



REPORT ON THE BALANCE OF PAYMENTS



2021
JULY

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

*Letters 27
Gábor Bethlen*



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In accordance with Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the primary objective of the MNB is to achieve and maintain price stability and, without prejudice to its primary objective, the central bank is also responsible for maintaining the stability of the financial intermediary system. Developments in the external balance are key to financial stability, as processes relating to the balance of payments allow for conclusions to be drawn concerning the sustainability of economic growth and the relevant risks. Moreover, the analysis of the balance of payments allows for the earlier identification of economic problems, when they are developing, and thus steps can be taken to avoid such problems.

To this end, the Magyar Nemzeti Bank regularly performs comprehensive analyses of the trends relating to Hungary's external balance, examining a number of indicators to assess macroeconomic imbalances and identifying elements and processes which are of critical importance for Hungary's vulnerability.

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

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This Report is based on information pertaining to the period ending 21 June 2021.

Summary

The **external balance indicators** of the Hungarian economy **continued to improve** in 2021 Q1. The **current account balance** showed a **small surplus**, while **net lending of the economy** also **continued rising**, to exceed 2 per cent of GDP. **Hungary's external balance position strengthened from the second half of 2020**, with similar trends observed in the regional countries as well; consequently, Hungary's current account and net lending were **close to the regional average**.

In early 2021, Hungary's **external balance continued to strengthen**, as the economy **gradually recovered from the impacts of the pandemic**. This was mainly due to **the rising goods balance**, which was also reflected in **improving net exports**, while the services balance continued to decline, due to the elimination of the higher base of previous year, which was only moderately affected by the coronavirus. The increase in the goods balance was mainly driven by **industrial production surpassing the previous year's level**, while **household consumption remained well below** last year's level; developments in the **terms of trade** also contributed to the higher surplus. In line with rising export revenues, **the increase in corporate profits slightly curbed** the rise in external balance indicators, while – similar to the previous quarter – the high absorption of EU transfers supported the economy's net lending via the **transfer balance**.

On the financing side, there was a net outflow of FDI during the quarter, due to **direct investments by Hungarian companies abroad**, in addition to reinvestments by foreign companies. A **significant shift occurred in debt liabilities**: as banks used a lower volume of **central bank euro liquidity providing swaps** than in the previous quarter, the banking sector's net liabilities increased while the government's net liabilities declined. Thus, the **increase in net external debt was mainly driven by** a decline in foreign currency reserves, partly related to **government procurements linked to the pandemic**, and by **non-residents' purchases of forint government bonds**.

At the end of the first quarter, the **net external debt ratio amounted to 8.6 per cent of GDP, as a combined result of a higher ratio for the banking sector and a lower ratio for the government and corporations**. The reduced utilisation of the central bank's euro liquidity providing swaps compared to the end of the year did not change the level of net external debt, but did cause a shift in the debt ratios of the banking sector and the government. Nevertheless, banks' external assets still moderately exceeded their external liabilities. In addition to the modest outflow of debt, the revaluation of outstanding stocks also contributed to lowering the government's net external debt, as the price of government securities held by non-residents declined due to the yield increase observed during the quarter. As a combined result of the rise in private sector debt and the decline in the government's gross external debt, the gross external debt of the Hungarian economy **was relatively stable, amounting to 58.3 per cent of GDP at the end of March**. Short-term external debt, which is of crucial importance in terms of Hungary's external vulnerability, amounted to EUR 21.9 billion at the end of 2020, while international reserves amounted to EUR 32 billion. **Accordingly, reserves still significantly exceed the level expected and deemed safe by investors**.

Examining the external balance positions based on the **sectors' savings approach**, the **government's net borrowing continued to increase**. The higher budget deficit is attributable to both **the lower tax revenues resulting from the pandemic** and the higher expenditures related to **economy protection measures**. On the other hand, in parallel with this (and partly due to the high government expenditures as well) the **private sector's net financial savings also rose**. Within this, growth in **households' government securities holdings continued to be strong**, which is a **positive trend in terms of external vulnerability**.

In our special topic, we examined **how households' financial savings – which rose significantly in 2020 – may change once the pandemic is over**. After a rapid economic recovery, the expected trends in savings are of the utmost importance for the economic balance. Based on the lessons from the 2008 crisis, **savings usually tend to fall gradually**, over several years, in parallel with **a stronger increase in consumption and a decline in unemployment** (i.e. as precautionary motives fade). **In Hungary, a moderate decline in savings is expected to occur in the coming years**, supported by an expected mild increase in consumption after its fall, which was modest by EU standards, as well as low unemployment, an expected future rise in household incomes and a likely decline in the dynamics of borrowing. In addition, **several domestic measures** (such as the tax allowances and reimbursements announced for 2022 and the gradual phase-out of the moratorium on loan instalments) **also suggest a steadily high level of household savings**.

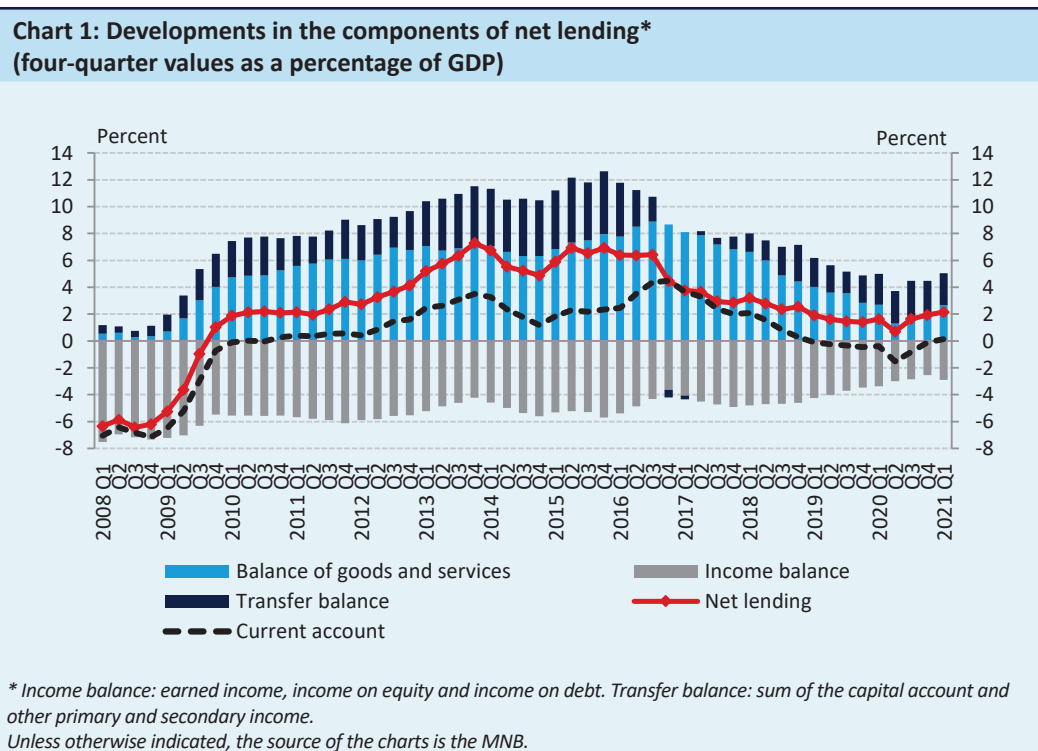
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1 Real economy approach

According to the real economy approach, in 2021 Q1 Hungary's four-quarter net lending rose to 2.1 per cent of GDP, while the current account showed a moderate surplus. The increase in external balance indicators was mainly driven by a rise in the trade surplus, which was linked to the goods balance and supported by the steadily high transfer balance surplus, while the slightly larger income balance deficit had an opposite effect. The contribution of net exports to economic growth was much stronger than observed in previous quarters. The higher trade balance was mostly attributable to favourable volume changes, but developments in the terms of trade also made a small contribution. Robust growth in net lending was also seen in the countries of the region, with the size of Hungary's external balance indicators corresponding to the regional average.

According to the real economy approach, in 2021 Q1 Hungary's four-quarter net lending rose to 2.1 per cent of GDP, while the previous deficit on the current account turned into a moderate surplus and amounted to 0.2 per cent of GDP (Chart 1). According to *unadjusted quarterly data*, net lending amounted to more than EUR 1 billion in Q1, based on the current account surplus of EUR 541 million and the capital account balance of EUR 508 million. The increase in four-quarter net lending was mainly driven by a rise in the goods and services balance, while the increase in the income balance deficit had an opposite effect.

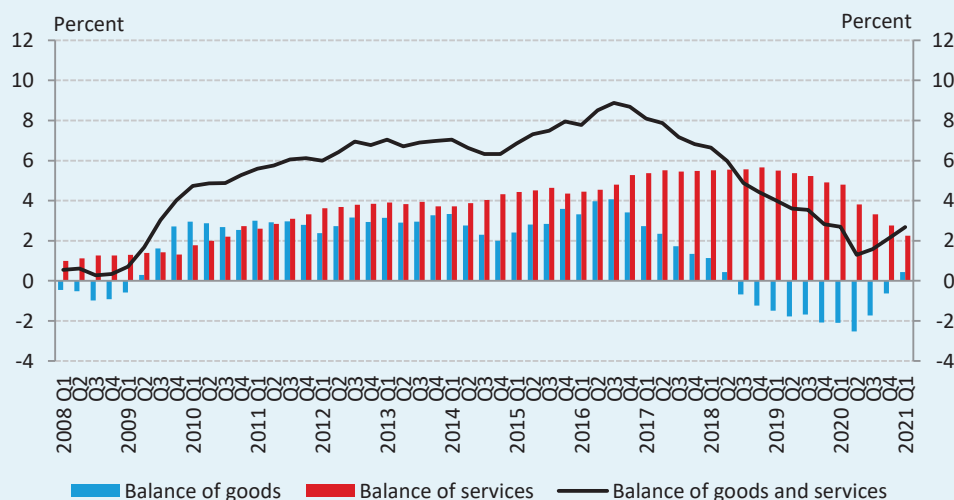


1.1 Trade balance

In 2021 Q1, the higher trade surplus was the combined result of the increase in the goods balance and the continued decline in the surplus of the services balance (Chart 2). The trend decline in the trade balance that had lasted for almost four years – due to changes in the dynamics of the goods balance – was interrupted in 2020 Q2, but since then, thanks to the turnaround in the goods balance, it was able to rise again, and thus the ratio as a percentage of GDP returned to its pre-pandemic level in the first quarter. After the fall registered in previous years, the *goods balance* as a percentage of GDP turned into a surplus, and thus it once again made a positive contribution to the level of the trade balance. The *services balance* continues to be an important contributor to the trade surplus, although the surplus of this balance had dropped from the level of nearly 5-6 per cent observed in previous years to close to 2 per cent by 2021 Q1. Tourism and transportation services, which are strongly weighted in the services balance, fell sharply as a result of the pandemic, and

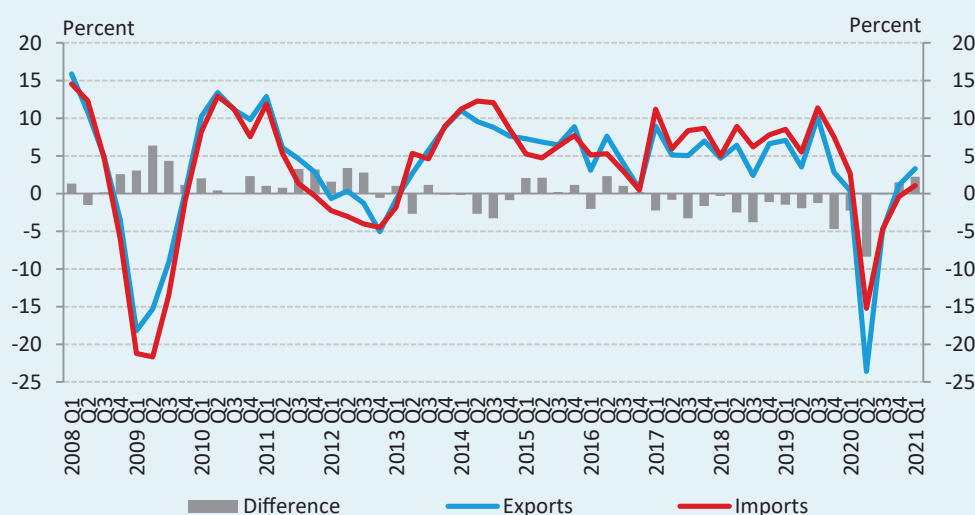
recovery in these sectors is proceeding slowly. In the first quarter, due to the tighter restrictions, none of these service types registered any substantial improvement compared to the previous quarter: the lockdowns connected to the third wave of the pandemic reduced both the income and expenditure sides of these sectors in quarter-on-quarter terms.

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



In 2021 Q1, exports continued to grow dynamically, while import performance also increased (Chart 3). In line with the continued growth in industrial production, annual real growth in exports reached 3.3 per cent, exceeding the rate registered in the previous quarter by 2 percentage points. However, part of this growth in industrial production is attributable to the low base from the previous year. In addition to stronger exports, imports also continued to rise and exceeded the level registered one year ago by 1 percentage point in the first quarter. At the same time, the moderate household consumption resulting from the third wave of the pandemic continued to curb import growth in the period under review. The gap between export and import growth persisted in early 2021, which was also reflected in the higher balance.

Chart 3: Annual real growth in exports and imports

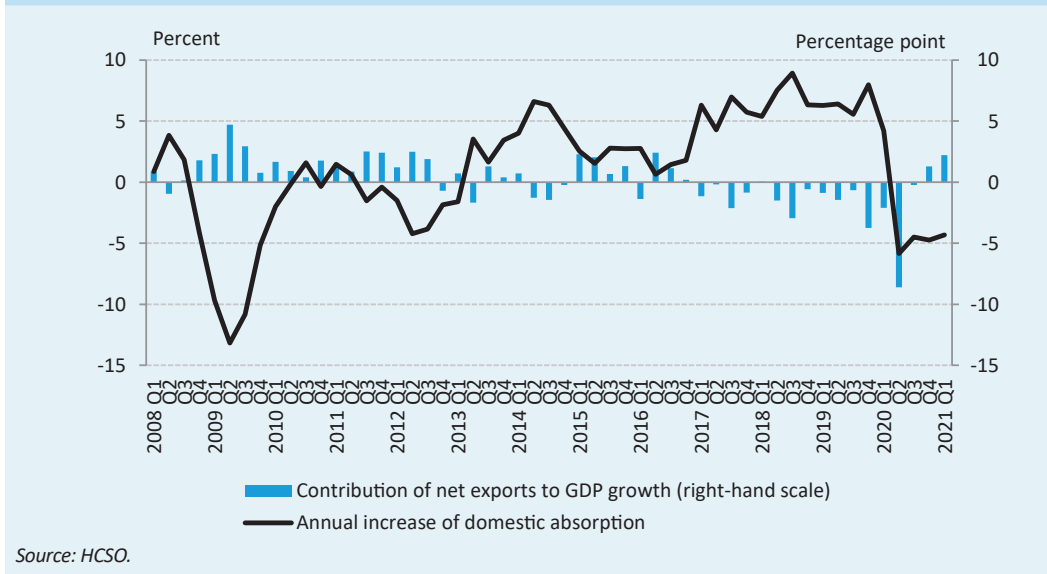


Source: HCSO, MNB.

At the beginning of 2021, the annual growth rate of domestic absorption remained at the low level observed in the second half of 2020, while the contribution of net exports to growth was substantially higher in the first quarter compared to previous years (Chart 4). Within the items of domestic absorption, the drop in household consumption remained at the same level as in the previous quarter, while the increase in public consumption mitigated the decline in

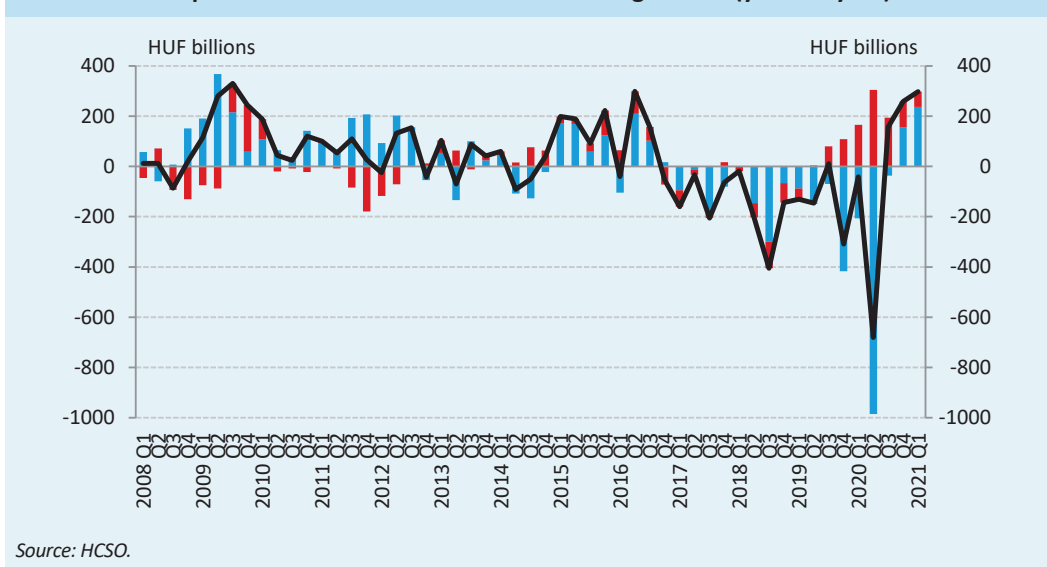
household consumption. In addition, the annual decline in investments curbed growth, as in the previous quarters. In contrast to the decline in domestic absorption items on an annual basis, the contribution of net exports to growth was the highest seen recent years in 2021 Q1, and thus this item substantially supported GDP growth.

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



The favourable developments in the 2021 Q1 trade balance were primarily due to volume changes, with the improved terms of trade also making a modest contribution. The Q1 increase in the volume of exports provided considerable support for the improvement in the trade balance, while import growth was curbed by the impact of the tighter restrictions in the first quarter due to the new wave of the pandemic. The much smaller contribution of the terms of trade to the balance compared to previous quarters was due to the gradually rising oil price in 2021 (Chart 5).

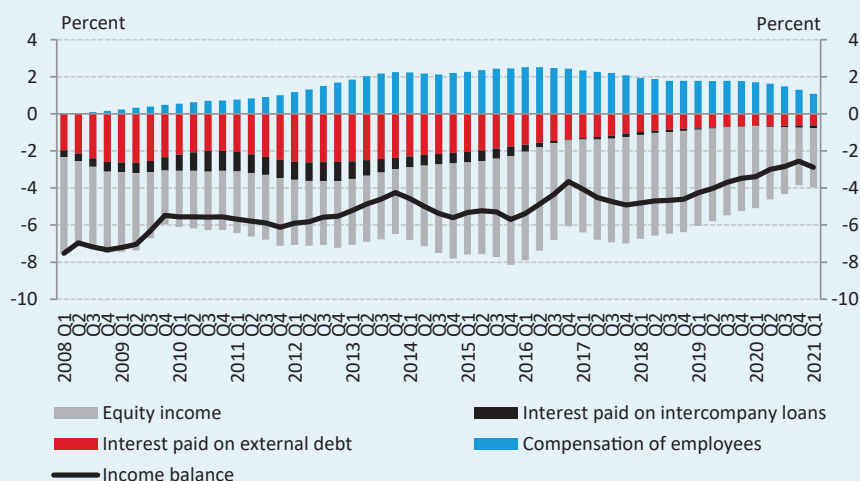
Chart 5: Development of trade balance factors according to GDP (year-on-year)



1.2 Income balance

Following the decline observed in previous quarters, the income balance deficit rose again in 2021 Q1, which was linked to the profit of foreign-owned companies and the decline in the income of Hungarian employees abroad (Chart 6). Following a decline since 2018, the four-quarter income balance deficit rose to 2.9 per cent of GDP in 2021 Q1, essentially due to two factors: on the one hand, the profit of foreign-owned companies, representing the largest weight within the income balance,¹ rose in parallel with stronger industrial production and exports, and on the other hand – presumably as a result of the stricter lockdowns related to the third wave of the pandemic – resident employees' income from abroad fell to an even larger degree than before and amounted to only 1.1 per cent of GDP compared to the its pre-pandemic value of 1.7-1.8 per cent, thereby contributing to the increase in the income balance deficit.

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



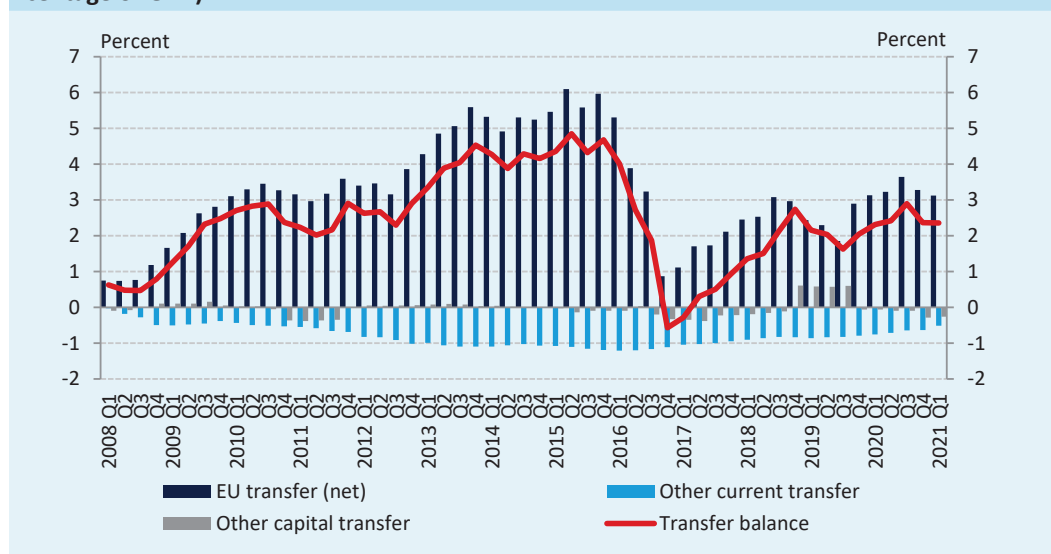
* Income balance: earned income, income on equity and income on debt.

1.3 Transfer balance

The transfer balance surplus as a percentage of GDP amounted to 2.4 per cent of GDP in 2021 Q1, corresponding to the level observed in 2020 Q4. Accordingly, the transfer balance surplus continued to contribute strongly to maintaining Hungary's favourable external balance position (Chart 7). Based on the four-quarter data, the net inflow of EU funds amounted to 3.1 per cent in 2021 Q1, falling slightly short of the value registered in the previous two quarters. However, in parallel with this, other current and capital transfers deteriorated the transfer balance to a lesser degree than before. The income of those employed temporarily abroad 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 somewhat to the improvement in the transfer balance. The surplus, which corresponds to that of the previous quarter, was the combined result of the aforementioned factors.

¹ We only have limited quarterly data on the profits of foreign-owned companies. Therefore, the information on profit outflows is based on estimates until the receipt of the corporate questionnaires in September of next year. For more details, see the publication 'Methodological notes to the balance of payments and international investment position'.

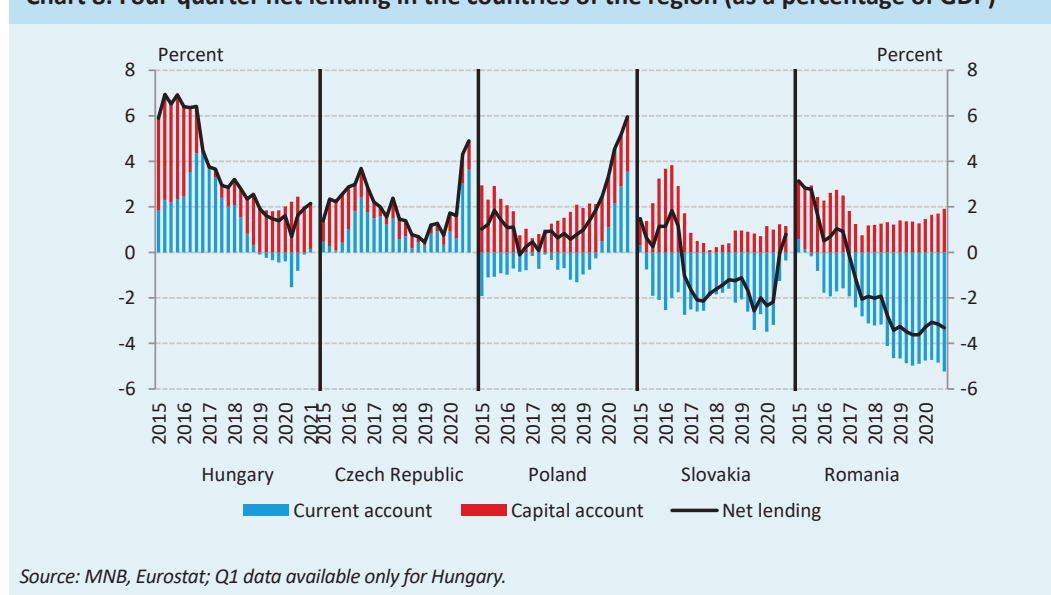
Chart 7: Four-quarter developments in transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

As a result of the pandemic, external balance indicators in the countries of the region generally continued to rise, while net lending shows a deficit only in Romania (Chart 8). Comparability with the countries of the region is limited by the fact that in the case of the neighbouring countries data are only available until the end of 2020. As a result of the pandemic, in 2020 H2 the external balance position of the regional countries typically rose significantly, primarily due to improvement in the current account balance. This occurred as declining domestic absorption increased the goods and services balance via a fall in imports. In most countries of the region, the capital account surplus was stable, in conjunction with the absorption of EU transfers. The Polish and Czech external balance developments are worth mentioning, as their current account balances rose significantly. In Poland – presumably due to the more closed economic structure – this is attributable to the improved trade balance, while in the Czech Republic the income balance deficit also declined considerably, due to the lower profits of foreign-owned companies.

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

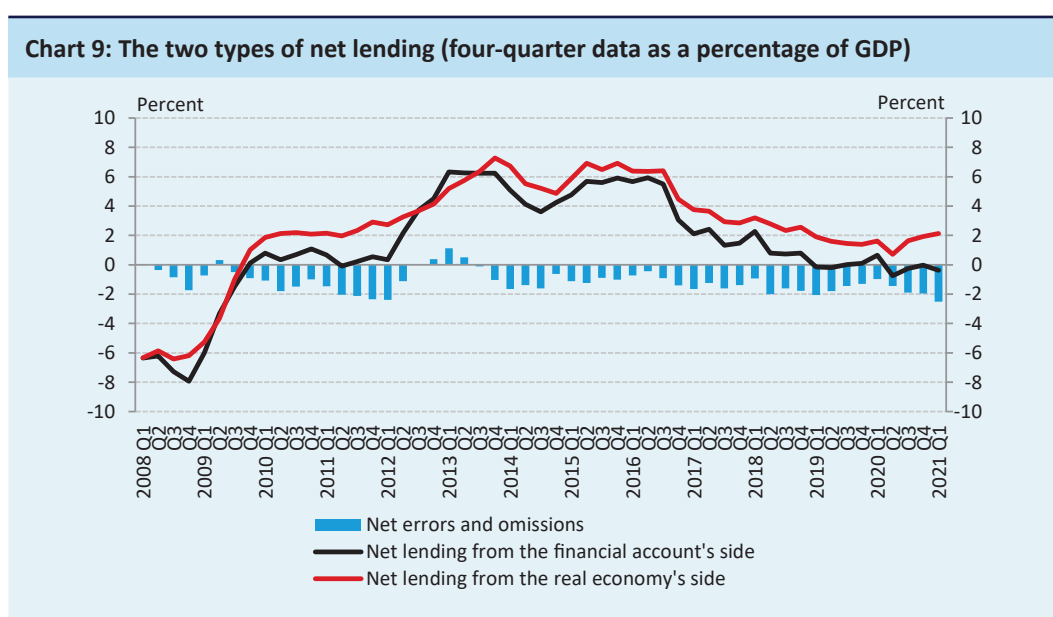


Source: MNB, Eurostat; Q1 data available only for Hungary.

2 Financing approach

In the first quarter, the financial account, i.e. the external balance position calculated from the financing side, turned into moderate net borrowing as a combined result of the inflow of debt liabilities and the outflow of non-debt liabilities. As regards transactions, net FDI funds declined due to the rise in resident FDI investments abroad, and – also due to the increase in domestic actors' investments abroad – net portfolio equity investments also registered an outflow. Ultimately, the inflow of debt liabilities was reflected in the rising debt ratio of the banking sector. However, this was attributable to the foreign exchange expenditures of the government – partly due to pandemic prevention measures and the procurement of assets – that reduced international reserves. The shift between the debt of the banking sector and the government was caused by the lower utilisation of the central bank's euro liquidity providing swap instrument at the end of 2021 Q1 compared to the end of the previous year. All of this offset the reserve reducing effect of the aforementioned expenditures for the government, and increased the banking sector's debt ratio.

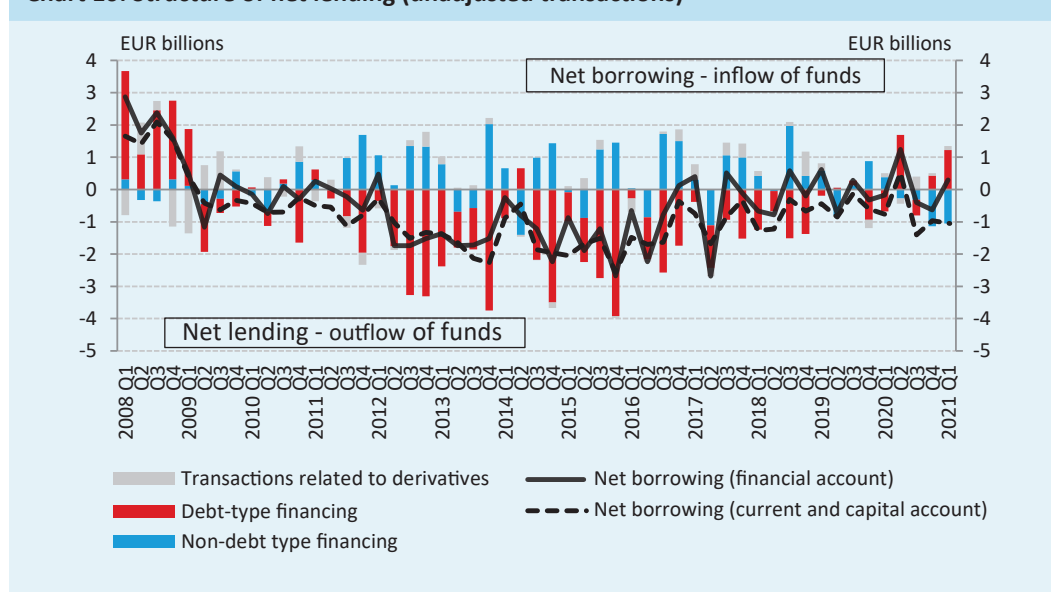
According to the financing side data, in 2021 Q1 the economy's four-quarter external balance position turned into a **minor deficit (Chart 9)**. By contrast, four-quarter net lending calculated based on the real economy approach rose moderately. This means that, according to the financing items, there was an inflow of funds, while according to the real economy side Hungary's net position improved further. Thus, the four-quarter rolling value of the two external balance indicators (i.e. the "balance of net errors and omissions"²) rose in the first quarter and moderately exceeds the average from previous years.



According to the four-quarter data, in the first quarter the economy's **net external liabilities rose moderately, since – contrary to the previous quarters – there was net borrowing (Chart 10)**. The net inflow of funds observed in the first quarter was primarily connected to debt liabilities: net outstanding debt rose by roughly EUR 1.2 billion due to transactions, accelerating compared to the previous quarter. The outflow of non-debt liabilities occurred in conjunction with strong growth in Hungarian investments abroad, which affected both foreign direct investments and portfolio investments. As a combined result of the foregoing, the external balance calculated based on the financial account shifted to a small net borrowing position in the first quarter, compared to the net lending registered in the previous two quarters.

² 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 the exchange rates, as indicated by the category 'Net errors and omissions'.

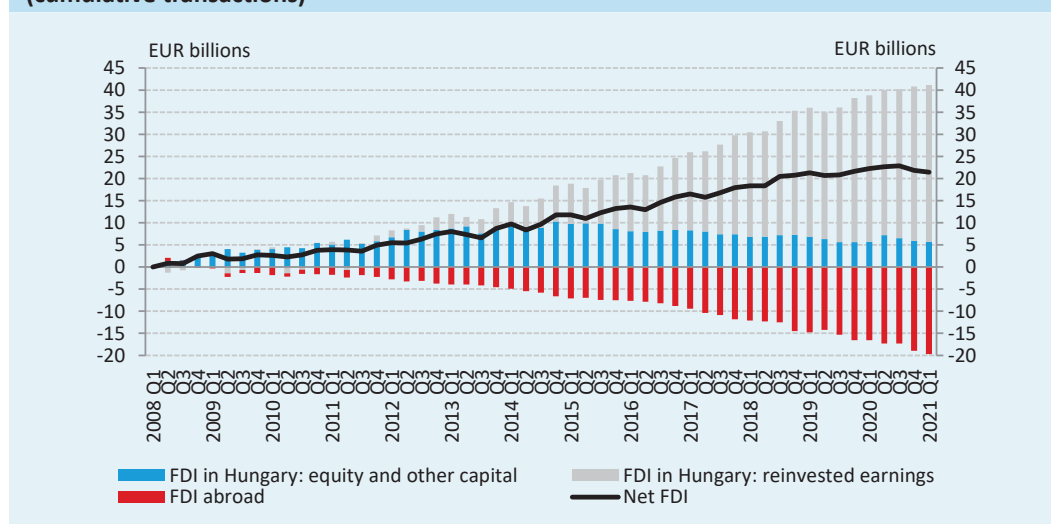
Chart 10: Structure of net lending (unadjusted transactions)



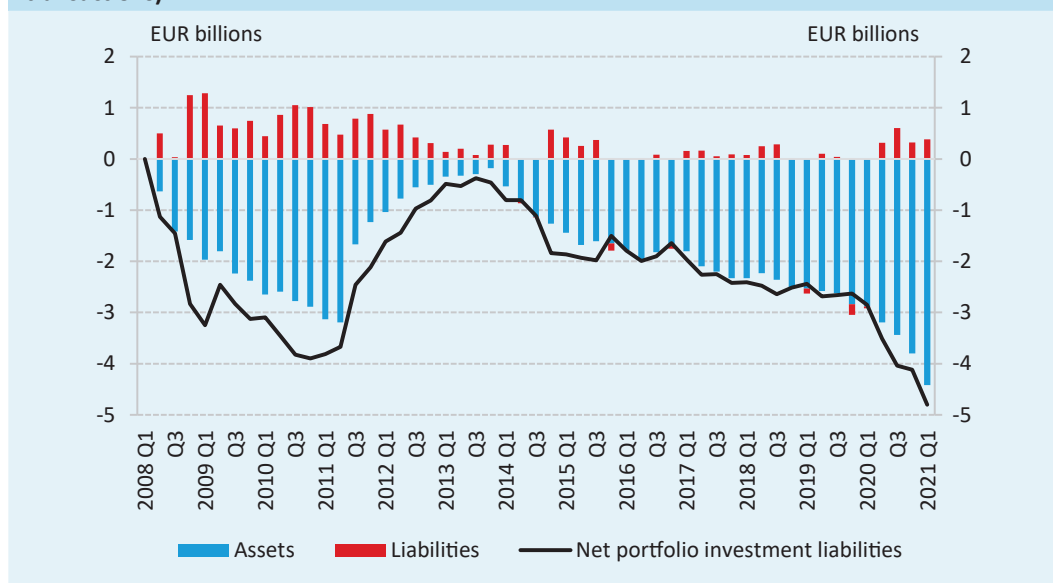
2.1 Non-debt liabilities

In the first three months of the year, the stock of net foreign direct investments declined once again, which – as in the previous quarter – was primarily linked to Hungarian investments abroad (Chart 11). Based on data excluding capital-in-transit transactions and asset portfolio restructuring, net FDI outflows amounted to EUR 0.4 billion in Q1. The reinvested earnings of non-resident companies caused a rise in net FDI, while growth in Hungarian direct investments abroad in excess of that reduced the indicator. The latter was linked to the purchase of foreign equity by several Hungarian large enterprises and to capital increases in foreign subsidiaries.

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

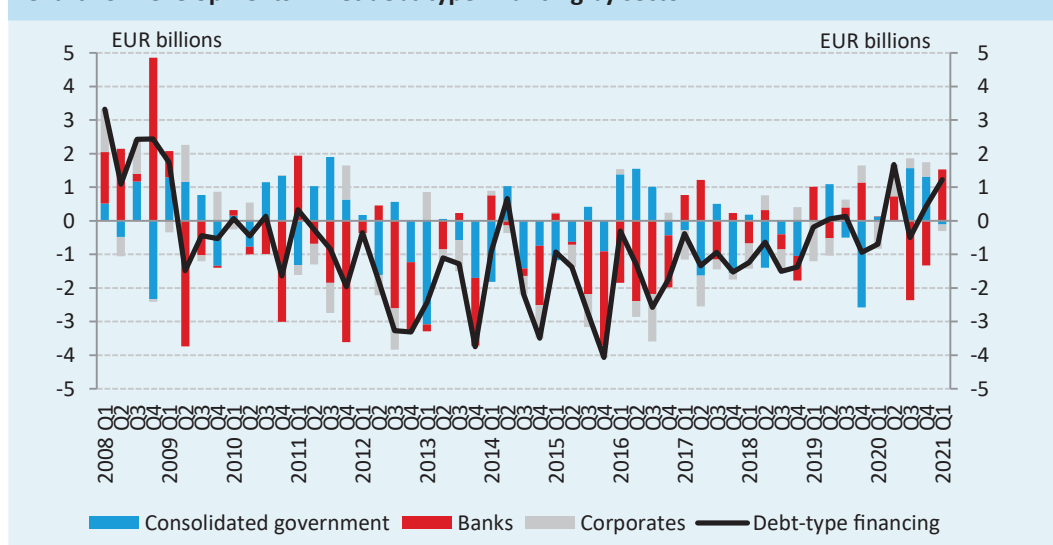


In the first quarter, net portfolio equity investments declined by almost EUR 700 million due to the rise in Hungarian investments abroad. In addition to Hungarian direct investments abroad, the fall in net portfolio investments also contributed significantly to the outflow of non-debt liabilities. The latter was mostly linked to the investments of Hungarian actors abroad, while non-residents' holdings of Hungarian equities and mutual fund shares declined only moderately, falling by roughly EUR 60 million. In the first quarter, residents substantially increased their holdings of foreign equities and mutual fund shares, with growth in this item amounting to almost EUR 620 million altogether. This may have been due to the fact that domestic investors may have regarded the lower stock exchange prices resulting from the pandemic as a good entry point.

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

2.2 Debt liabilities

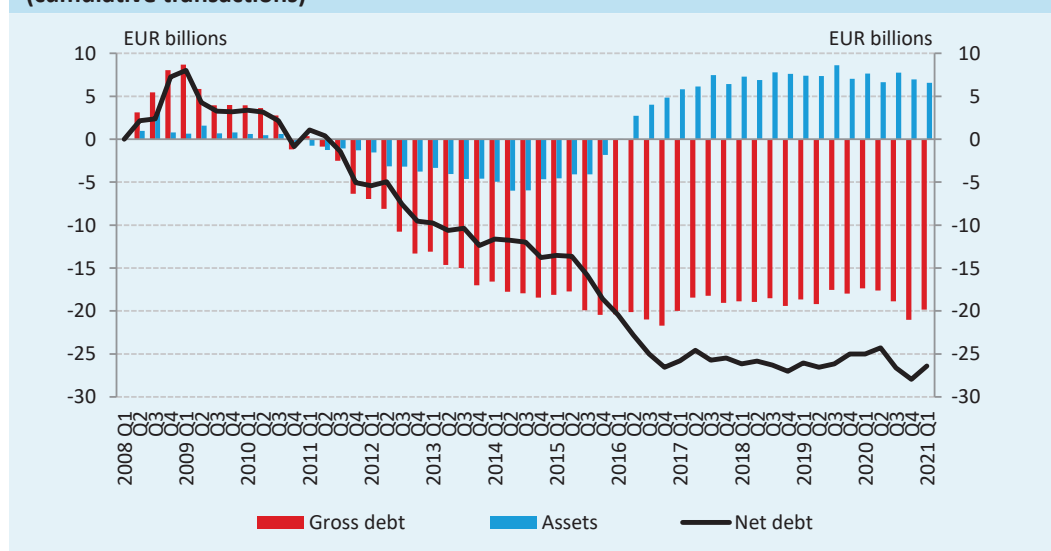
In the first quarter, the economy's net external debt rose due to transactions, which was ultimately reflected in the banking sector (Chart 13). In the first quarter, banks' net external debt rose by roughly EUR 1.5 billion due to transactions, while the general government's ratio, consolidated with the MNB, fell moderately, declining by EUR 0.1 billion. The increase in banks' external liabilities was mostly attributable to the fact that compared to the previous quarter they used less central bank euro liquidity providing swaps, resulting in smaller adjustment compared to the deleveraging observed at the end of the year. On the other hand, the stock of central bank foreign currency liquidity providing swaps was neutral for the level of net external debt, since it also reduced foreign exchange reserves to a smaller degree as at the end of the year. Corporations' net external debt fell by roughly EUR 200 million in relation to growth in external assets.

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

Compared to the significant year-end deleveraging, the external liabilities of the banking sector increased, while its receivables declined, as a combined result of which the sector's net external debt rose by EUR 1.5 billion (Chart 14). The rise in the net indicator was due to the growth in banks' liabilities in the amount of EUR 1.2 billion and the fall in external assets of roughly EUR 300 million. The robust growth in banks' net external liabilities was mostly attributable to

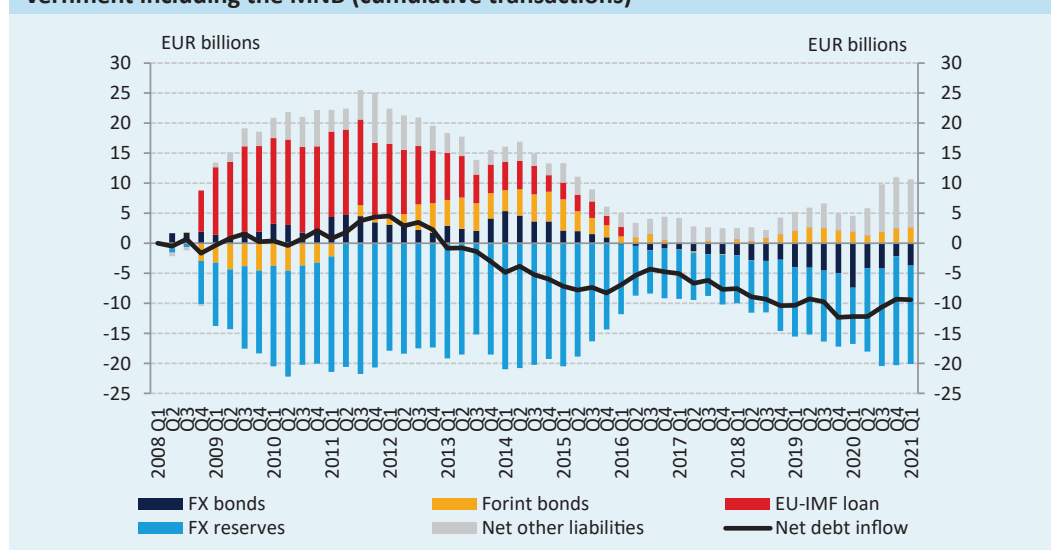
the fact that the amount of the stock of central bank euro liquidity providing swaps used by the banks fell short of the value registered in the previous quarter by EUR 1 billion, which may have impacted both gross legs.

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



The net external debt liabilities of the consolidated general government including the MNB fell slightly, by roughly EUR 0.1 billion, during the reference quarter (Chart 15). The net external debt of the consolidated government was reduced by the fact that banks used less central bank euro liquidity providing swaps compared to the previous quarter, which caused an increase in foreign exchange reserves. On the other hand, foreign exchange reserves were reduced by the government's asset purchases and other disbursements related to the pandemic. Non-residents slightly increased their forint government securities holdings, which raised the government's liabilities by roughly EUR 150 million. The foreign currency bonds expiring in the quarter under review, consisting primarily of a USD bond expiring in March, significantly reduced non-residents' government securities holdings, but also lowered foreign exchange reserves, and thus had no impact on net external debt. As a result of the countervailing effects of the above factors, the government's net external debt declined moderately.

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



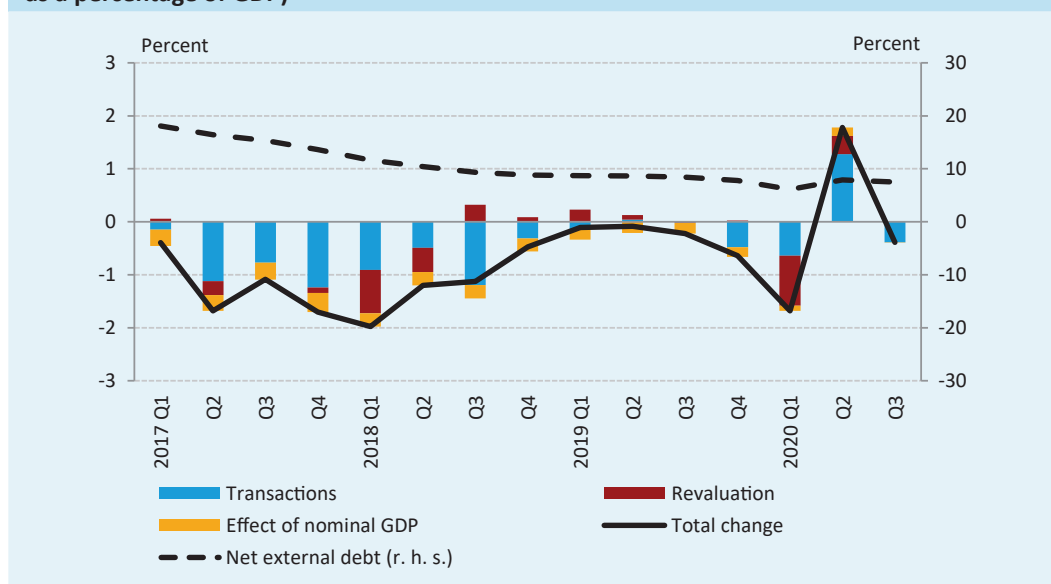
3 Developments in debt ratios

At the end of the quarter, net external debt was close to 8.6 per cent of GDP. The rise in the debt ratio was linked to the banks and was offset by the fall in the debt ratio of the government and corporations. Changes in the banks' and the government's debt ratios were also influenced by the cross-sectoral rebalancing effect of the lower utilisation of the central bank's euro liquidity providing swap instrument compared to the end of the year. As regards the indicator as a percentage of GDP, the effect of the net debt inflow was mitigated by the revaluation effects resulting from the yield increase observed during the quarter and by the restarting of economic growth. Gross external debt amounted to 58.3 per cent of GDP, which was relatively stable due to the combined result of the private sector's rising liabilities and the government's falling external debt. At the end of the quarter, international reserves amounted to EUR 32 billion, providing headroom of EUR 10 billion over short-term external debt, and thus reserves still exceed the level expected and deemed safe by investors.

3.1 Developments in debt indicators

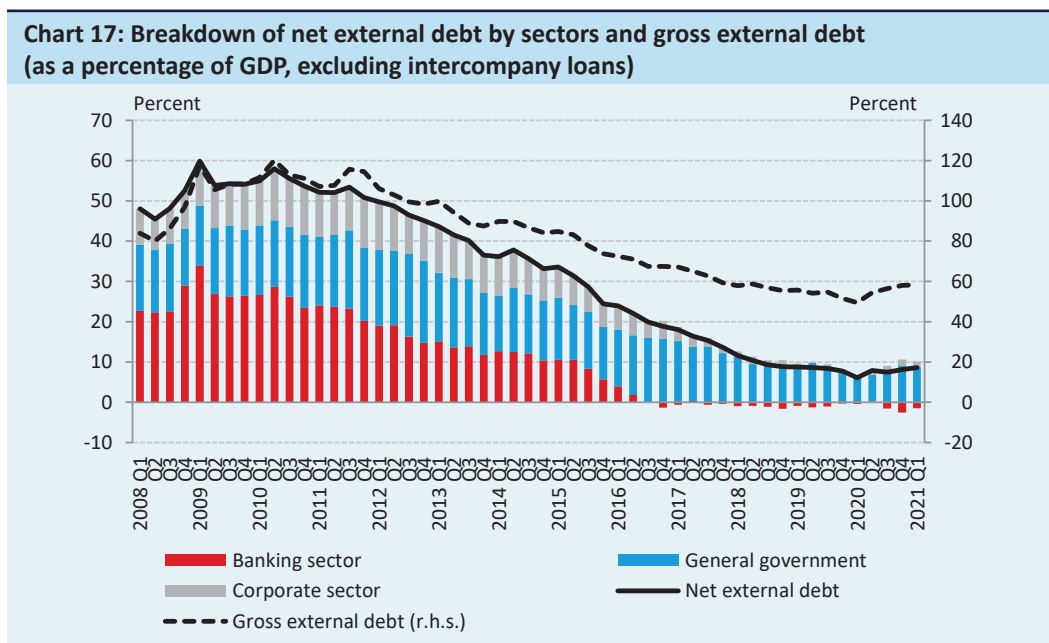
Net external debt stood at 8.6 per cent of GDP at the end of the first quarter. The index was increased by the effect of net debt inflow, which was partly offset by the revaluation of outstanding stocks and the rise in GDP. The revaluation causing a decrease in net external debt was mostly related to the price effect: rising yields led to lower prices of government securities held by non-residents, thereby reducing outstanding debt. In addition, nominal GDP – growing in parallel with the restarting of the economy – also decelerated the rise in the debt ratio due to transactions (Chart 16).

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



The 0.5-percentage point rise in net external debt as a percentage of GDP was linked to banks' net debt inflow, which was offset by the decline in the debt ratio of the government and corporations (Chart 17). The banking sector's net debt ratio rose by 1.1 per cent of GDP, but still remained negative, i.e. banks' stock of external assets exceeds their external liabilities. The rise in the ratio was also attributable to the fall in banks' external assets and the growth in their liabilities, which may have partly been due to the fact that the central bank's euro liquidity providing swaps outstanding at the end of the quarter fell short of that registered in the previous quarter by EUR 1 billion, thus supporting the improvement in the banking sector's external debt ratio to a lesser degree than before. The net external debt of the consolidated general government, including the MNB, fell by 0.5 per cent of GDP, which – in conjunction with a moderate debt outflow – was also connected to the revaluation effect resulting from the fall in the price of government securities held by non-residents. The central bank euro liquidity providing swap instrument had an opposite effect on the government's net external debt compared to that of banks: the provision of a lower volume of foreign currency compared to the end of the year

curbed the fall – related to several other factors – in foreign exchange reserves and thus improved the indicator. The drop in international reserves was mainly related to the foreign currency funding of the government and to the government's foreign currency expenditure, partly connected to the pandemic control measures. On the other hand, the foreign currency bonds expiring during the first quarter reduced the government's external liabilities as well and thus had no effect on the net indicator. The rise in non-residents' foreign government securities holdings due to transactions moderately increased net external debt. Corporations' net external debt as a percentage of GDP declined slightly, falling by 0.1 per cent of GDP: the growth in external assets attributable to commercial loan receivables and the inflow of EU funds exceeded the growth in liabilities, which was linked to commercial loans.



At the end of the first quarter, Hungary's gross external debt as a percentage of GDP amounted to 58.3 per cent of GDP. As a combined result of the rise in the private sector's debt and fall in the government's gross external debt, the debt ratio was relatively stable. The rise in the private sector's gross liabilities was partly linked to the increase in the **banking sector's** short-term outstanding debt, which may have been attributable to the lower level of foreign currency acquired through the central bank euro liquidity providing swaps compared to the end of the year, which allowed for smaller deleveraging than the adjustment at the end of the year. In addition, the rise in **corporations'** outstanding external debt also raised the gross index, which was primarily connected – in parallel with the restarting of the economy – to the growth in commercial loan debts.

The fall in the gross external debt of the consolidated general government **including the MNB** was primarily related to the redemption of the foreign currency bonds expiring during the quarter. In addition, the lower utilisation of the central bank euro liquidity providing swap facility compared to the end of 2020 also contributed to the lower debt ratio. The impact of these factors was partly offset by the rise in non-residents' government securities holdings and the effect of the foreign currency loan drawdowns during the quarter. The revaluation of stocks – related to the higher yields resulting from the price change – also contributed to the decline in the government's gross external debt.

3.2 Foreign exchange reserves and reserve adequacy

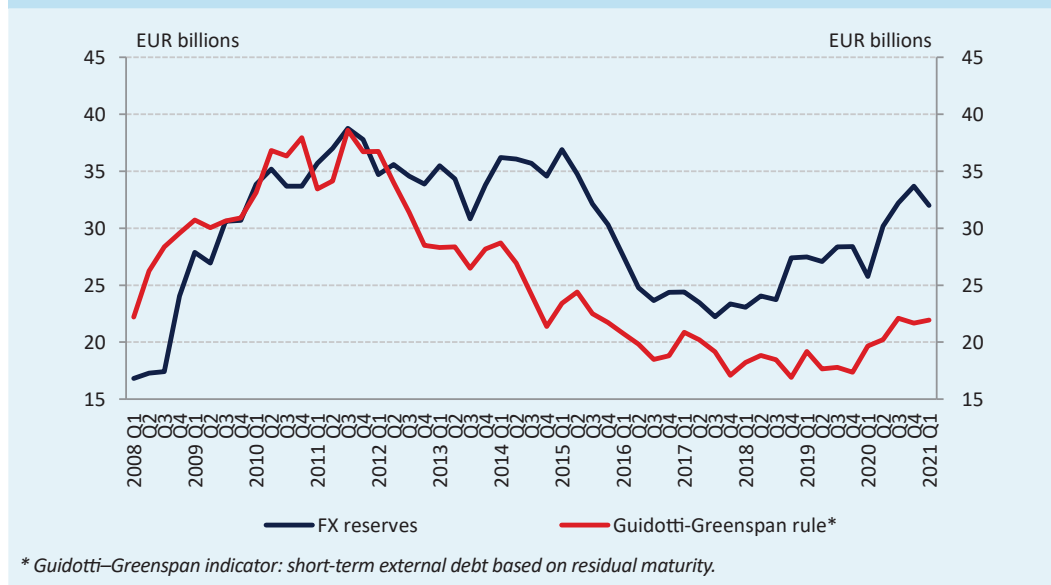
Compared to December 2020, the level of FX reserves decreased by EUR 1.7 billion in 2021 Q1, and amounted to EUR 32 billion at end of the first quarter. The development of reserves was affected by various factors, the most important of which were the following:

- The *net FX financing of the Government Debt Management Agency (ÁKK)* lowered reserves by EUR 1.5 billion in total, which reflected the expiration of a larger stock of USD bonds in March.

- The reserve reducing effect of the *Hungarian State Treasury's foreign currency transactions* amounted to almost EUR 0.7 billion.
- The change in the stock of the forint liquidity providing FX swap instrument reduced the reserve level by nearly EUR 0.2 billion. The forint equivalent of the outstanding swap contracts declined from HUF 1,606 billion to HUF 1,553 billion. The euro equivalent of the outstanding stock at the end of March 2021 was EUR 4.3 billion.
- The reserve-increasing effect of *EU funds* was some EUR 0.7 billion, resulting primarily from agricultural subsidy programmes.
- The exchange rate change of other currencies against the euro, and the *revaluation* of gold expressed in euro boosted foreign exchange reserves by almost EUR 0.2 billion.
- The balance of the lower *utilisation of the euro liquidity providing swap instruments* compared to the end of the year and of the *drawdowns of international repos* increased reserves to a small degree.

At the end of 2021 Q1, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 10.1 billion. At end-March 2021, international reserves and short-term external debt amounted to EUR 32.0 billion and EUR 21.9 billion, respectively. The moderate rise in short-term external debt during the first quarter occurred in parallel with a rise in the private sector's short-term external debt and a fall in the short-term debt of the consolidated general government including the MNB. Accordingly, the headroom above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, still exceeds EUR 10 billion, providing particularly strong reserve adequacy (Chart 18).

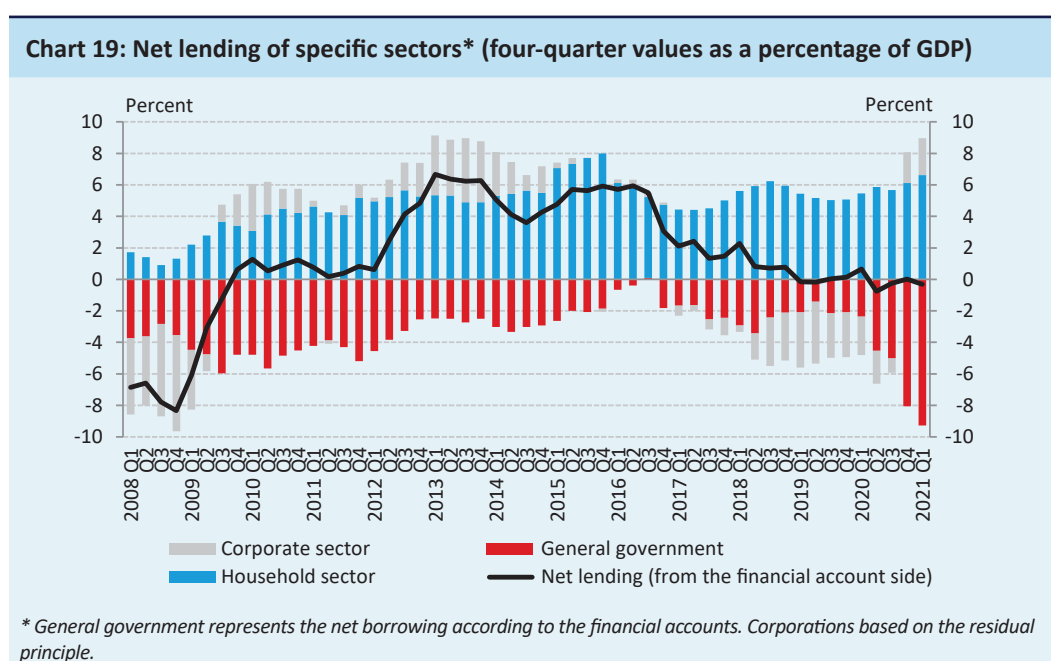
Chart 18: Short-term external debt of the Hungarian economy and foreign exchange reserves



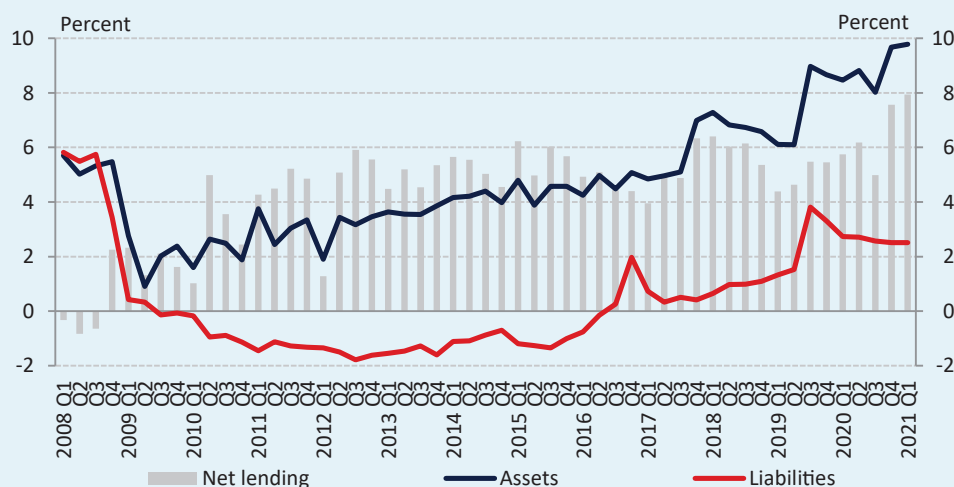
4 Sectors' savings approach

Examining the external balance positions based on the sectors' savings approach, it can be seen that the general government's net borrowing increased further. The higher budget deficit is attributable to the declining tax revenues and rising expenditures resulting from the pandemic. On the other hand, in parallel with this (and partly also due to the higher government expenditures), the private sector's net financial savings also rose. Households' high net savings are primarily linked to rising financial assets, which affected a wide range of financial instruments, but growth in households' government securities holdings also remained strong.

According to the sectors' savings trends, the rise in the government's net borrowing was broadly offset by the continued improvement in the private sector's position at the beginning of 2021 again, and thus net lending has not changed significantly (Chart 19). The four-quarter budget deficit amounted to around 9 per cent of GDP, reflecting lower revenues due to the contracting economy, the costs of pandemic control measures and expenditures related to economy protection measures. This was broadly offset by the increase in the private sector's net financial savings: in the context of falling domestic absorption and high government expenditures, households' four-quarter net savings rose further to exceed 6 per cent of GDP, while net lending of corporations also exceeded 2 per cent of GDP.

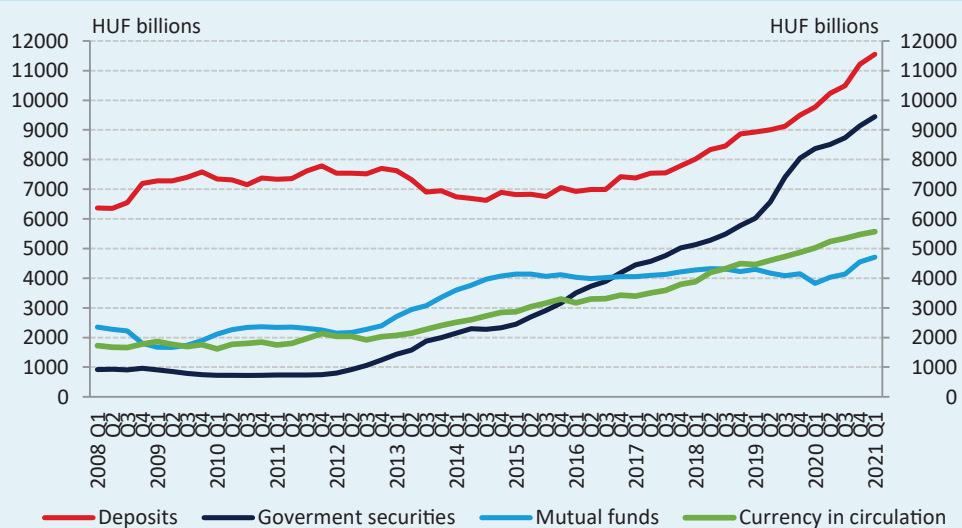


The net financial savings of households, which were significant at the beginning of 2021 as well, primarily stem from the large increase in financial assets, while net new borrowing was broadly stable (Chart 20). The large-scale accumulation of assets by households reflected the combined effect of several factors: on the one hand, caution due to the more uncertain income prospects as a result of the pandemic, and on the other hand the consumption curbing effect of the restrictive measures to control the pandemic, together with saving part of the instalments that declined as a result of the loan moratorium. Households' net new borrowing as a percentage of GDP was around the level observed in previous quarters and was primarily shaped by the drawdown of prenatal baby support loans and housing loans. However, it should be noted that the drawdown of these loans may have also contributed to the high growth in financial instruments: the prenatal baby support loans may have been temporarily channelled into financial instruments, while loans taken for purchasing a used home increase the financial assets of another household.

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 significant growth in households' financial assets affected a wide range of instruments, but growth in government securities also continued to be significant (Chart 21). The pandemic presumably influenced households' asset allocation decisions at the beginning of 2021 as well, which was reflected in the continued strong demand for liquid forms of saving: growth in current account deposits exceeded HUF 300 billion, which is almost twice as high as the year-on-year value, while demand for cash also remained robust. Similar to previous quarters, households' financial assets held in investment funds rose further, and households were also net buyers in the equity market in the first quarter. In early 2021, a significant amount of household savings, i.e. more than HUF 300 billion, continued to flow into the government securities market, with the Hungarian Government Security Plus (MÁP+) scheme remaining the most popular: its stock increased by more than HUF 300 billion in the first quarter. The decline in the shorter-maturity 1MAP securities decelerated to some extent, while PMAP securities also decreased by HUF 180 billion. Overall, the growth in households' government securities holding continued to support the financing of the government from internal funds.

Chart 21: Developments in households' key financial assets

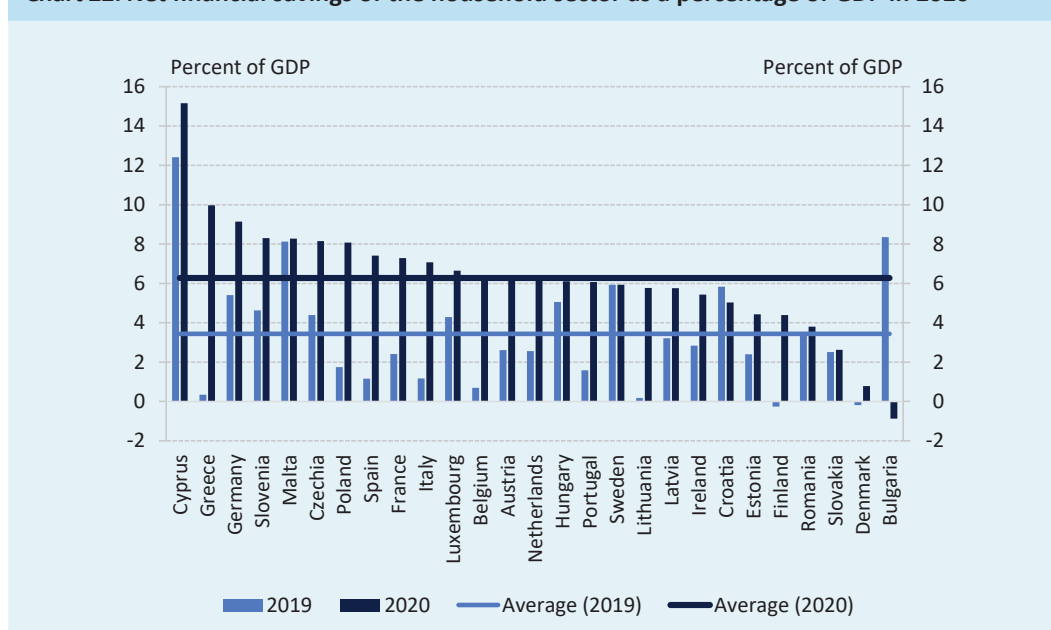
5 How may households' financial savings develop after reopening?

In our special topic, we examine how households' financial savings may change once the pandemic is over. In 2020, as a result of the coronavirus, households' financial savings rose significantly in the EU countries. The type of savings trends after a rapid economic recovery and the degree to which savings – after having risen during the crisis – may fall are of key importance for the balance of the economy. Major declines in savings are relatively rare in EU countries, and such cases were usually associated more with the period of rapid growth prior to 2008. A larger decline in savings as a percentage of GDP in Hungary was also linked to rapid credit growth in the early 2000s. In 2020, as an economic impact of the pandemic, households' net financial savings – similar to the situation in the EU countries – also rose in Hungary. However, the degree thereof was moderate, in the context of a mild decline in consumption by international standards and a relatively stable labour market. In the European countries, savings fall in parallel with a more robust increase in consumption and a decline in unemployment (i.e. as precautionary motives fade). Based on the lessons from the 2008 crisis, this is expected to take place gradually over a period of several years. In Hungary, the temporary effects of a surge in consumption in parallel with the reopening of the economy are expected to be accompanied by a mild decline in savings in the coming years. This is supported by the fact that the fall in consumption in 2020 was moderate compared to the EU, and thus the savings reducing impact of the recovery may also be restrained. Over the longer run, the fundamental trends – low unemployment, the expected future rise in households' income and the expected decline in borrowing dynamics – also point to a steadily high saving rate, supported by several domestic measures (e.g. the tax allowance and reimbursement announced for 2022 and the gradual phase-out of the moratorium on loan instalments).

This special topic in the Report on the Balance of Payments focuses on developments in household savings, as the pandemic has generated major uncertainties about the underlying trends. When the pandemic started, it was not clear whether – as a result of the crisis – households' financial savings would increase as occurred during the 2008 crisis, or the fall in incomes due to the sudden drop in external demand and employment would not allow this. In the previous crisis, households' net financial savings were also increased by the fact that the previous significant borrowing turned into repayment. At the same time, borrowing by households remained subdued in recent years. Accordingly, the “forced savings” related to loans seen after the previous crisis are not able to add to net financial savings in the current case. Moreover, the prenatal loans with favourable conditions may have had an opposite effect (which, at the same time, helps to mitigate the negative impact of the crisis on the economy). **Nevertheless, the restrictions on certain services (e.g. rules affecting places of entertainment, restaurants and accommodation facilities) as well as on movement may have entailed higher savings for households than before in various other respects.** An outline of the domestic real economy developments below is followed by a more detailed presentation of the trends in financial savings and the changes in their composition. Subsequently, the savings of households in EU countries are also examined in order to situate the domestic developments in an international and regional context.

As an economic impact of the pandemic, in 2020 households' net financial savings tended to increase strongly in the EU countries, significantly mitigating the negative impact of the pandemic on the external balance. In the European Union, as a result of the pandemic, there were several factors that curbed growth in households' consumption. Accordingly, despite the lower rate of income growth, the sector's net financial savings as a percentage of GDP rose considerably (Chart 22). In addition to precautionary motives, which strengthened due to rising unemployment, “forced savings” resulting from the lockdowns may have also contributed significantly to this growth. The expansion in households' savings was particularly important when budget deficits surged, as it mitigated the spillover of fiscal imbalances into the external balance. However, it should be also noted that household and corporate transfers, which partly played a role in the deficit, may have also contributed to the increase in the household sector's financial savings.

Chart 22: Net financial savings of the household sector as a percentage of GDP in 2020



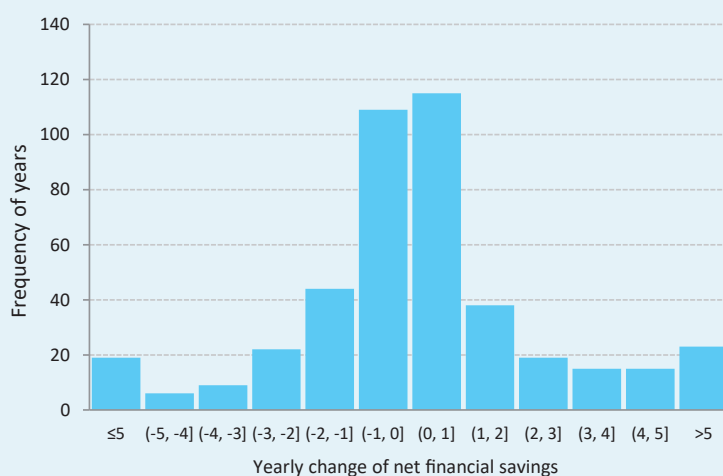
There is a considerable uncertainty about the extent to which the financial savings accumulated during last year may decrease in 2021. In parallel with rising vaccination coverage, the EU countries are steadily reopening their economies and as result of the broadening consumption opportunities some of the formerly accumulated – partly “forced” – savings may also be spent. Accordingly, one of the key issues in 2021 – both in terms of growth and balance – is the degree to which the household saving rate may decline. Accordingly, in our special topic we examine this issue based on past trends: first examining the magnitude of the changes that occurred in households’ financial savings and then the response thereof to major macroeconomic variables, and finally touching upon idiosyncratic factors that inform the Hungarian trends.

5.1 Magnitude of past changes in savings

In the EU countries, households’ net financial savings are typically stable and hardly change at an annual level. However, the rise in savings observed during the previous crisis was followed by a larger decline in some of the countries. According to the savings data available from 2000 (in some countries only from a later date), the household sector’s net financial savings as a percentage of GDP changed in more than two thirds of the cases by not more than 2 per cent of GDP (Chart 23). On the other hand, when examining the more than 430 annual changes there were also 19 years when the saving rate declined by more than 5 percentage points in some of the countries. Apart from the special cases,³ the larger declines typically related to two periods: on the one hand, to the prosperity and abundance of liquidity before 2008, which for households represented persistently favourable income trend and significant borrowing; and on the other hand, to the post-crisis savings adjustments (e.g. in Greece, Bulgaria, Latvia and Lithuania). By contrast, the large (over 5-percentage point) increases were strongly related to the elevated caution after the crises, as the cases usually reflect the surges in savings observed in 2009 and 2020.

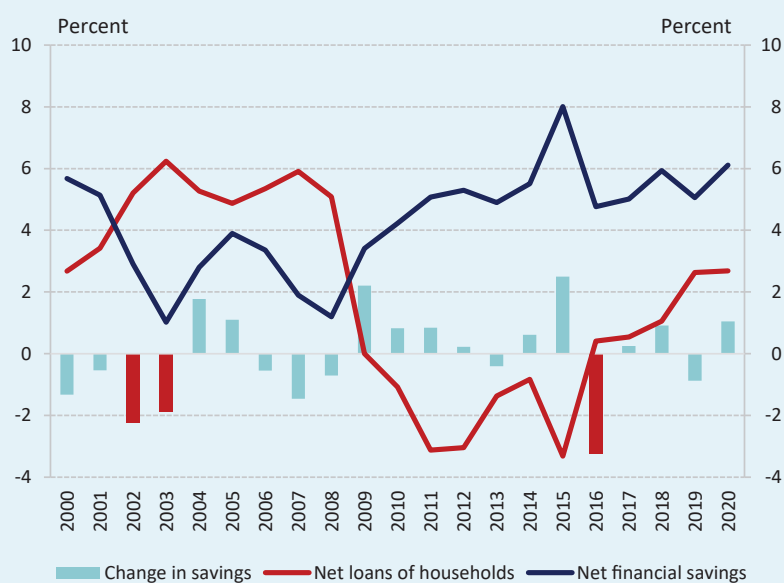
³ Almost one quarter of the larger declines are related to Romania, where the shift of contribution payments between corporations and private individuals in recent years contributed to the decline observed in the saving rate. In Lithuania, the fall of 15 percentage points, as a percentage of GDP, in savings in the form of non-listed equities, was also presumably attributable to a factor independent of households’ savings intentions, which in some years was accompanied by a significant reduction in financial instruments.

Chart 23: Distribution of the annual change in households' net financial savings a percentage of GDP (based on the data of EU countries available from 2000, excluding Malta and Cyprus)



In Hungary, compared to other countries, households' financial savings appear to be particularly stable, and in the past they declined at a rate slightly exceeding 2 percentage points only as result of the major change in borrowing. In the past two decades, the Hungarian saving rate fluctuated in a relatively narrow – i.e. 1-8 per cent of GDP – band, while in the countries of the region the fluctuation of households' financial savings as a percentage of GDP was as high as 18-20 per cent. Accordingly, the Hungarian saving rate only declined by roughly 2 per cent or more in three individual years, each of which was characterised by a significant change in borrowing (Chart 24). In 2002-2003, the decline in net financial savings was caused by the easing of earlier liquidity constraints and the unprecedented surge in borrowing resulting from the housing loan subsidy scheme. On the other hand, in 2015 the financial saving rate jumped higher due to the settlement and conversion of foreign currency loans into forint, and then during the adjustment in the year after households' net lending declined.

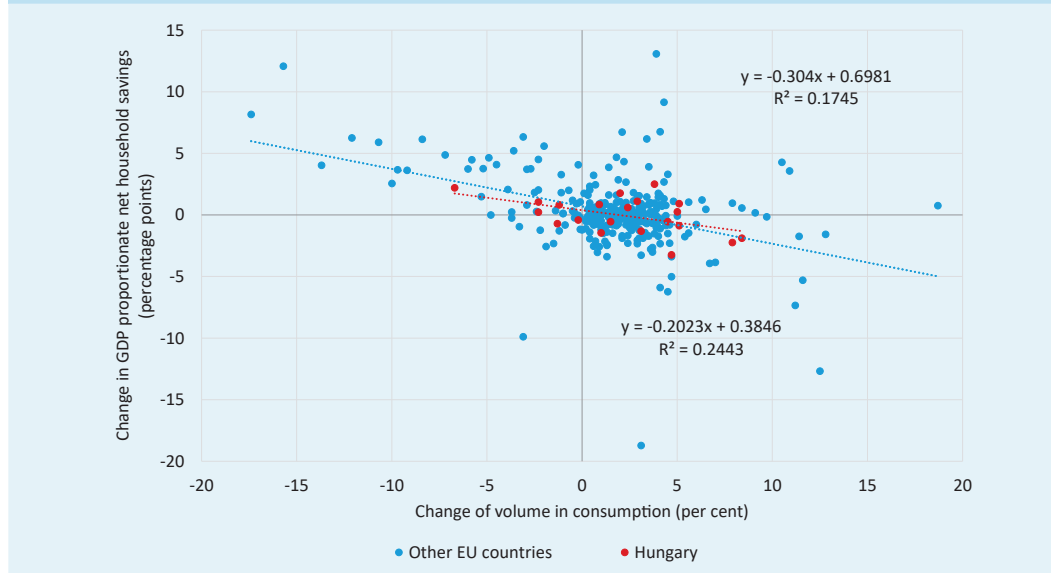
Chart 24: Net financial saving of Hungarian households as percentage of GDP and it changes



5.2 Impact of key macroeconomic variables

In addition to the negative correlation between consumption and savings, simultaneous growth in the two variables has also occurred on several occasions (Chart 25). There are numerous macro variables that may influence developments in savings or reflect the changes in households' financial savings. One of the strongest correlations across the EU countries is found with changes in household consumption, as a fall in household consumption (typically during crises) is generally accompanied by an increase in household savings as a percentage of GDP. However, the change is not so obvious when consumption increases: whereas savings tend to decline in parallel with growth in consumption, there are also several cases when households' financial savings rose substantially even as consumption increased. This is presumably attributable to the fact that a rising wage bill in conjunction with stable GDP growth may provide sufficient funds for a simultaneous rise in consumption and savings. It is also obvious from the chart that the volatility of the Hungarian saving rate is much smaller and that households' net lending responds more weakly to consumption growth compared to the trends observed in other European countries (the steepness of the trend line is smaller): even relatively large real growth of 7-8 per cent in consumption was not accompanied by strong growth in financial savings.

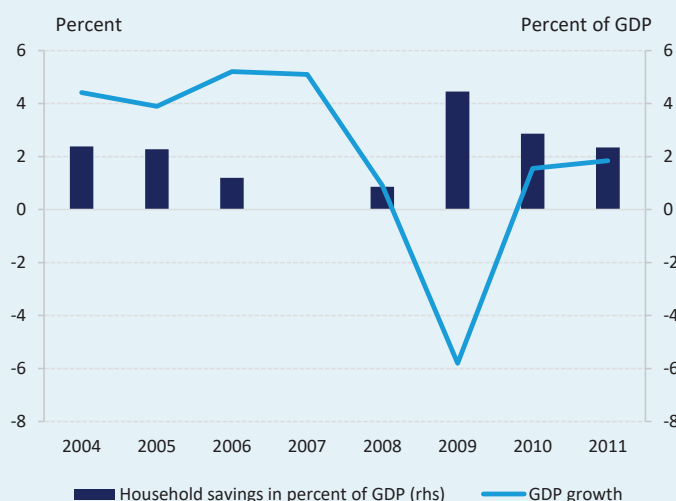
Chart 25: Growth in the volume of household consumption and changes in households' financial savings as a percentage of GDP



Households tend to react to rising uncertainty due to unemployment by increasing their financial savings, the impact of which is only later reduced by households' lower income (Chart 26). Another relatively easy-to-understand correlation is that rising unemployment is usually accompanied by an increase in households' financial savings. This is because the rise in unemployment is usually also accompanied by growing uncertainty, when the household sector typically tries to boost the value of its financial reserves. Increasing unemployment may be perceived by households as a higher probability of unemployment, which leads to higher savings. Naturally, the effect of this is mitigated by the fact that the total income received by households declines – due to lower employment as a result of higher unemployment – and thus the amount that households can save is lower.

Chart 26: Unemployment and changes in net financial savings as a percentage of GDP in the EU Member States

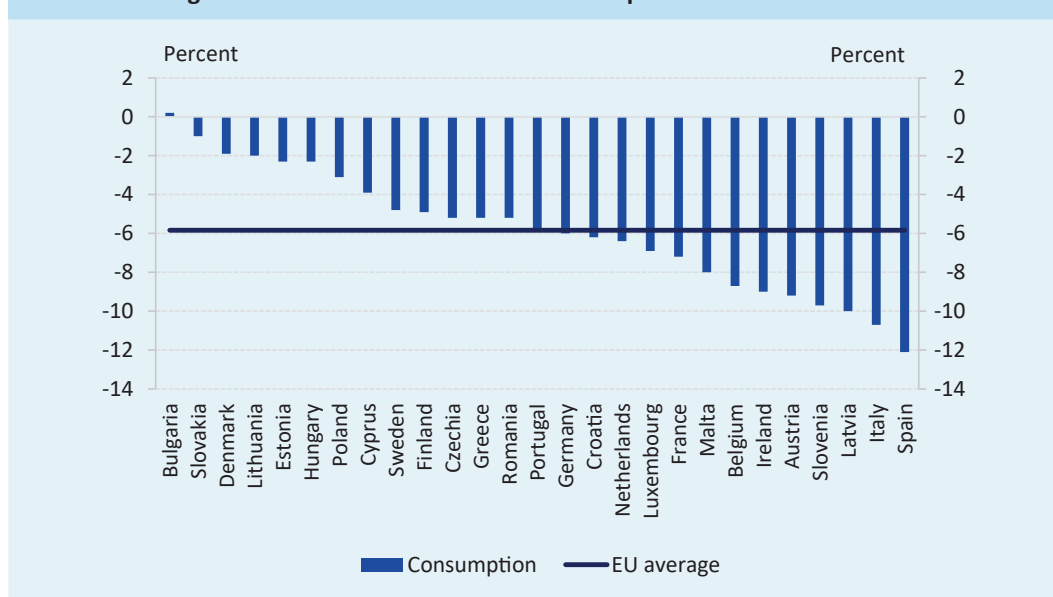
In the EU Member States, the rapid growth – which was also based on the abundant liquidity before the 2009 crisis – was accompanied by a fall in savings, while the economic downturn caused by the crisis was accompanied by a rise in net financial savings, after which savings gradually adjusted to their previous levels as GDP grew in the following years (Chart 27). Households' financial savings as a percentage of GDP gradually declined on average for the EU countries during the period of fast growth with abundant liquidity observed in the pre-crisis years. In line with the fall in GDP in the second half of 2008, households' savings rose already that year, increasing further in 2009 as a result of the sharper economic downturn. Then, as GDP returned to a growth path, in 2010-2011 households' net financial savings gradually declined. Accordingly, based on the experiences of the EU countries, the contraction of the economy was accompanied by a substantial rise in households' financial savings on average, which then returned to the previous "normal" level in about 2 years.

Chart 27: Change in GDP growth and in savings as a percentage of GDP

5.3 What can we expect in the period ahead?

Hungary has seen one of the smallest declines in household consumption, which – together with the low unemployment both by international standards and based on time series – may point to a moderate decline in savings in 2021. As presented above, growth in household consumption in 2021 may be a defining factor for developments in savings in 2021. On the other hand, the decline in Hungarian household consumption in 2020 was one of the lowest in the EU and was well below the EU average (Chart 28). As a result, consumption growth is expected to remain relatively low in 2021, also due to the comparatively high base, which may lead to a moderate decline in savings versus EU countries. This is also implied by the central bank's latest forecast – published in its June Inflation Report – according to which household consumption growth in 2021 is expected to be close to the growth rate of 5 per cent registered in 2019. A moderate decline in savings is also suggested by the fact that unemployment in Hungary was particularly low – merely 4.3 per cent compared to the EU average of 6.8 per cent – and thus the expected fall in unemployment may also have only a minor effect on savings.

Chart 28: Changes in the volume of household consumption in 2020



A moderate decline in savings is supported by a number of measures in Hungary. In addition to the smaller changes in consumption and unemployment compared to other countries, fundamental factors and domestic economic policy measures also suggest a more moderate decline in savings:

- As the third wave of the pandemic subsides, **household incomes** may once again rise at a faster rate, and thus even in conjunction with a significant increase in consumption, financial savings will not necessarily fall more sharply.
- During the pandemic, many households were faced with the vulnerability of their financial position, and thus as income conditions return to normal following the crisis, it is likely that more households will increase their saving rate preparing for a possible future emergency, in order to have sufficient **precautionary reserves**.
- In the coming years, no major growth can be expected in **borrowing** dynamics, which contributed strongly to the decline in financial savings in the past.
- Moreover, the **gradual phase-out of the moratorium on loan instalments** may increase savings, as the decline in loan debts alone represents a rise in net financial savings. This is possible due to the fact that during the moratorium, households may have saved a smaller part of the released income and spent most of it. Loan instalments, which will start to increase as the pandemic ends and household incomes are expected to rise again, will increase households' net lending by reducing their loan debt.
- Finally, we already know of further two measures with a stronger impact that point to growth in household savings in 2022 via a larger increase in income. These include the **reimbursement of personal income tax** to

households with children, and to a smaller degree **the tax allowance for employees below 25** may also increase households' net financial savings.

In the coming years, due to the high saving rate, households' funds will continue to play an important role in financing the growth of the Hungarian economy. As a result of the coronavirus pandemic, in line with past experiences, households' net savings typically rose in the EU countries in 2020. This was primarily attributable to the temporarily rising uncertainty due to the coronavirus and the consumption reducing effect of the lockdowns, as a result of which households boosted their savings. However, based on past experience, these higher savings may adjust within a relatively short time, and as a result savings are expected to fall around the world. However, the degree of this decline is an important issue: what effect will economic reopening have on the sustainability of saving trends. Overall – although the level of forced savings in Hungary is relatively low by EU standards, and thus the shift may be smaller in this respect – in parallel with economic reopening, the surge in demand on the consumption side (particularly in services) may be accompanied by a temporarily faster decline in savings. On the other hand, fundamental trends – growth in income, precautionary savings resulting from the lessons from the pandemic, economic policy measures improving households' financial position – imply that over the longer run the decline in savings may be more moderate in a European comparison. The continued persistently high saving rate supports financing the growth of the Hungarian economy from domestic sources.

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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.

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