion in the first quarter, as a result of a current account deficit of almost EUR 0.8 billion, which was significantly offset by a capital account surplus of EUR 0.4 billion. The decline in four-quarter net borrowing was mainly due to the improvement in the trade balance as a percentage of GDP.

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

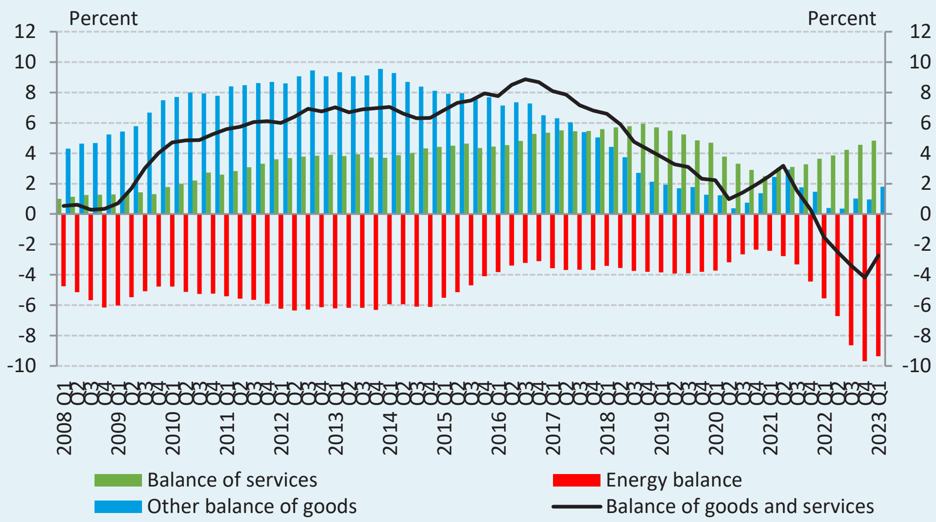


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

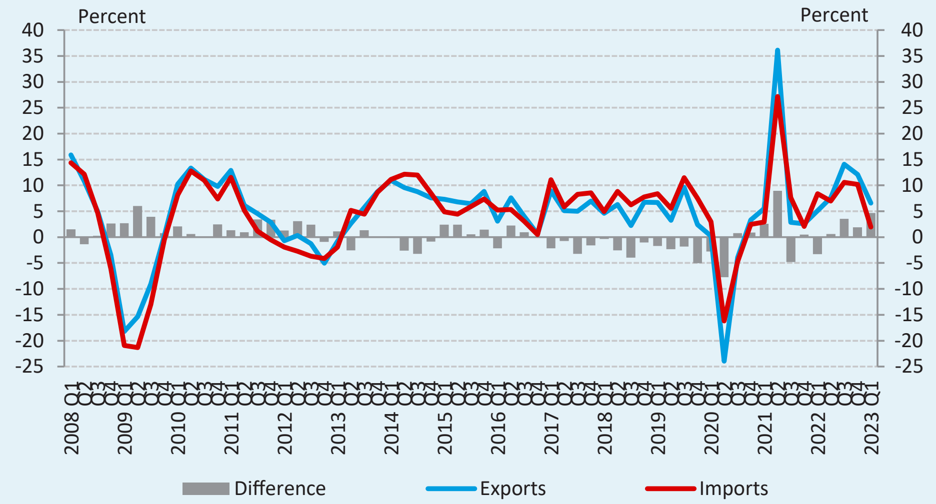
In 2023 Q1, the four-quarter trade deficit declined, while the energy balance, the balance of goods excluding energy and improved. The improvement in the trade balance is mainly attributable to the adjustment of domestic sectors, while the terms of trade improving as a result of the decline in energy prices at the beginning of the year also reduced the growth rate of imports in Q1 (Chart 2). Following the growing negative balance in previous years, the *balance of goods* as a proportion of GDP improved temporarily in 2021 H1, but this positive trend stalled in 2021 H2, and the balance of goods showed an increasing deficit until the end of 2022. Nevertheless, the degree of the deficit declined considerably in 2023 Q1, and thus halting the deterioration of the previous period. The improvement is primarily due to the balance of goods excluding energy, but in addition, the energy balance improved. This is demonstrated by the balance of goods excluding energy, which showed a surplus of nearly 2 percent in Q1. Following the downturn due to the outbreak of the pandemic, with the lifting of the containment measures the surplus on the *balance of services*, which plays an important role in trade balance developments, reached 4.9 percent of GDP in 2023 Q1, marking the highest level since the outbreak of the pandemic.

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



Compared to previous periods, export and import growth slowed down significantly in 2023 Q1, but the still positive export-to-import ratio contributed to the improvement in the trade balance (Chart 3). In parallel with the downturn in domestic industrial production, the dynamics of exports decelerated, which was attributable to the declining performance of the majority of domestic manufacturing sectors. The significantly slowing import dynamics reflects the fall in domestic demand. In Q1, real growth in exports and imports was nearly 7 percent and around 2 percent, respectively.

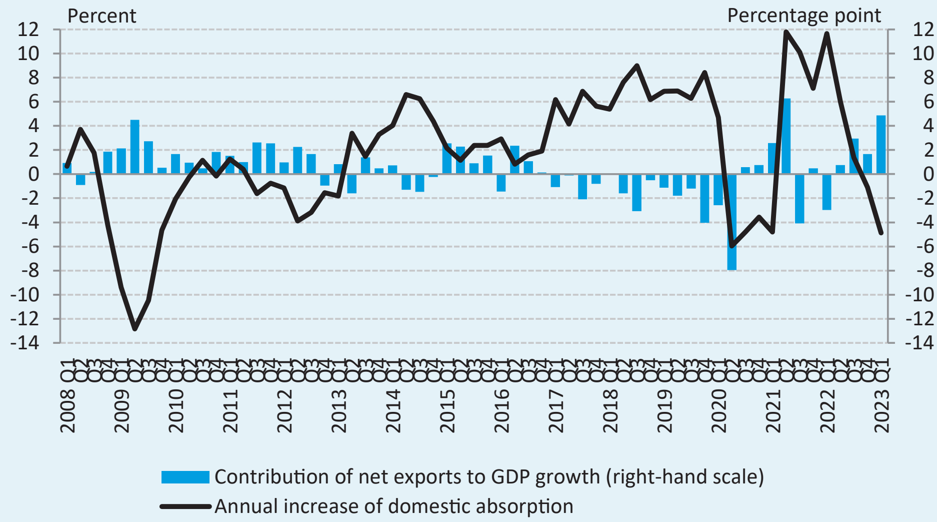
Chart 3: Annual real growth in exports and imports



Source: HCSO, MNB.

In relation to the above, the contribution of net exports to growth continued to strengthen in Q1, while the annual growth rate of domestic absorption is increasingly contracting, parallel to the subdued demand of domestic economic agents (Chart 4). A wide range of absorption items was responsible for the decline in the growth rate of domestic absorption: in addition to the decrease in the real expansion of household consumption and actual final government consumption, the volume of whole-economy investment and stockpiling also dropped. The subdued consumption is primarily attributable to the consumer adjustment that evolved due to the high inflation and falling real income. In line with the decline in domestic absorption and the expansion of exports, the contribution of net exports to GDP was positive.

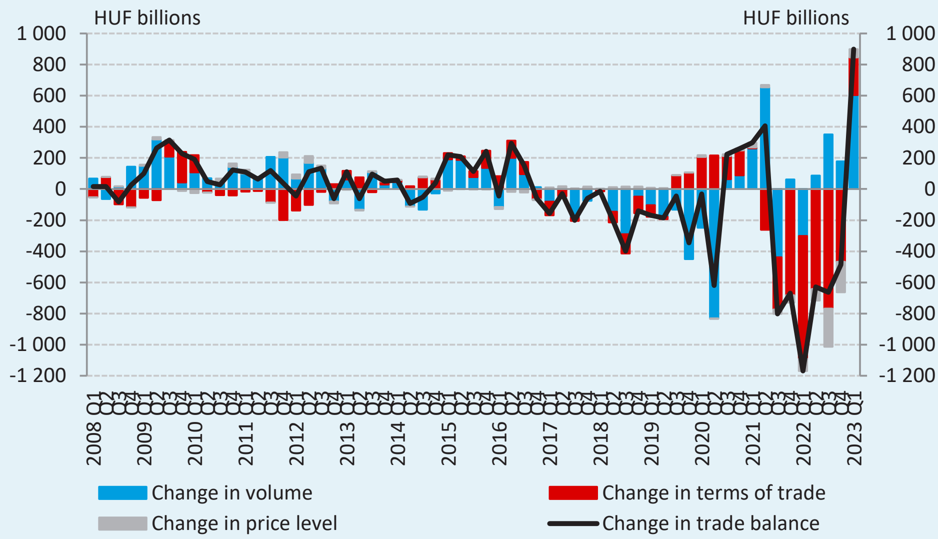
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The favourable developments in the trade balance in 2023 Q1 were primarily due to the effect of the change in volume, but the effect of the terms of trade resulting from falling energy prices also contributed to the improvement in the balance (Chart 5). In the first quarter, in line with the positive contribution to growth of net exports, the increase in exports due to volume exceeded that of imports and thus improved the trade balance. This was complemented by the decrease in commodity and energy prices, which was reflected in a major improvement in the terms of trade and had a favourable impact on the nominal size of net exports.

Chart 5: Development of trade balance factors according to GDP (year-on-year)

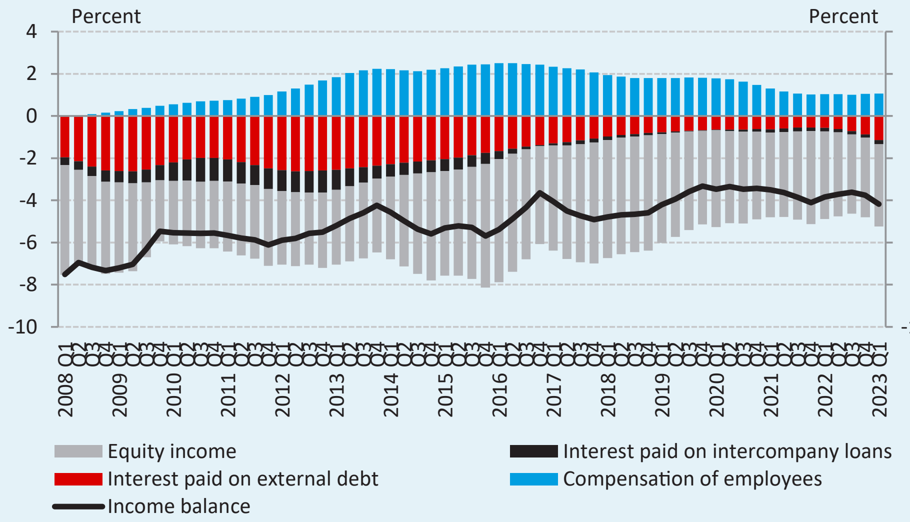


Source: HCSO.

1.2 Income balance

The deficit of the income balance as a percentage of GDP increased in 2023 Q1, which was attributable to increases in foreign-owned companies' profit-sharing incomes and in the interest balance of foreign loans (Chart 6). In 2021, while the income of residents working temporarily abroad declined, the four-quarter deficit of the income balance reached 4 percent of GDP, before falling to 3.8 percent of GDP in 2022, primarily due to the lower estimated profit of foreign-owned companies (expected because of the extra profit taxes). However, in 2023 Q1, in parallel with the higher nominal debt and the increasing yields, the rise in foreign-owned companies' profit-sharing incomes and the interest balance of foreign loans had a slightly negative impact on the income balance. Despite the lifting of containment measures, Hungarian employees' income from abroad remained unchanged at a low level of around 1 percent of GDP (compared to nearly 2 percent prior to the pandemic).

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

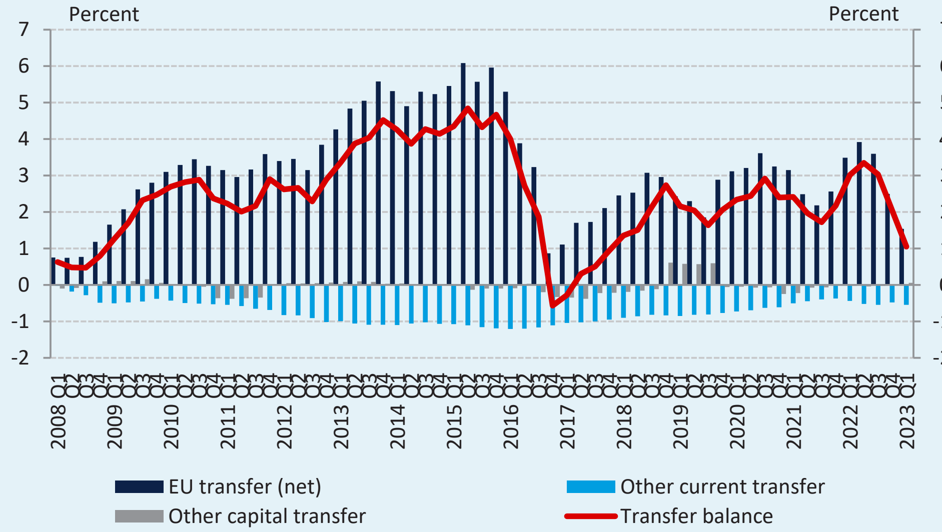


** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

The transfer balance surplus amounted to 1 percent of GDP in 2023 Q1, and it is still lower than the level seen in the previous quarters. Nevertheless, the transfer balance surplus continues to improve Hungary's external balance position (Chart 7). According to four-quarter data, net EU fund inflows in 2023 Q1 corresponded to 1.5 percent of GDP, representing a major decline again compared to the previous quarter. The level of EU transfers was this low at end-2016 when the inflow of funds was much lower than before due to the shifting of the EU's seven-year budget period. Other current transfers only resulted in a mild deterioration in the transfer balance. The four-quarter surplus on the transfer balance, which was lower than in the previous quarter, stemmed from the above factors.

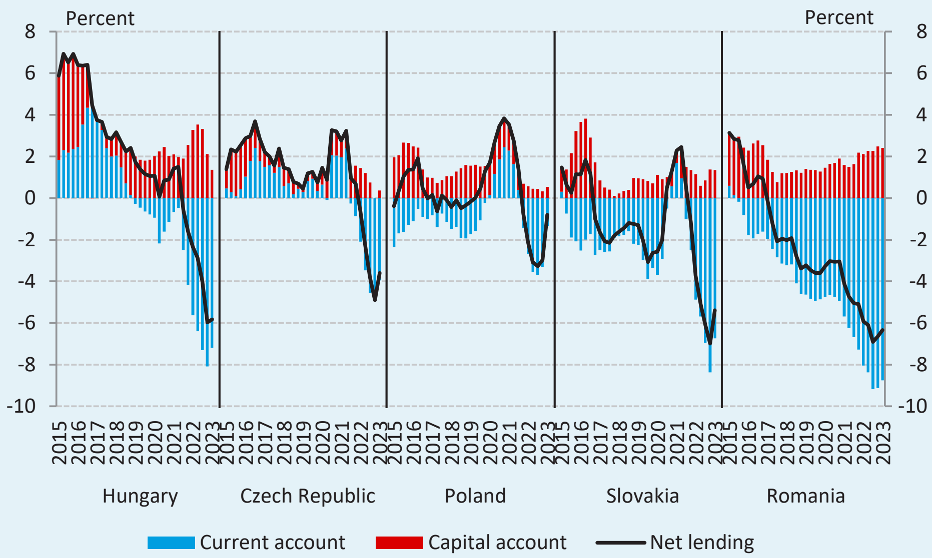
Chart 7: Four-quarter development of transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

With the decline in global commodity and energy prices, external balance indicators improved in the countries of the region as well, and thus net borrowing decreased everywhere (Chart 8). Starting from 2021 H2, the trade balance, and thus the current account balance as well, deteriorated in all the countries of the region because of economic growth restarting following the pandemic, the disruptions in supply chains as well as the global commodity and energy price increases. In 2023 Q1, external balance indicators improved in the countries of the region as well, primarily in relation to the improving terms of trade, in view of the decline in the deficit on the energy balance and the decrease in domestic demand. While Poland's net borrowing started to improve in the last quarter of 2022, in other countries of the region – including Hungary – favourable developments began only in 2023 Q1. After Poland, the net borrowing of Slovakia and Czechia showed the greatest improvements in Q1, standing at around 5 percent of GDP in these two countries. The net borrowing of Romania is still the highest among the countries of the region, corresponding to nearly 7 percent of GDP.

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



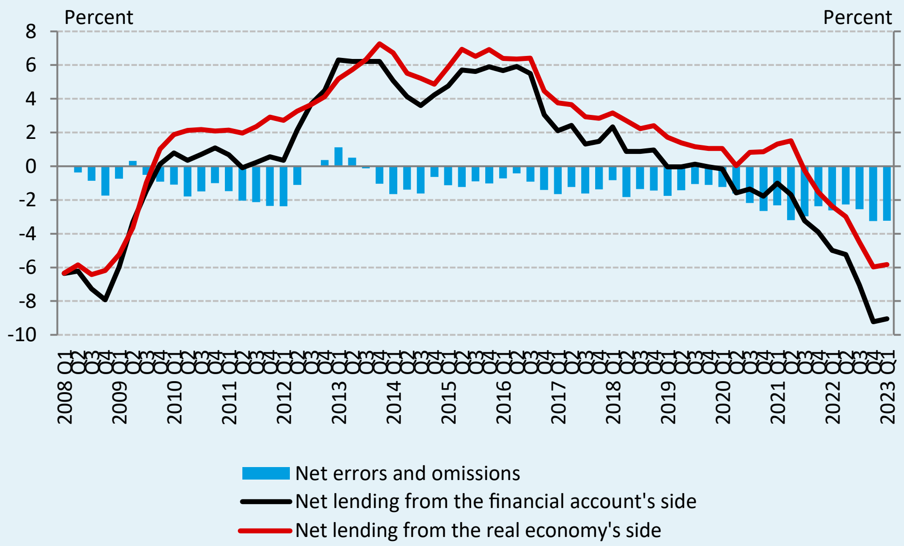
Note: Except for Hungary, the 2023 Q1 data were calculated from monthly data.
Source: MNB, Eurostat.

2 Financing approach

In 2023 Q1, the four-quarter value of the net borrowing of the economy according to the financial account corresponded to around 9 percent of GDP, similar to the previous quarter. The borrowing requirement during the quarter was primarily financed by inflows of debt liabilities, while there was an outflow of net FDI, partly as a result of one-off factors. The main contributor to the steady net debt inflow was the banking sector, and the general government also continued to borrow (although at a decelerating pace compared to the previous quarter), while the indicator for companies declined considerably.

In 2023 Q1, the external balance position stopped deteriorating according to financing data as well. Similarly to the previous quarter, the four-quarter net borrowing of the economy amounted to 9 percent of GDP (Chart 9). The four-quarter net borrowing according to both the real economy and financing approaches showed a slight improvement compared to the previous quarter. As a result, the difference between the four-quarter external balance indicators ('Net errors and omissions'[1]) was about 3 percent of GDP, similar to the previous quarter.

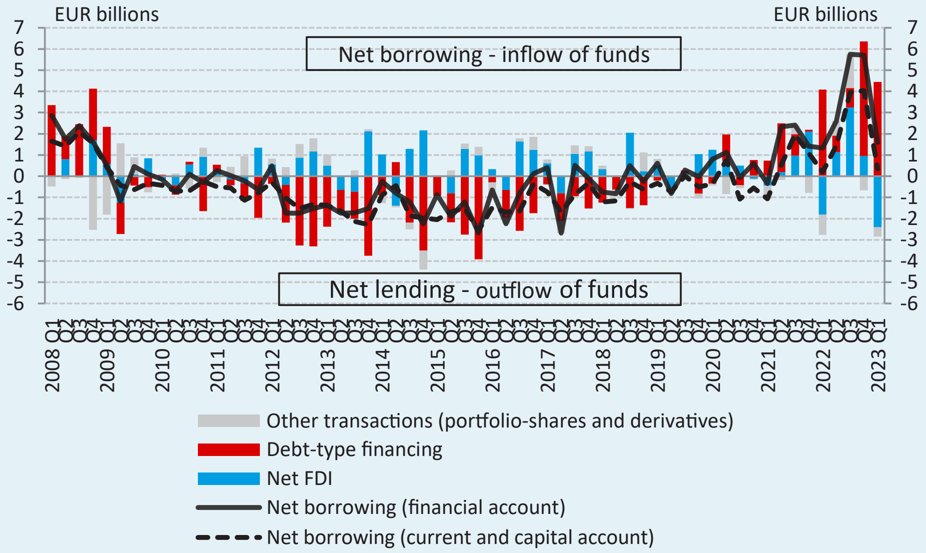
Chart 9: Two types of net lending (four-quarter data as a percentage of GDP)



According to quarterly data, net borrowing of the economy amounted to some EUR 1.6 billion in 2023 Q1, financed by inflows of debt liabilities, while net FDI outflows had a contrasting effect (Chart 10). Compared to the previous quarters, net borrowing in 2023 Q1 was already much lower, around EUR 1.6 billion. Fund inflows were financed by debt liabilities, which was partly offset by net FDI outflows (worth EUR 2.4 billion). Net outstanding debt due to transactions increased considerably, by nearly EUR 4.4 billion, in the first quarter of the year as well, falling slightly short of the last quarter of 2022.

[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 can 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)

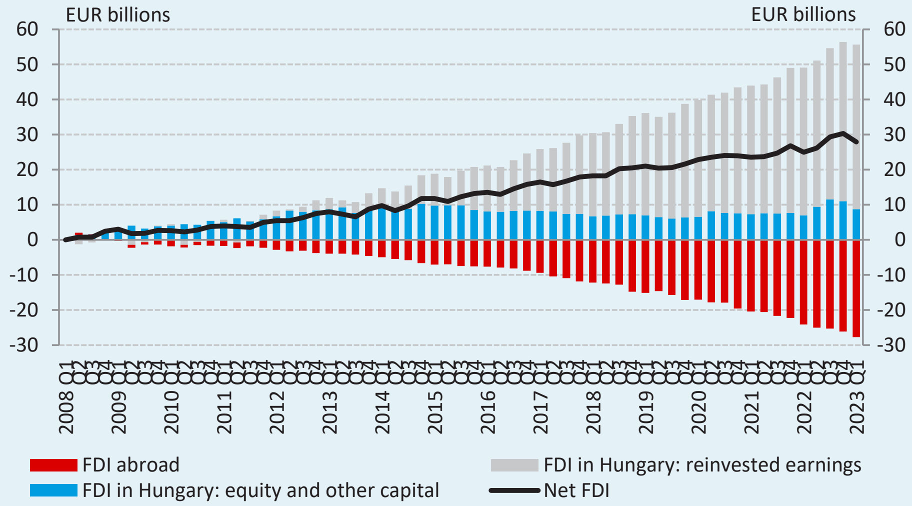


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and so this technical effect has been eliminated.

2.1 Non-debt liabilities

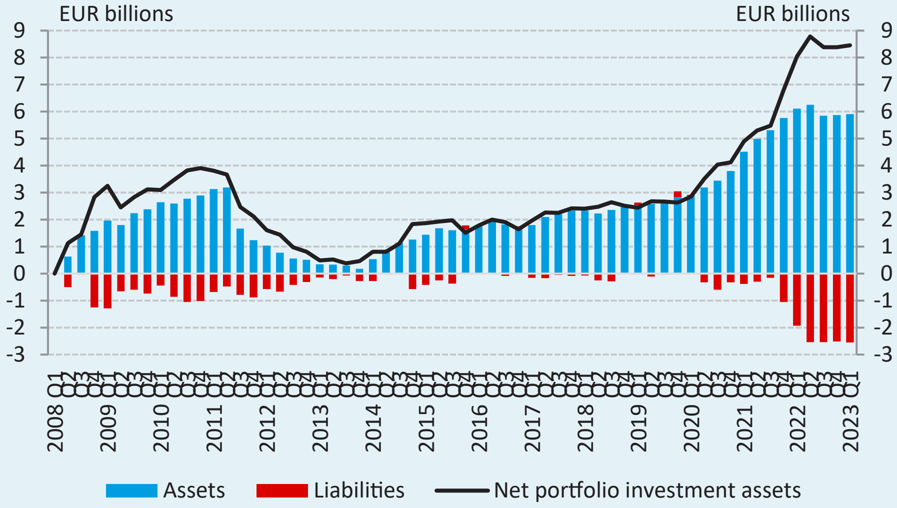
As opposed to previous quarters, net direct investments abroad due to transactions increased in 2023 Q1 (Chart 11). Net FDI outflows excluding capital-in-transit amounted to EUR 2.4 billion in Q1, which was partly related to a Hungarian financial institution's acquiring of shares in a bank located in a country in the region and partly to the domestic acquisition of a foreign-owned telecommunications company. By contrast, the rise in reinvested earnings increased FDI liabilities as before.

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



In 2023 Q1, outflows of net portfolio investments were subdued, amounting to some EUR 70 million (Chart 12). The trend of significant net outflows of funds seen during 2020–2021 (and related to an increase in domestic actors' investments abroad) in the case of portfolio investments stopped in 2022. As in the previous quarters, portfolio investment transactions were more restrained in 2023 Q1 as well: residents increased their holdings of foreign equities and mutual fund shares accumulated in the previous quarters by nearly EUR 30 million, while non-residents slightly (EUR 40 million) reduced their holdings of portfolio investments.

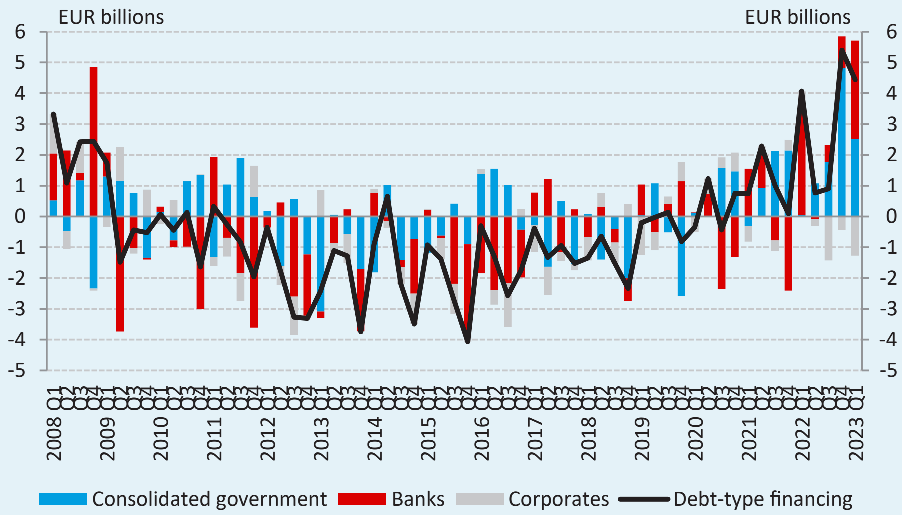
Chart 12: Developments in net portfolio equity and mutual fund share receivables (cumulative transactions)



2.2 Debt liabilities

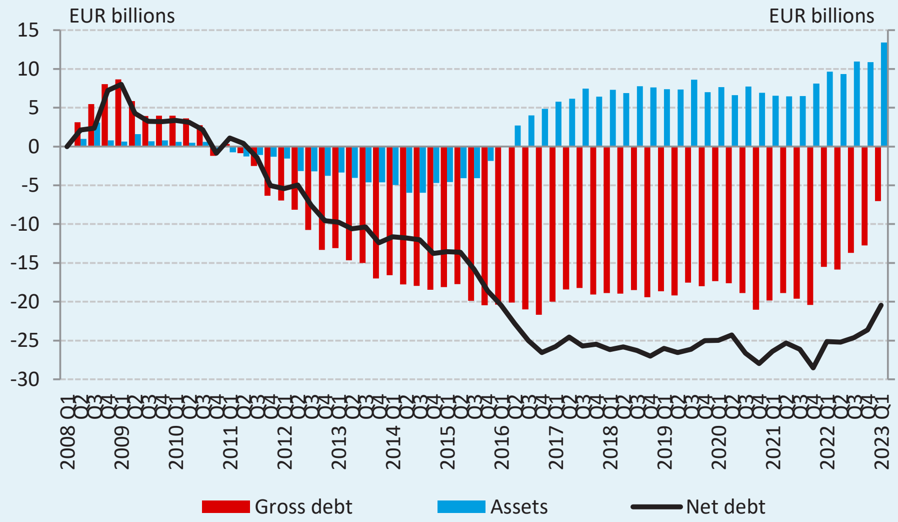
Compared to the previous quarter, the inflow of debt liabilities continued at a slower pace of around EUR 1 billion in Q1 (Chart 13). Net outstanding debt rose by EUR 4.4 billion due to transactions, which was partly related to the banking sector and partly to the consolidated general government, while the indicator for companies declined. Net external debt of the banking sector grew by more than EUR 3 billion during the quarter. The aforementioned domestic acquisition of a telecommunications company also increased net external debt in Q1.

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



The net external debt of the banking sector rose significantly in the first quarter to a greater extent than in previous quarters (Chart 14). The growth of more than EUR 3 billion in the net indicator was because the expansion in banks' liabilities substantially exceeded the increase in assets. The rise in liabilities was primarily related to the increase in client deposits and to borrowing, affecting short-term debt and long-term liabilities alike.

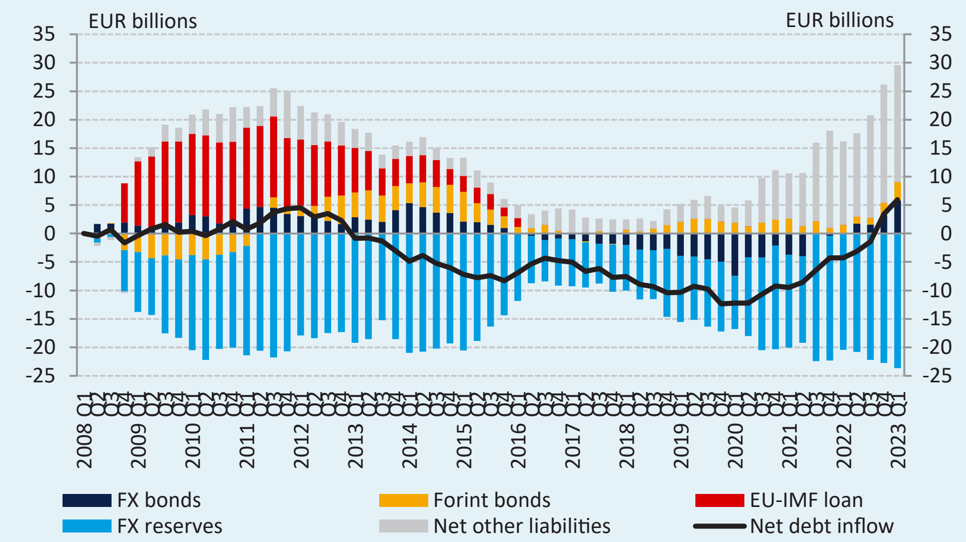
Chart 14: Changes in the banking sector's external debt and assets as of early 2008 (cumulative transactions)



Due to transactions, the expansion in the net external debt of the consolidated general government including the MNB amounted to EUR 2.5 billion in Q1, representing more subdued borrowing compared to the previous quarter. The change in the net external debt of the state was the result of contrasting effects (Chart 15):

- Non-residents' forint-denominated government securities holdings increased by EUR 1 billion during the quarter, contributing to the growth in the net external debt of the state.
- Issuance of the one-off central bank discount bond used to ease swap market tensions, which exceeded the previous quarter's issuance by EUR 0.4 billion, also increased the net external debt of the government.
- Foreign exchange expenditures of the Hungarian State Treasury reduced the FX reserves, contributing to the rise in net external debt.
- Helping to reduce banks' external debt, the central bank FX swaps that provide FX liquidity have a neutral effect on net external debt at whole-economy level, but the facility results in a rearrangement across the net debt indicators of economic sectors. Recourse to the swap instrument at end-March was lower than in the previous quarters, and this contributed to the rise in the indicator for banks and the decline in the net indicator of the government.
- Primarily because of the dollar bond issue in Q1, the FX bond holdings of the state increased by some EUR 2 billion. Foreign exchange reserves also increased parallel to that, and so this foreign currency funding did not affect net external debt.
- The absorption of EU funds also contributed to the decrease in the net external liabilities of the government.

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



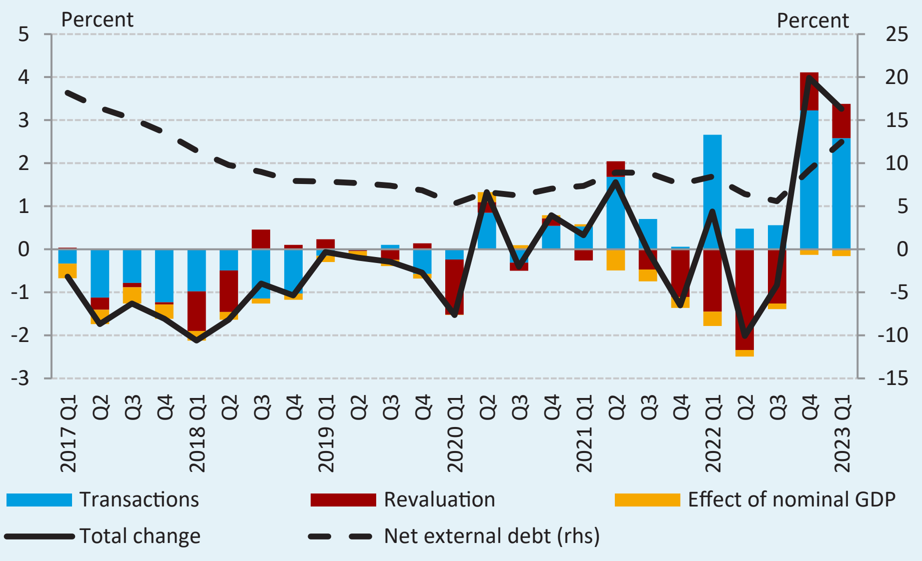
3 Developments in debt ratios

From earlier levels close to historical lows, following the end of 2022 the debt indicators of the country continued to increase in Q1. According to the underlying trends, the net external debt amounted to 12.5 percent of GDP at the end of March 2023. The increase in the debt indicator observed since end-2022 is attributable to the fact that the effect of the debt-type financing, which is part of the external funding of the country, has no longer been offset by revaluation since end-2022, as the adjustment following the period of major yield increases and exchange rate weakening contribute to the growth in net outstanding debt. The expansion in nominal GDP continues to reduce the debt indicator slightly. The increase in net external debt was related to the rise in the indicators of the banking sector and the general government, while the debt ratio of non-financial corporations improved slightly. Gross external debt increased marginally in relation to the banking sector and the state, corresponding to 69 percent of GDP at end-March 2023. International reserves were close to their historical high, i.e. close to EUR 40 billion at the end of the quarter, exceeding the level of short-term external debt, closely monitored by investors, by EUR 2 billion.

3.1 Developments in debt indicators

In the first quarter, the net external debt of the economy according to underlying trends rose to 12.5 percent of GDP. In parallel with major inflows of debt liabilities, the revaluation of stocks also increased the indicator to some extent, which was slightly attenuated by the effect of the expansion in nominal GDP (Chart 16). Inflows of debt liabilities increased net external debt by some 2.6 percentage points, which was primarily related to the banking sector. The adjustment of the former revaluations with a stock-reducing effect seen in 2021 and 2022 H1, mainly related to higher yields and exchange rate depreciation, continued in 2023 Q1 as well, parallel to the strengthening of the forint exchange rate and the decline in yields. As in the previous quarters, the rise in nominal GDP moderately reduced the net external debt-to-GDP ratio in the first quarter as well.

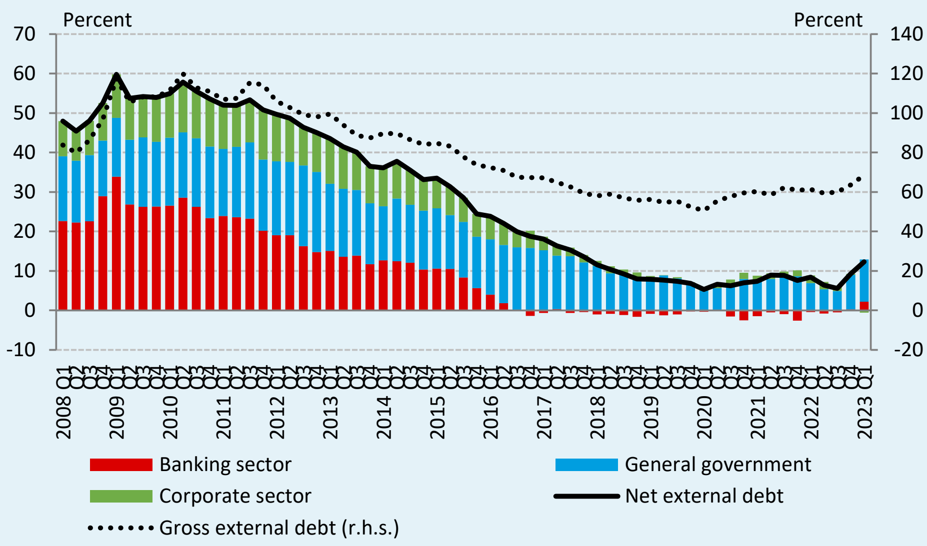
Chart 16: Components of the change in net external debt (values excluding intercompany loans as a percentage of GDP)



The rise in the net external debt ratio was primarily related to the banking sector and the state, while the debt indicator of non-financial corporations declined (Chart 17). Net external debt of the *consolidated general government including the MNB* increased by 2 percent of GDP, which primarily reflected the effect of the debt liability inflow of the state (e.g. increase in non-residents' forint government securities holdings, transactions contributing to the decline in foreign exchange reserves and growth in the stock of central bank discount bonds). In addition, the revaluation related to the yield decline and the exchange rate change (forint appreciation) observed during the quarter also increased the debt indicator, to a lesser degree.

On the whole, the private sector's net external debt-to-GDP ratio increased: the rise in the banks' debt indicator significantly exceeded the decline in the indicator for companies. In view of the debt-type financing, the net external debt of *banks* rose by 2 percent of GDP, as a result of liabilities increasing to a greater extent than the expansion in foreign receivables. Accordingly, at the end of Q1 the *banking sector's* foreign liabilities already exceeded foreign receivables, i.e. the sector's net debt indicator rose into positive territory, from the negative, close-to-zero level seen since 2017. *Companies'* net external debt-to-GDP ratio dropped by 0.8 percent of GDP: the rise in foreign receivables (related to commercial lending) exceeded the expansion in foreign liabilities, which was also related to commercial loans. The net external debt indicator for companies turned negative by the end of the first quarter, i.e. foreign assets exceed foreign liabilities.

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 as a percentage of GDP amounted to 69 percent of GDP. From the level seen in 2022 Q3, which was close to the historical low, the debt indicator started to rise at the end of 2022, and this trend continued in Q1 as well. The rise was primarily attributable to the increase in the indicator for the *banking sector*, which was related to the growth in the sector's foreign liabilities in connection with client deposits and borrowing. *Companies'* gross external debt as a percentage of GDP remained practically unchanged in Q1. The indicator of the *consolidated general government including the MNB* rose, primarily as a result of the expansion in liabilities due to the FX bond issue and an increase in non-residents' forint government securities holdings, while the aforementioned revaluation effects also contributed to the growth in outstanding debt.

3.2 Foreign exchange reserves and reserve adequacy

At the end of 2023 Q1, international reserves amounted to EUR 39.8 billion, which is close to the historical high. Following EUR 38.7 billion at end-December 2022, the MNB's international reserves amounted to EUR 39.8 billion at end-March 2023. The development of reserves was affected by various factors, the most important of which were the following:

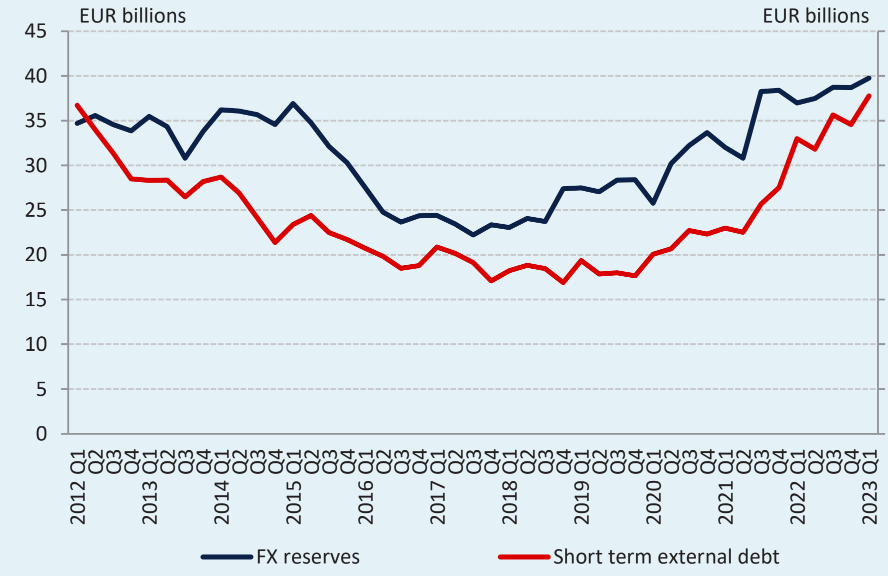
- The *net FX financing operations of the Government Debt Management Agency* (*GDMA)* boosted reserves by EUR 2.3 billion in total, with the GDMA's dollar bond issues in January the main contributors.
- The net reserve-increasing effect of *EU funds* amounted to EUR 0.5 billion, which was still primarily related to cohesion funds and agricultural financing inflows linked to the 2014–2020 period, but already partly contained advance payments from the new programming period as well.
- The reserve-reducing effect of the *Hungarian State Treasury's foreign currency* transactions amounted to EUR 0.4 billion.

- The instrument related to *covering net energy imports* was launched by the MNB in November 2022 and closed in March 2023; satisfying the FX liquidity needs reduced the level of reserves.

- The utilisation of the *swap instrument providing end-of-quarter euro liquidity and the* balance of the *international repo drawdowns* were nearly neutral for the reserves compared to end-2022.

At the end of 2023 Q1, the MNB's international reserves exceeded the level of short-term external debt, closely monitored by investors, by EUR 2 billion. At end-March 2023, international reserves and short-term external debt amounted to EUR 39.8 billion and EUR 37.8 billion, respectively. The increase in the short-term external debt of the economy was attributable to the rise in the indicators for the corporate sector and the banking sector, while the debt of the general government consolidated with the MNB declined compared to the previous quarter. In the case of the corporate sector, this was caused by the growth in commercial loans outstanding, while in the case of the banking sector it was both the increase in originally short-term FX debt and debt maturing within 1 year. The leeway above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, amounted to EUR 2 billion at the end of March 2023 (Chart 18).

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

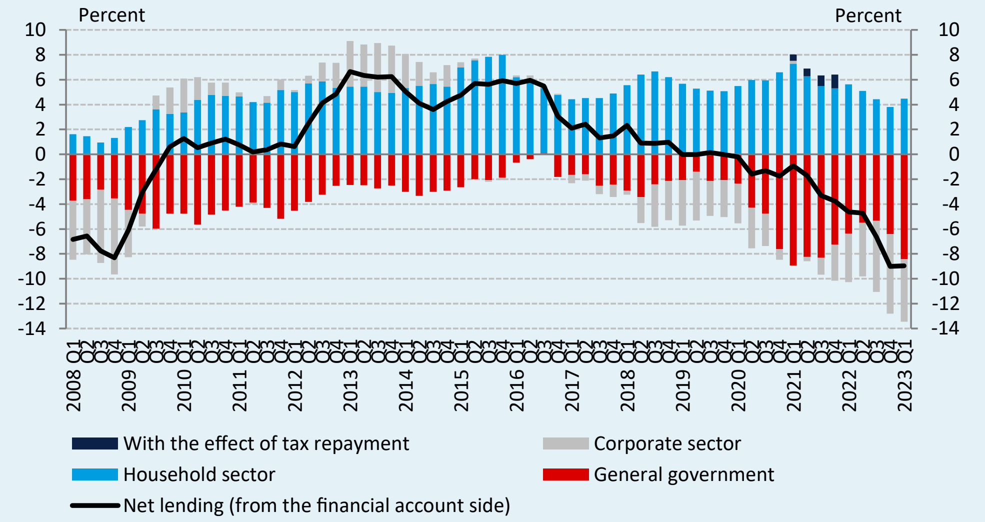


4 Sectors' savings approach

In 2023 Q1, the growing general government deficit was more than offset by the improving net position of the private sector, and thus the external balance according to the savings of economic sectors improved slightly. Lower VAT revenues, compensation for the effects of higher energy prices, the carry-over effect of the home improvement programme being phased out at the end of last year and the increase in interest expenditures contributed to the worsening of the general government indicator. The net position of households and companies improved significantly, which was mainly attributable to the decline in consumption and investment, but it was also supported by increasing corporate profits. In the high inflation environment, inflation-indexed government securities holdings continued to increase, while the demand for fixed- or low-yield forms of investment dropped.

According to the developments in sector savings, the growing net borrowing of the state was more than offset by the private sector's improving net position, and thus the net borrowing of the economy declined slightly in the first quarter of the year (Chart 19). The general government deficit increased considerably in Q1, which was attributable to decelerating VAT revenues due to declining consumption, for subsidies to energy supply companies, the carry-over fiscal effect of the large number of applications submitted in the last two months of last year in relation to the home improvement programme as well as to a surge in interest expenditures. The four-quarter deficit of the general government rose to 8.6 percent of GDP, nearly reaching the outlier seen two years ago due to the pandemic and to addressing its effects. Reversing the declining trend of the previous period, households' net savings rose as a result of increasing pension payments as well as the downturn in consumption and investment due to high inflation. Accordingly, households' four-quarter net lending expanded to 4.6 percent of GDP, following the low of 4 percent of GDP at the end of the previous year. In parallel with that, companies also restrained their investment activity as a result of declining domestic demand, while high inflation allowed firms to price their products in excess of the rise in costs, and thus profits also increased, and so the sector's net borrowing decreased. On the whole, the adjustment of the private sector exceeded the rising budget deficit of the state, and thus net borrowing according to economic sector savings declined slightly.

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

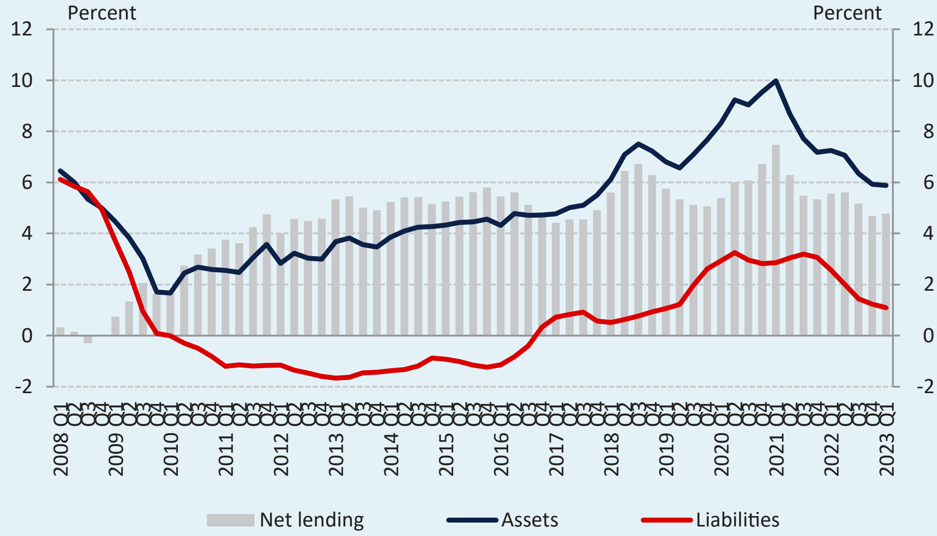


** General government represents the net borrowing according to the financial accounts. Corporations based on the residual principle.*

According to the underlying trends, households' four quarter net financial savings increased slightly in 2023 Q1 versus the previous quarter, parallel to an expansion in financial assets and a decline in liabilities (Chart 20). For economic considerations, the MNB excludes 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, personal income tax refunds) from the indicator based on underlying trends. One-off effects also influence the net indicator via the accumulation of financial assets and the liabilities, and therefore the underlying trends are presented using the net data along the gross legs.

According to the indicator as a proportion of GDP, which captures the underlying developments, households' financial asset accumulation increased as a result of one-off government transfers in Q1 (13th month pension) and the decline in domestic absorption. Households' net borrowing as a percentage of GDP continued to decrease, mainly in view of the lower demand for real estate loans. The subdued demand for housing loans was attributable to the decrease in demand due to high interest rates and the fall in housing market activity in view of the elevated uncertainty.

Chart 20: Households' net lending according to underlying trends (four-quarter adjusted data as a percentage of GDP*)

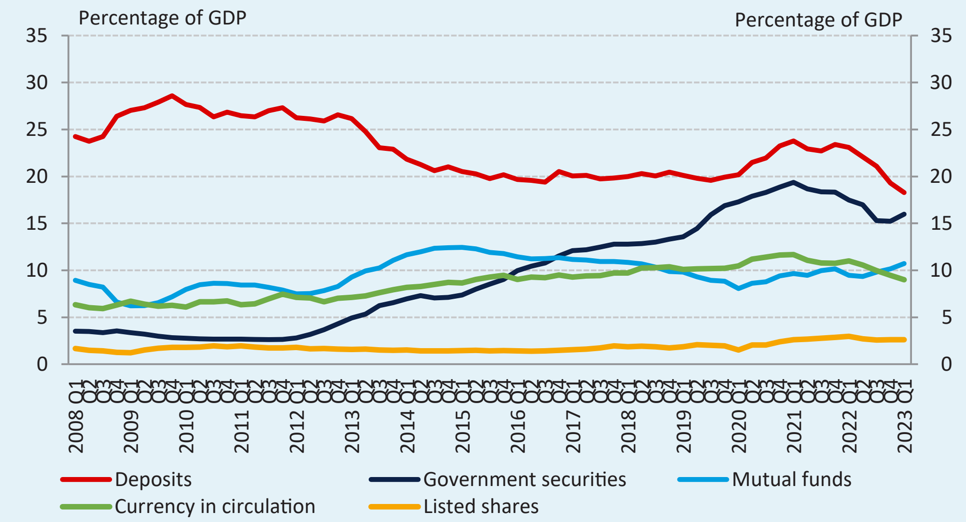


** Figures showing underlying trends, adjusted for pension fund savings, the early repayment scheme and the real yield disbursement, the indemnification of the depositors of liquidated mutual savings banks, the effect of forint conversion and settlement, and the PIT refund. Time series adjusted separately.*

The rearrangement of asset types within the slightly declining financial asset accumulation continued (Chart 21).

- Compared to the previous quarter, in relation to the negative interest rates, overnight and other deposits decreased significantly in Q1, by more than HUF 300 billion. Foreign currency deposit holdings remained practically unchanged, but foreign deposits continued to increase due to transactions.
- Presumably in relation to the high inflation as well, the amount of banknotes and coins held by households declined further: households reduced their cash holdings by HUF 150 billion, and thus households' cash holdings decreased to 9 percent of GDP.
- Households' demand for government securities continued to grow in Q1: on the whole, households' government securities holdings increased by more than HUF 800 billion due to transactions. Within the retail government bond portfolio, in connection with the high inflation the redemptions of MÁP+ government securities continued, although at a much slower pace: the holdings of MÁP+ securities declined by some HUF 800 billion in Q1. The upswing of inflation-indexed PMÁP and BMÁP securities continued (partly as a result of the outflow from MÁP+); net inflows in Q1 exceeded HUF 1200 billion. The short-term discount treasury bill remained the main contributor to the nearly HUF 400 billion rise in other government securities.
- In the past two years, with the widening of investment opportunities, households steadily increased their financial wealth placed in investment funds. Accordingly, retail investors increased their purchases of foreign mutual fund shares last year. Some change is seen in this investment strategy in Q1: although inflows into domestic investment funds (mainly bond funds) remained persistently high, net purchases of foreign funds decelerated.

Chart 21: Development of households' key financial assets



5 Factors behind current account improvement

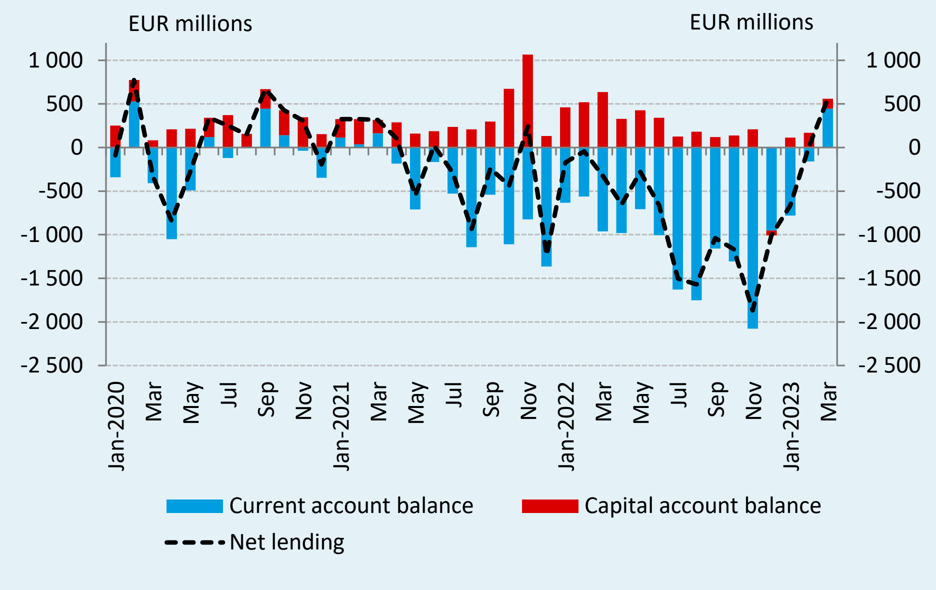
In our special topic we examine the factors behind the fast improvement in the current account balance in Q1 in more detail. On an annual basis the balance was primarily increased by the energy and non-energy components of goods trading and by the balance of services. The increase in the surplus on the balance of goods excluding energy is attributable to the dynamic expansion in exports as well as to the import-suppressing effect of the moderating domestic demand. Besides the rapid expansion in road vehicle and battery production, the decline in inventories presumably also contributed to the increase in exports. In addition to the previous year's high domestic consumption base, the decline in demand due to buoyant inflation also explained the slow growth in imports. The gradual pass-through of lower international energy prices to Hungarian import prices and the quantitative adjustment that took place in domestic consumption both contributed to the decline in the energy deficit. Transportation was the main contributor to the increase in the surplus on the balance of services, but the performance of toll manufacturing, tourism and other business services also improved in Q1.

The current account balance is a key macroeconomic indicator for a small, open economy like Hungary. Therefore, following the major deterioration observed in 2022, there is keen interest surrounding the rapid and significant improvement in recent months. In this chapter we first identify the key factors affecting the current account balance in 2023 Q1, then we examine the main items behind the improvement more thoroughly: we analyse the changes in the goods balance decomposing it to energy and non-energy parts, and finally we review the components of the balance of services.

5.1 Turnaround in the current account balance

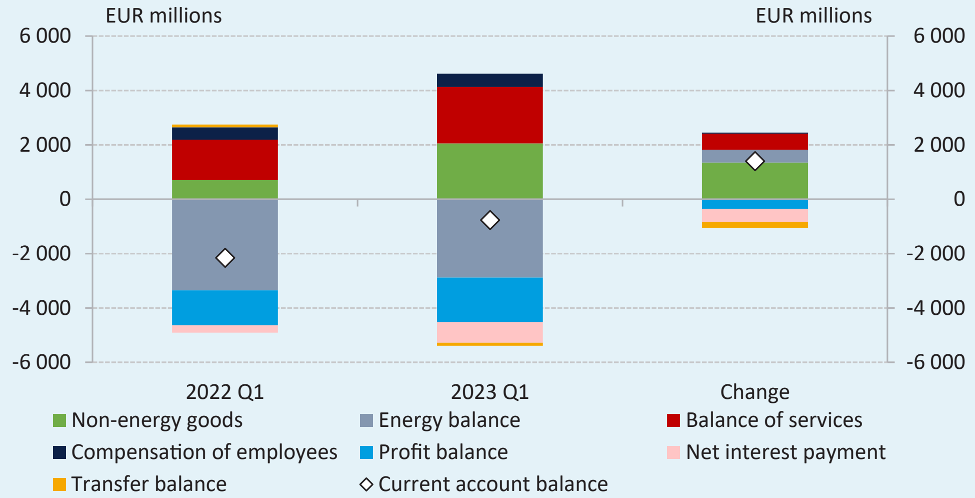
At end-2022 there was a reversal in the current account balance, which continued in the first quarter of this year (Chart 22). The current account deficit started to grow in mid-2021, which initially was primarily explained by higher consumption following the lifting of the COVID-lockdowns, but later in the year, the rise in energy prices also contributed to the deficit. The deficit increased further in 2022 parallel to the explosion of energy prices due to the war, the disruptions in supply chains occurring as a result of the conflict restrained exports, while domestic demand (also driven by government transfers early in the year) continued to feed imports. At end-2022, the rapid improvement in the current account balance was attributable to the upswing in exports, more favourable energy market developments and to the decline in import growth in parallel with the fall in domestic demand. Until 2022 H1, the significant surplus on the capital account was still able to offset the increase in the current account deficit, and thus net lending declined only slightly. However, in line with the increase in the debates about EU funds, the surplus on the capital account has been decreasing since 2022 H2, and thus the changes in net lending have basically been determined by the developments in the current account.

Chart 22: Current account balance and net lending



Based on the comparison of the current account components in the first quarter of this year and in the first quarter of last year, it is clear that the improvement in the four-quarter balance is mainly due to the goods balance excluding energy, but the energy balance and the balance of services also increased during the year that elapsed (Chart 23). In the first two quarters of this year, compared to the first quarter of last year the increase in the goods balance excluding energy expressed in euros significantly exceeded the degree of the improvement that took place in the energy balance and the balance of services together. At the same time, the rise in the net outflows of capital income (FDI and equity income as well as interest income) and the decline in current transfers had a negative impact on the current account balance. Changes in compensation of employees did not affect the annual change in the balance significantly. The factors behind the improvement in the current account balance are examined in more detail as well below.

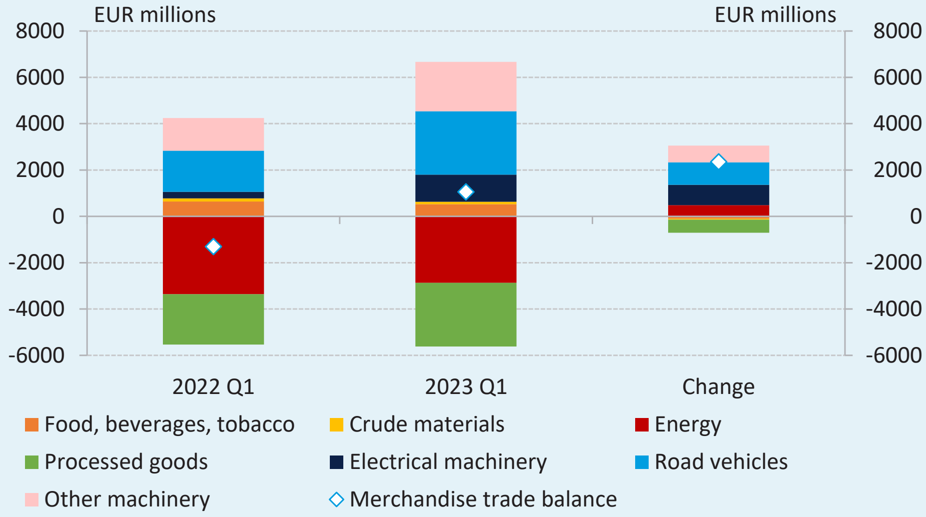
Chart 23: Composition of the current account balance in 2022 Q1 and 2023 Q1 and its changes



5.2 Major improvement in balance of goods excluding energy

Compared to the same period of the previous year, in 2023 Q1 the balance of trade in products was primarily increased by goods belonging to the product groups of road vehicles, electrical machinery as well as other machines, in addition to energy (Chart 24). The increasing trade surplus of the road vehicles and electrical machinery product groups is attributable to the dynamic expansion in exports, which in the latter case is partly the result of the upturn in battery manufacturing in Hungary. Domestic industrial production declined by 2.9 percent in Q1 year on year, but the expansion in battery and vehicle manufacturing, which plays an increasing role in foreign trade, continued, contributing to the significant growth in the exports of these products in Q1. Nevertheless, the annual change in the balance of processed products reduced the whole balance of trade in products, while imports of this product group grew faster than their exports. The year-on-year growth in the imports of processed products in the first quarter of this year is primarily attributable to the increase in the imports of pharmaceuticals and other chemical substances as well as chemical products. Looking at the aggregated gross components, according to merchandise trade statistics, the year-on-year increase in goods exports excluding energy and goods imports excluding energy was some 18 percent and 13 percent, respectively, in Q1.

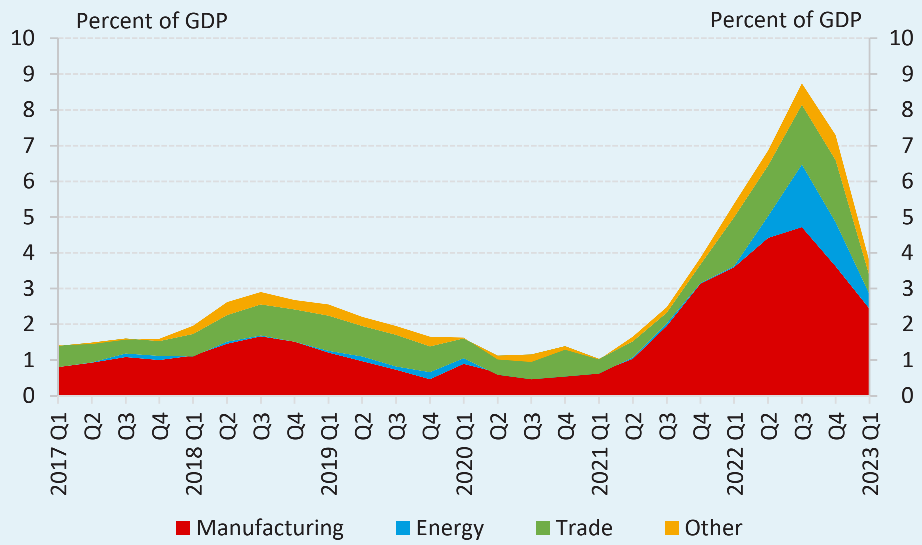
Chart 24: Merchandise trade balance according to SITC



Note: The difference between trade in goods according to the trade balance and the balance of payments depends on the different requirements of the methodologies and the content of data sources. We obtain the trade in goods figures of the balance of payments by means of adjustment factors derived from the external trade statistics (for more details, see the publication on the methodology of the balance of payments statistics).
The two types of data have been similar in recent years, so they are suitable for analysing the trends.
The Standard International Trade Classification (SITC) classifies products based on their processing stage, uses and importance in world trade.
Source: HCSO, MNB.

The decline in inventories may also have contributed to the increase in goods exports excluding energy in Q1 (Chart 25). Presumably because of the disruptions in supply chains due to the pandemic, inventories as a percentage of GDP increased in 2021 and 2022, but the four-quarter growth in inventories already started to decelerate at end-2022. Lower stockpiling was mainly typical in manufacturing (and within that mostly in the sectors of road vehicle manufacturing, crude oil processing and the manufacturing of electronic products), where the value of inventories declined in nominal terms as well in 2023 Q1. The fall in the four-quarter increase in inventories was significant in the fields of electric energy and gas supply as well as trade. In the case of the former, this was in line with the decline in domestic gas stocks.

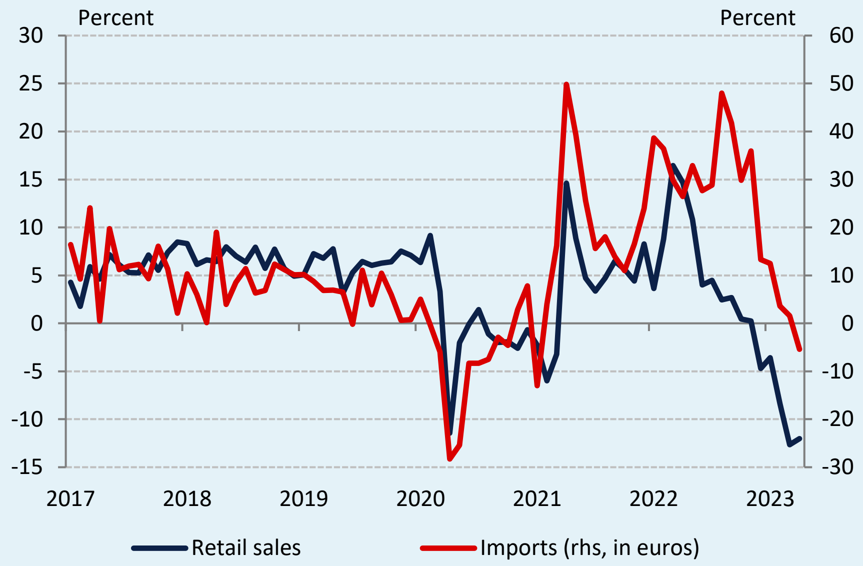
Chart 25: Components of the changes in inventories, as a percentage of GDP



Source: HCSO, MNB.

The major downturn in household demand suppressed imports of goods (Chart 26). The volume of retail declined by 9.5 percent in 2023 Q1 compared to the same period of the previous year (the decline was 7.5 percent excluding fuel sales). The previous year's high base also contributed to the significant decline. The NTCA online cash register turnover adjusted for inflation, which represents a wider range of domestic demand, showed a similar downturn. Whole-economy investment decreased by 2.8 percent year on year in 2023 Q1, which also had a negative effect on imports. On the whole, the decline in volume of the retail turnover in Q1 may have reduced the quantity of the imports of consumer goods, which may have played an important role in the fact that the annual change in goods imports of the current account turned into a decline by the end of the quarter.

Chart 26: Annual changes in retail sales and goods imports (according to the balance of payments)



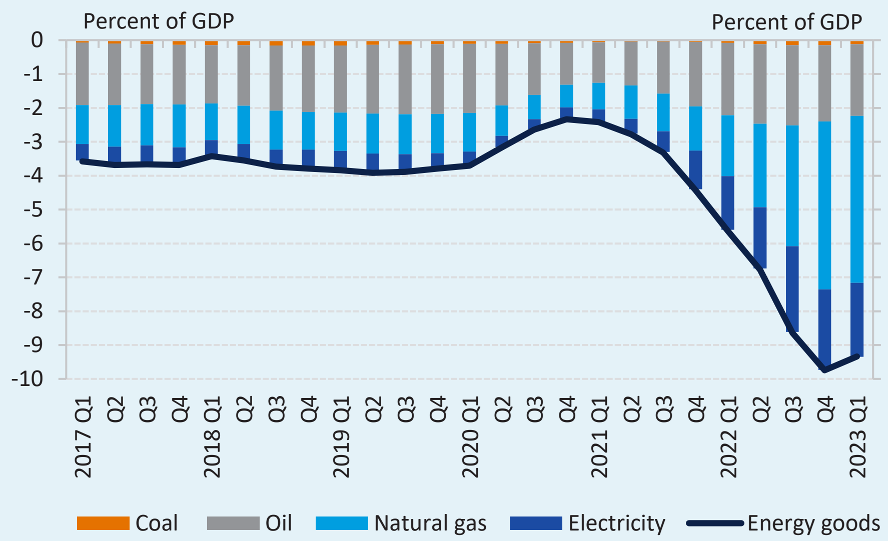
Note: The volume of retail sales is adjusted for seasonal and calendar effects.
Source: HCSO, MNB.

5.3 The energy deficit decreased due both to lower prices and adaptation

The four-quarter merchandise trade energy balance as a percentage of GDP bottomed out with a deficit close to 10 percent in the fourth quarter of last year (27).[2] Following the shock of the COVID period, which was favourable in terms of energy costs, the upturn in global demand due to the reopening and the rise in energy prices as a result of the war in Ukraine extremely increased Hungary's energy expenditures in 2022. While the energy balance deficit was around 3.5–4.0 percent of GDP prior to the pandemic, it was only 2.3 percent of GDP in 2020, growing to 9.7 percent of GDP by 2022. The surge in the energy deficit was mainly attributable to the deterioration in the balances of natural gas and electric energy, while the oil deficit only slightly exceeded the level that had been typical before. In 2023 Q1, the four-quarter energy deficit slightly fell to 9.3 percent of GDP. The electric energy component was the most important factor behind the indicator improvement. In the first quarter of this year, the price of electricity dropped to well below the level observed in 2022 Q1, similarly to the price of Ural oil, which is considered to be the benchmark for Hungary's crude oil imports. At the same time, the natural gas import price, which is the biggest item within the energy balance, was still higher on average in the first quarter of this year than a year earlier. According to market information and our own calculations, the price of natural gas imports to Hungary followed the current monthly TTF gas prices with a delay of approximately two months. This is why there has not been a major decline yet in the four-quarter rolling net gas imports in the first quarter of this year.

[2] In the case of the components of the energy balance, the effect of the methodological differences between the statistics of foreign trade in products and the balance of payments statistics is not significant. Therefore, developments in the latter can be well illustrated by the former. Due to the seasonality of energy consumption in the course of the year, it is justified to examine four-quarter rolling data.

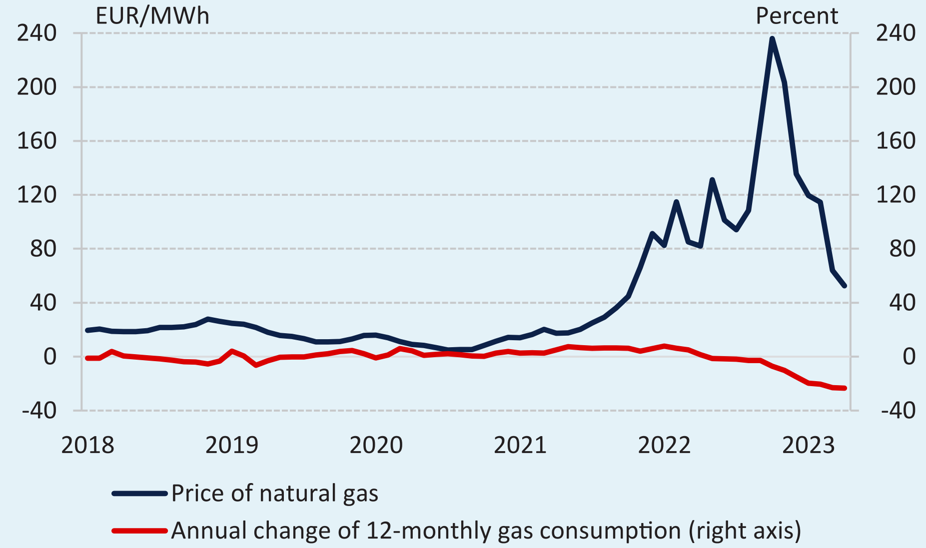
Chart 27: Four-quarter balance of various energy carriers as a percentage of GDP



Note: We use a rolling four-quarter chart to illustrate the developments behind the annual change of the quarterly data, because it better depicts the developments that take place in the background due to the smoothing of outliers, originating, for example, from the seasonality in the course of the year. At the same time, this method is also suited to presenting the annual change in the 2023 Q1 data, which is the main subject of our analysis, because the difference between the four-quarter data for the last quarter of 2022 and 2023 Q1 is determined by the annual change in the 2023 Q1 data.
Source: HCSO, Eurostat.

The quantitative adjustment that took place in domestic consumption also contributed to the improvement in the energy balance. In 2022, the appearance of sharply increased market energy prices in domestic consumer prices was attenuated by government measures (e.g. gradual phasing out of the cap on fuel prices, regulation of gas price for households), which decelerated the quantitative adjustment in the case of energy used by households. By 2023 Q1, however, significant quantitative adaptation had already developed in household energy consumption. The decline in domestic energy consumption was supported, inter alia, by the favourable weather as well, since the mild winter reduced the quantity of natural gas needed for heating. Domestic electricity consumption was 7 percent lower in 2023 Q1 than in the same period of the previous year, while domestic electricity production declined by 8 percent, mainly due to the fall in natural gas-based electricity production, while the role of solar energy continued to increase. Accordingly, domestic gas consumption declined by some 23 percent in 2023 Q1 compared to the level seen one year before (Chart 28). The sales volume of fuel retail trade in Q1 was 19.1 percent lower than the extremely high base one year earlier, which was also increased by the cap on fuel prices. Although the developments in domestic energy consumption may differ from the changes in imported quantities in the short run, consumers' adaptation to the higher prices results in a decline in the quantity of imported energy in the long run.

Chart 28: Changes in the price of natural gas and domestic natural gas consumption

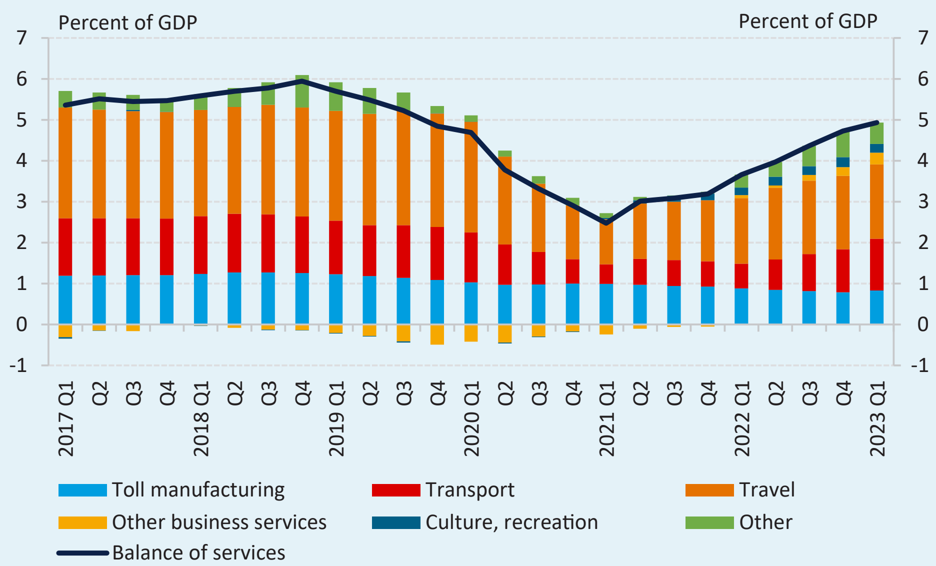


Note: Domestic natural gas price estimated using the value of the monthly TTF gas price with a delay of two months.
Source: Hungarian Energy and Public Utility Regulatory Authority (MEKH), MNB.

5.4 Wide-ranging improvement in services

With the contribution of a wide range of sectors, the services balance improved steadily from the COVID-induced low, which is mainly attributable to the increase in the surplus of transport and tourism (Chart 29). Hungary traditionally achieves most of the surplus on services in the area of travelling (tourism). In the year starting with 2023 Q1, the surplus reached 1.8 percent of GDP, but partly due to the war nearby presumably, it is still one percentage point of GDP below the level of the pre-pandemic period. Last year the fastest improvement was observed in transportation: by 2023 Q1, the surplus as a percentage of GDP doubled in a year, and reached 1.3 percent. Toll manufacturing also traditionally produces a stable surplus in Hungary, and although its relative role in the export of services is slowly declining, it developed favourably in the first quarter of this year. The surplus on other business services also grew in the first quarter of this year, but at the same time there was a decline in the surplus on services related to culture and entertainment and in the case of other items. The latter include, inter alia, the services related to telecommunication and computer technology, which reliably produce a surplus, and the performance of which improved in the first quarter of this year as well.

Chart 29: Composition of the balance of services (four-quarter data as a percentage of GDP)



List of charts

Chart 1: Development of the components of net lending* (four-quarter values as a percentage of GDP) 7

Chart 2: Development of the balance of trade and its components (four-quarter values as a percentage of GDP) 8

Chart 3: Annual real growth in exports and imports 8

Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth 9

Chart 5: Development of trade balance factors according to GDP (year-on-year) 9

Chart 6: Development of income balance items* (four-quarter values as a percentage of GDP) 10

Chart 7: Four-quarter development of transfer balance items (four-quarter values as a percentage of GDP) 11

Chart 8: Four-quarter net lending in the countries of the region (as a percentage of GDP) 11

Chart 9: Two types of net lending (four-quarter data as a percentage of GDP) 12

Chart 10: Structure of net lending (unadjusted transactions) 13

Chart 11: Development of FDI, excluding capital-in-transit transactions (cumulative transactions) 13

Chart 12: Developments in net portfolio equity and mutual fund share receivables (cumulative transactions) 14

Chart 13: Development of net debt-type financing by sector 14

Chart 14: Changes in the banking sector's external debt and assets as of early 2008 (cumulative transactions) 15

Chart 15: Breakdown of the change in the net external debt of the consolidated general government including the MNB (cumulative transactions) 16

Chart 16: Components of the change in net external debt (values excluding intercompany loans as a percentage of GDP) 17

Chart 17: Breakdown of net external debt by sectors and gross external debt (as a percentage of GDP, excluding intercompany loans) 18

Chart 18: Short-term external debt of the Hungarian economy and foreign exchange reserves 19

Chart 19: Net lending of specific sectors* (four-quarter values as a percentage of GDP) 20

Chart 20: Households' net lending according to underlying trends (four-quarter adjusted data as a percentage of GDP*) 21

Chart 21: Development of households' key financial assets 22

Chart 22: Current account balance and net lending 23

Chart 23: Composition of the current account balance in 2022 Q1 and 2023 Q1 and its changes 24

Chart 24: Merchandise trade balance according to SITC 25

Chart 25: Components of the changes in inventories, as a percentage of GDP 25

Chart 26: Annual changes in retail sales and goods imports (according to the balance of payments) 26

Chart 27: Four-quarter balance of various energy carriers as a percentage of GDP 27

Chart 28: Changes in the price of natural gas and domestic natural gas consumption 28

Chart 29: Composition of the balance of services (four-quarter data as a percentage of GDP) 28

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

July 2023

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

H-1013 BUDAPEST, KRISZTINA KÖRÚT 55.