REPORT ON THE BALANCE OF PAYMENTS

2021
JANUARY

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

Letters 27
Gábor Bethlen

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

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

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

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

The Report is based on information pertaining to the period ending 21 December 2020.

Summary

Hungary's external balance indicators improved significantly in Q3. The current account balance showed the **highest quarterly surplus of the past three years**, as result of which the four-quarter value of **net lending rose to 2.4 percent of GDP**, considerably exceeding the level observed in 2019. The increase strengthened **Hungary's favourable external balance position in the region**, while net borrowing remains high in a number of countries.

Following the downturn in Q2, which was impacted the most by the pandemic, the **external balance indicators of the Hungarian economy improved substantially in Q3**, **with contributions by all three factors on the real economy side.** Following a sharp decrease in the previous quarter, the **trade surplus expanded for the first time since 2016**. The downturn in tourism and transportation services continued to reduce net exports, but – in conjunction with an upswing in external demand and industrial production –**export growth picked up, while a further decline in domestic demand and a further improvement in the terms of trade decelerated the increase in imports.** As a result of the **lower profits of foreign-owned companies**, the deficit on income balance continued to decline. The **increase in the absorption of EU transfers** improved the external balance of the economy via the transfer balance.

Four-quarter net lending calculated on the basis of financing data also rose slightly in Q3. **Net FDI inflows continued**, and – as a result of domestic actors' higher investments abroad – net portfolio equity liabilities declined further. The **decline in debt liabilities was primarily related to the banking sector**, mainly driven by the FX liquidity temporarily provided by the central bank at the end of the quarter, which resulted in net external debt outflows in the case of banks and debt inflow for the general government consolidated with the MNB.

Following a brief rise in the previous quarter, net external debt dropped to 7.4 percent of GDP by end-September. In relation to the provision of foreign exchange liquidity by the central bank at the end of the quarter, the improvement in the debt indicator along with the economy's net lending was primarily due to the net outflow of debt liabilities of the banking sector, which was partly offset by the debt inflows of the general government consolidated with the MNB and of the corporate sector. **Gross external debt increased slightly, rising to above 56 percent of GDP**, with FX bond issuance by the state, a rise in non-residents' HUF-denominated government securities holdings and the central bank's FX liquidity providing swap facility as contributing factors, as the MNB may also use its repo agreements with international organisations to finance the latter. Foreign exchange reserves grew to a slightly larger degree than short-term external debt, and thus **FX reserves continue to significantly exceed the level expected and deemed safe by investors (by more than EUR 10 billion)**.

Looking at the balance positions according to the savings of sectors, **the general government deficit continued to increase, the effect of which was offset by a further rise in the net financial savings of the private sector**. The containment and economy protection measures as well as the decline in tax revenues were the main causes of the surging deficit. **Households' net financial savings remain high**, in spite of the declining gross components, while **corporate net borrowing fell to zero**. **As a result of the purchases of MÁP+ securities, the increase in households' government securities holdings accelerated in Q3.**

Changes in household savings are examined in more detail as a special topic. The **fall in consumption** as a result of the pandemic increased the sector's net financial savings-to-GDP ratio, despite the weaker expansion of income. Within consumption, **growth in demand for durable goods came to a halt in the past months, and – due to its high import content – this improved the current account balance**. Households' **financial savings tended to increase according to EU countries' experiences as well** in Q2, which is especially important for offsetting the substantial rise in the budget deficit resulting from the pandemic situation. In addition to the **precautionary motive**, **the 'forced savings' due to the containment measures, i.e. the increase in savings as a result of the decline in consumption possibilities, also contributed strongly** to growth in savings. Looking ahead, following the return to normal in Q3, real economy developments **may once again result in higher household savings at end-2020 due to the reintroduction of the restrictive measures regarding to movement**.

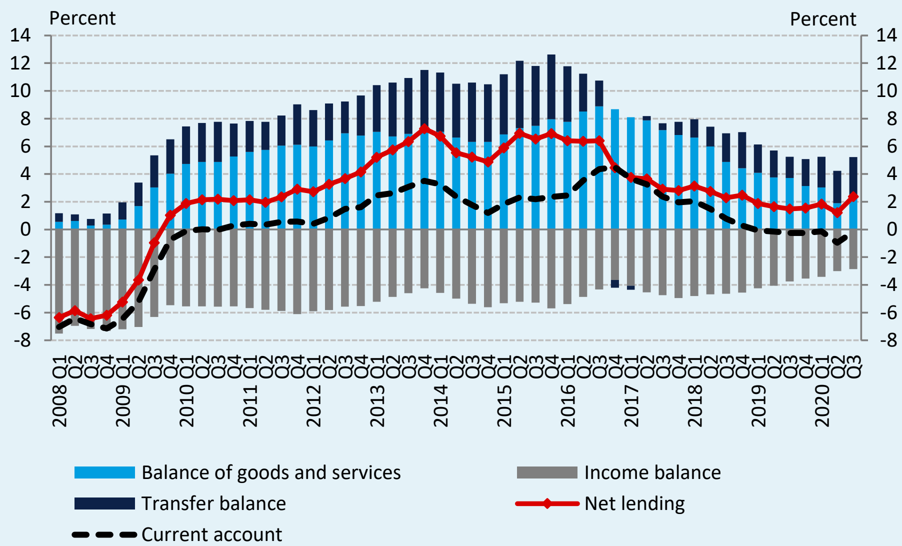
Contents

1 Real economy approach

According to the real economy approach, Hungary's four-quarter net lending rose to 2.4 percent of GDP in 2020 Q3, while the current account deficit fell to 0.2 percent of GDP. The rise in external balance indicators is primarily attributable to the increase in the transfer balance as well as in the trade surplus (in relation to the goods balance), along with a contribution from the modest improvement in the income balance as well. Unlike in the previous quarters, net exports no longer decelerated growth, while favourable changes in the terms of trade continued to play a major role in the rise in the balance. As a result of these developments, net lending of the Hungarian economy remains high in a regional comparison.

In 2020 Q3, Hungary's four-quarter net lending according to the real economy approach rose to 2.4 percent of GDP, while the current account deficit was down considerably compared to the previous quarter, standing at 0.2 percent of GDP (Chart 1). According to *unadjusted quarterly data*, in Q3 net lending amounted to nearly EUR 1.7 billion, as a result of a current account surplus of EUR 752 million in Q3 (following a deficit in the previous quarter) and a capital account balance of EUR 932 million. The increase in four-quarter net lending was primarily attributable to rises in the transfer balance as well as in the goods and services balance, along with a contribution from a moderate decline in the income account deficit.

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

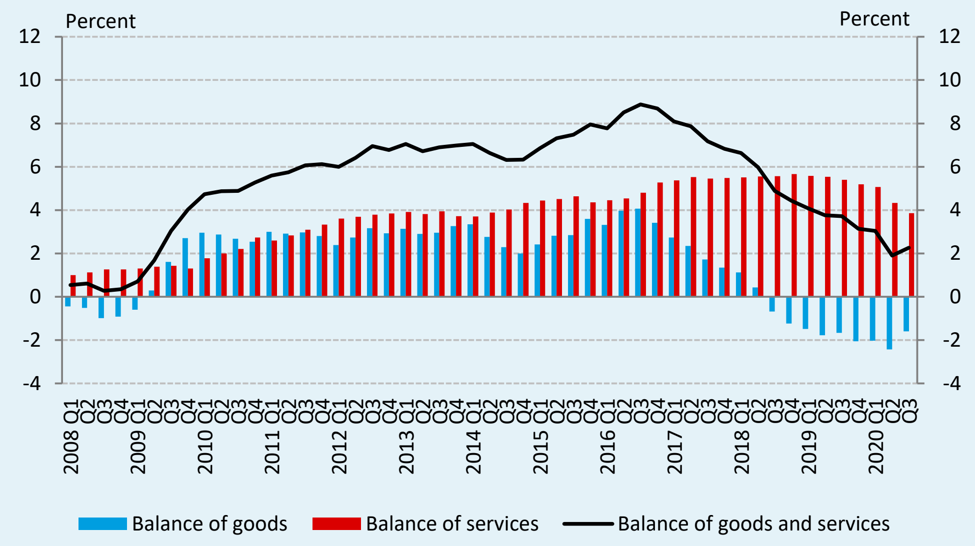


** Income balance: earned income, income on equity and income on debt. Transfer balance: sum of the capital account and other primary and secondary income.*
Unless otherwise indicated, the source of the charts is the MNB..

1.1 Trade balance

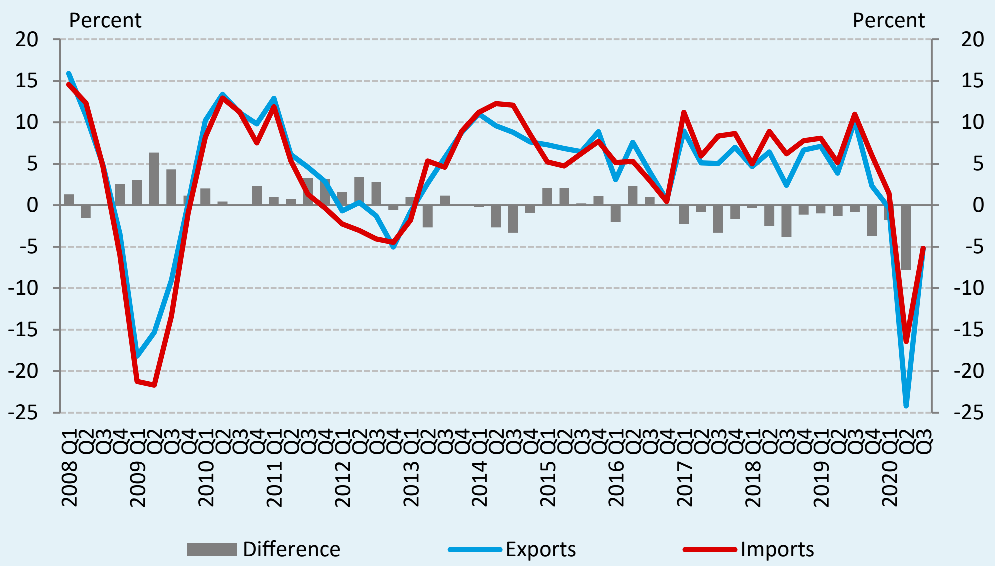
In 2020 Q3, the four-quarter trade surplus rose for the first time since 2016. While a turn took place in the goods balance, the services balance surplus continued to decline as a result of the pandemic (Chart 2). The downward trend in the trade balance, which had lasted for nearly four years, accelerated in 2020 Q2 as a result of the pandemic, but the decline then stopped in Q3, and the balance rose again slightly, because the *goods balance* as a proportion of GDP reduced the trade balance to a much lower degree than in the previous quarters. The *services balance* continues to be a major contributor to the trade surplus, although the surplus of the former fell from the level of nearly 6 percent observed in previous quarters to below 3.9 percent by 2020 Q3. Tourism and transportation services, which represent a major weight within the services balance, declined in Q2, but a slight improvement was seen in both sectors in Q3. Although due to seasonal reasons the balance of tourism exceeded its Q1 and Q2 values, it was still well below its level seen one year earlier. The strengthening cautiousness related to the pandemic and its second wave significantly reduced both the revenue and expenditure components.

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



Although both exports and imports decreased year on year in 2020 Q3, in both of these sectors strong improvement was seen compared to the sharp, pandemic-driven downturn in Q2 (Chart 3). Following a 25-percent drop in Q2, year-on-year real growth in exports only fell by 5 percent in Q3. This means that the sector was able to offset most of the downswing related to Q2, which is in line with the upturn in industrial production in Q3. In September, the export sales of vehicle manufacturing, which has the highest weight in production in Hungary, already exceeded last year's level. Stronger export performance was also reflected in rising imports, but compared to the previous quarter imports expanded more slowly than exports. This was presumably attributable to the import decelerating effect of more subdued household consumption: following a slight rise in the summer months, retail sales in August and September already showed a slight decline year on year – presumably due to the second wave of the pandemic.

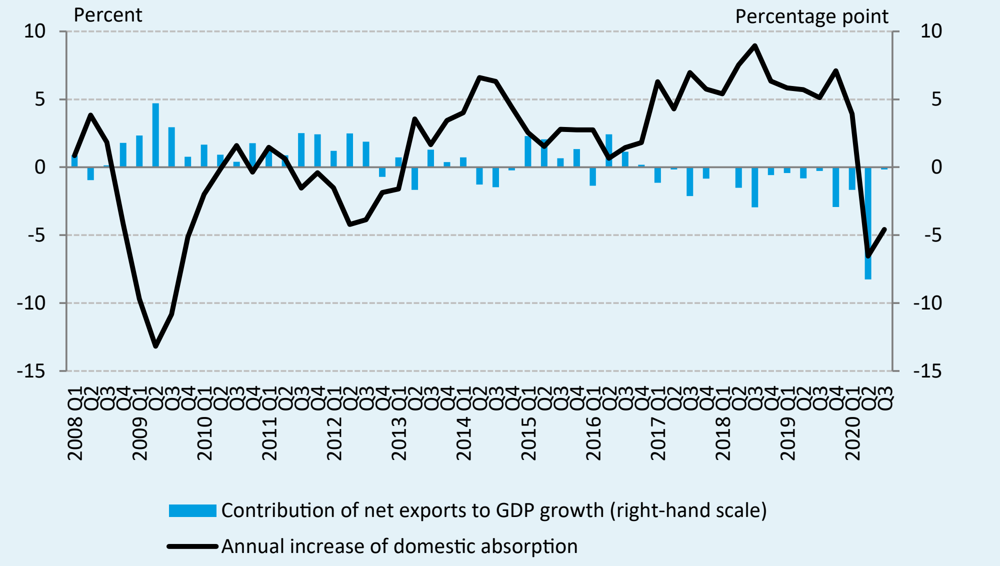
Chart 3: Annual real growth in exports and imports



Source: HCSO and MNB.

The slowdown in the annual growth rate of domestic absorption reversed in Q3: the decline was smaller compared to Q2, and – unlike in the previous quarters – net exports did not decelerate growth (Chart 4). Within domestic absorption items, the drop in household consumption was no longer as significant in Q3 as in the previous quarter, but the growth contribution of government consumption was negative. In addition, the fall in investment, which was even stronger due to the second wave of the pandemic, also restrained growth. As opposed to the year-on-year decline in domestic absorption items, the contribution of net exports no longer restrained economic growth in 2020 Q3 and was more or less neutral.

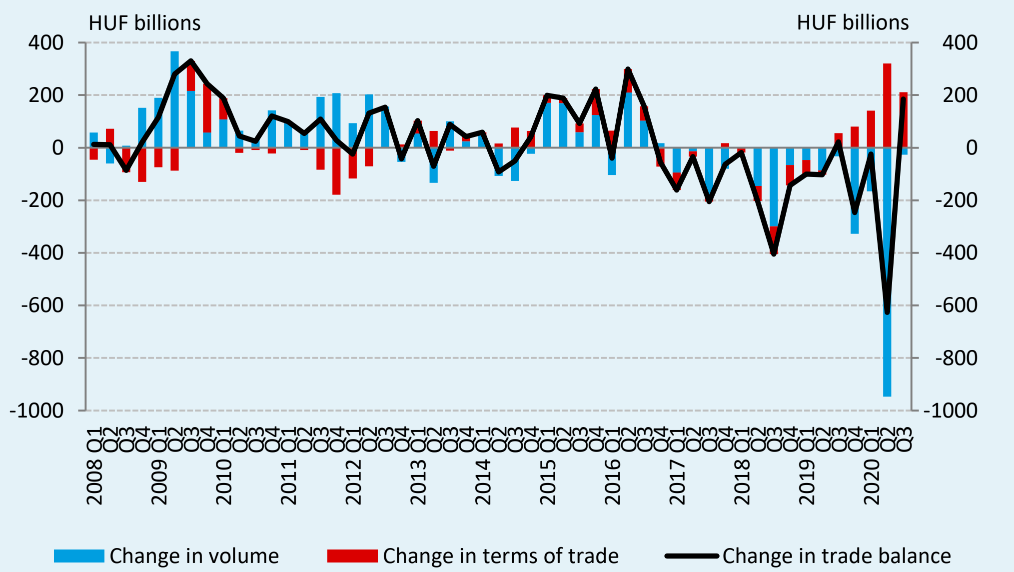
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

An improvement in the terms of trade was the main contributor to the favourable developments in the trade balance in 2020 Q3, while the change in volume only slightly impaired the balance in Q3, following a major fall in the previous quarter. Following a sharp drop in oil prices in Q2, the price of oil stabilised at a somewhat higher level in the summer months, but remained considerably lower than the average value recorded in 2019. Accordingly, the improvement in the terms of trade continued to support the changes in the trade balance, albeit less than in the previous quarter. By contrast, as a result of the growth in export volume compared to the previous quarter, the change related to quantities hardly impaired the trade balance in year-on-year terms (Chart 5).

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

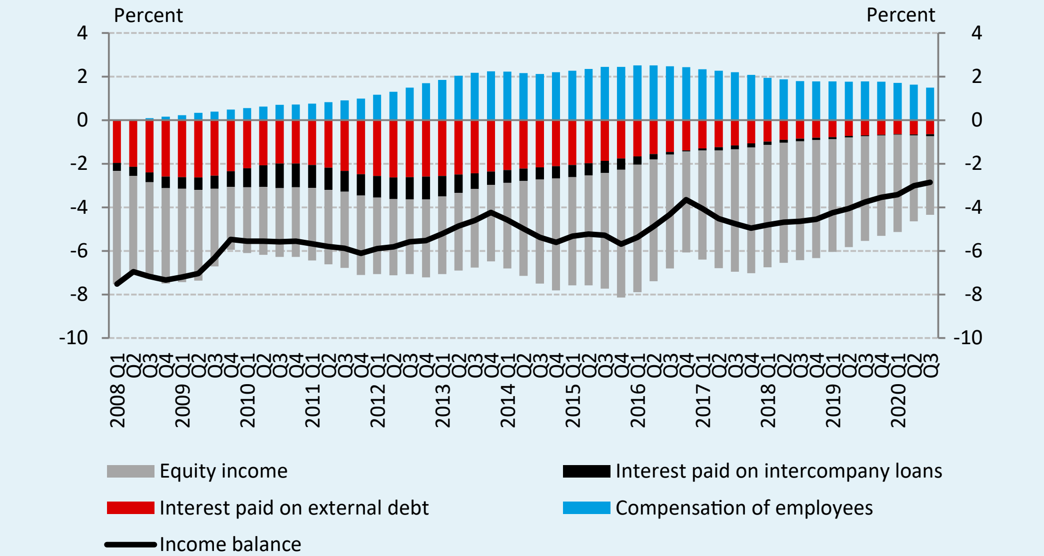


Source: HCSO.

1.2 Income balance

The deficit on the income balance declined further in 2020 Q3, primarily due to the falling profits of foreign-owned companies (Chart 6). The four-quarter deficit on the income balance dropped to 2.9 percent of GDP in Q3, owing to a further decrease in foreign-owned companies' income related to equity,[1] which represent the greatest weight within the income balance. The declining trend since 2018 may also have been exacerbated by the impacts of the pandemic this year. Net interest expenditure related to foreign loans and intercompany loans fell to a low level (around 0.6 percent of GDP). Employees' income from abroad decreased slightly compared to the previous quarter, presumably as a result of lay-offs due to the pandemic and the global downturn in tourism.

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



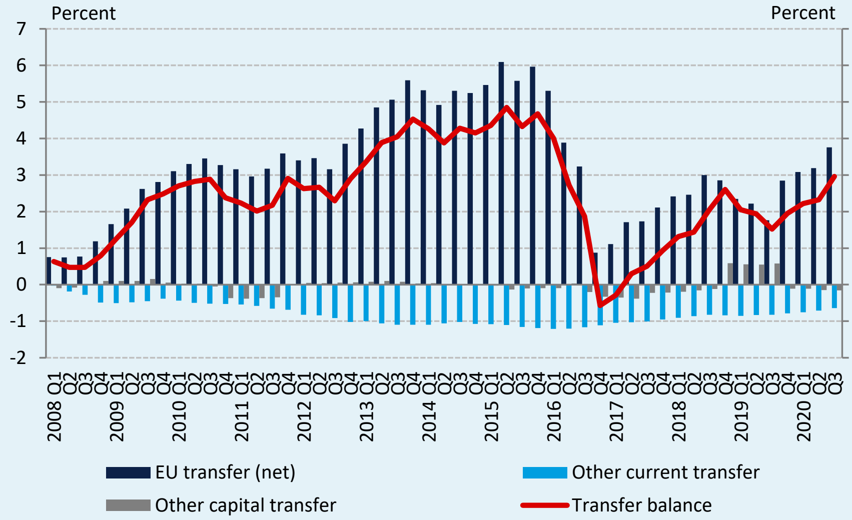
** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

In Q3, the transfer balance surplus as a proportion of GDP rose to a greater degree than before. In 2020 Q3, the transfer balance surplus corresponded to 3 percent of GDP, contributing strongly to maintaining Hungary's favourable external balance position (Chart 7). According to four-quarter data, net inflows of EU funds in 2020 Q3 corresponded to 3.8 percent of GDP, while other current transfers had a less negative impact on the transfer balance than before, with the larger surplus resulting from these two factors. The income of those employed abroad for a short time declined due to the pandemic, and thus the amount of taxes and contributions paid abroad also decreased within the other current transfers item, which contributed modestly to the improvement in the transfer balance.

1 We only have limited quarterly data concerning 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'.

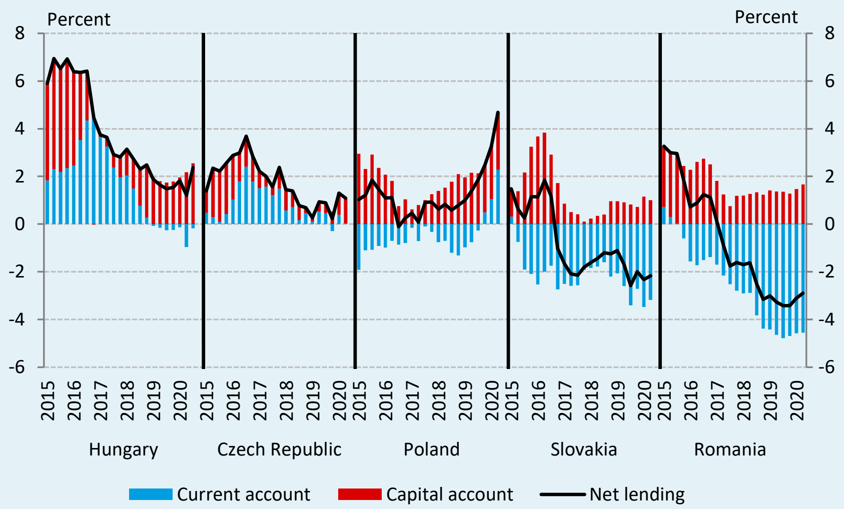
Chart 7: Four-quarter developments in transfer balance (four-quarter values as a percentage of GDP)



1.4 Regional comparison

Net lending typically increased in the countries of the region as a result of the pandemic. In terms of the levels, the external balance position of the Hungarian economy continues to be favourable in a regional comparison (Chart 8). The external balance position is still supported by the surplus on the capital account, which is significant compared to other countries in the region. At the same time, although Hungary's current account balance – and that of the Czech economy – is below the Polish level, it significantly exceeds the figures for Romania or Slovakia. Comparability with the countries of the region is limited by the fact that in the case of the neighbouring countries only 2020 Q2 data are available, and thus the impact of the autumn upswing in the pandemic on the economy is not yet reflected in the regional data. External balance indicators have typically declined in the countries of the region since 2016, which is attributable to the decrease in capital account balances between two EU programming period as well as to declines – related to economic growth – in the countries' current account balances. As a result of the pandemic, net lending picked up in almost all the countries; the figure for Hungary is the second highest among the countries in the region. It is worth highlighting the developments in the external position in Poland, where improvement in external balance indicators has been observed for several quarters: presumably due to the more closed economic structure, the goods balance – as opposed to other countries in the region – has increased considerably since 2019, while the income account deficit has also declined significantly.

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



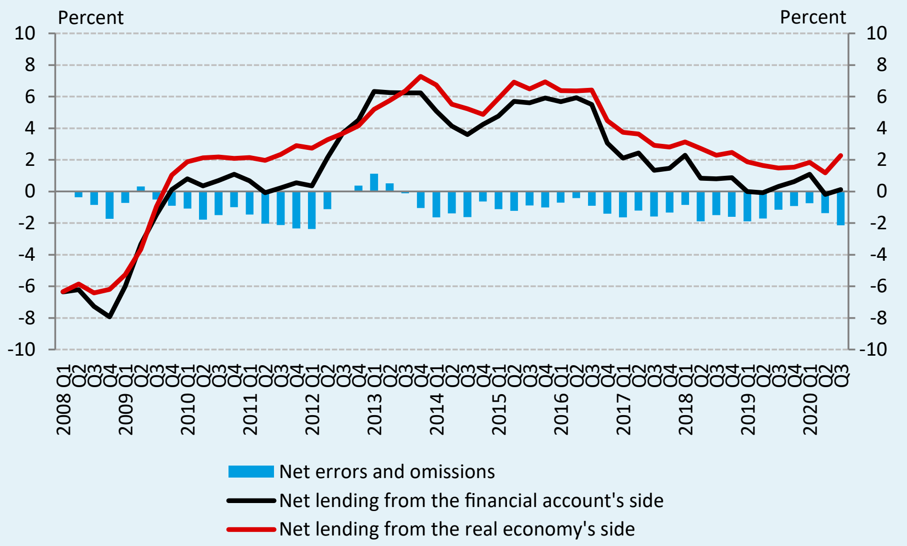
Sources: MNB and Eurostat. Q3 data available for Hungary only .

2 Financing approach

According to the financial account, net lending rose in Q3, and thus according to the financing side as well. Looking at the transactions, net FDI inflows continued, and – as a result of domestic actors' investments abroad – net portfolio equity funds declined further. The decline in debt liabilities was primarily related to the banking sector, which was mainly due to the FX liquidity temporarily provided by the central bank at the end of the quarter.

According to financing data, the four-quarter external balance position of the economy was around zero in 2020 Q3 (Chart 9). Similarly to the real economy approach, four-quarter net lending calculated on the basis of the financing side also rose. The difference between the four-quarter rolling values of the two external balance indicators increased slightly as a result of the faster rise in the indicator calculated using the top-down approach.[2] Accordingly, the four-quarter value of 'Net errors and omissions' increased to 2.2 percent of GDP in Q3, which means that the external liabilities of the economy are declining to a lesser extent than indicated by the real economy.

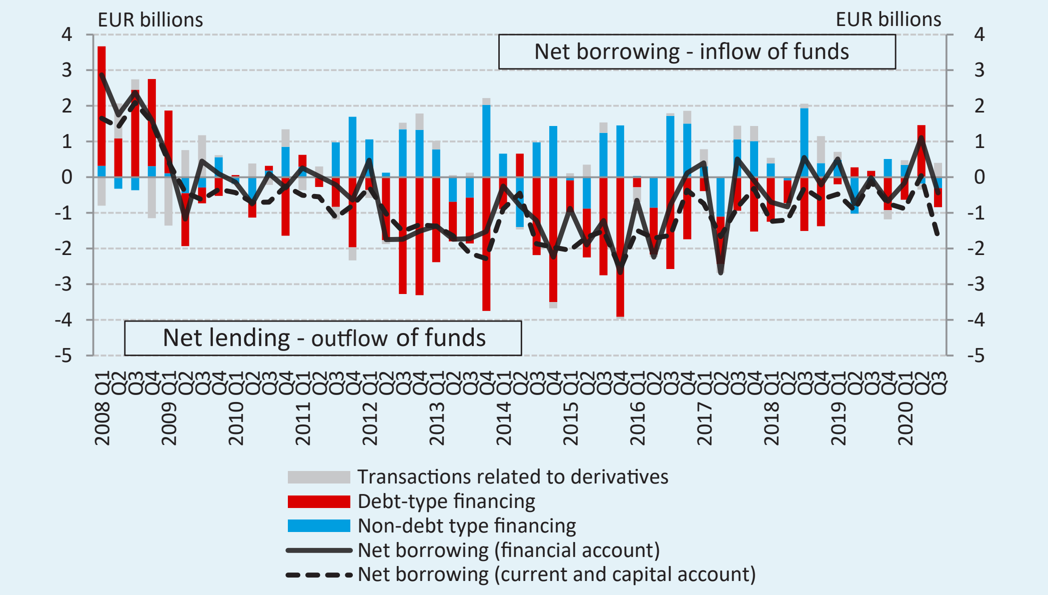
Chart 9: The two types of net lending (four-quarter data as a percentage of GDP)



Looking at the quarterly data, the net external debt of the economy contracted in Q3, as net lending evolved as opposed to the net borrowing of the previous quarter (Chart 10). The change in the sign of the external balance indicator was basically related to the outflow of debt liabilities: while net debt liabilities increased by more than EUR 1.5 billion in Q2, they decreased by EUR 0.5 billion in Q3. Non-debt liabilities fell by nearly EUR 0.3 billion, as net portfolio investments abroad exceeded the slight FDI inflow. As a result of these developments, the external balance position calculated on the basis of the financial account changed from the previous quarter's net borrowing into net lending of more than EUR 0.4 billion in Q3.

2 Developments in the balance of payments can also be described in terms of the financing of real economy transactions, as 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'.

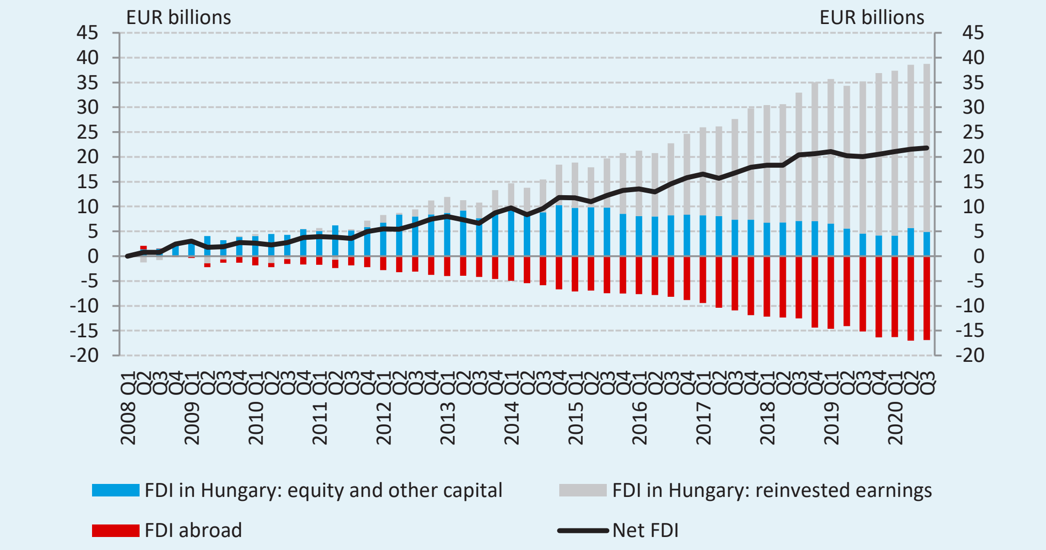
Chart 10: Structure of net lending (unadjusted transactions)



2.1 Non-debt liabilities

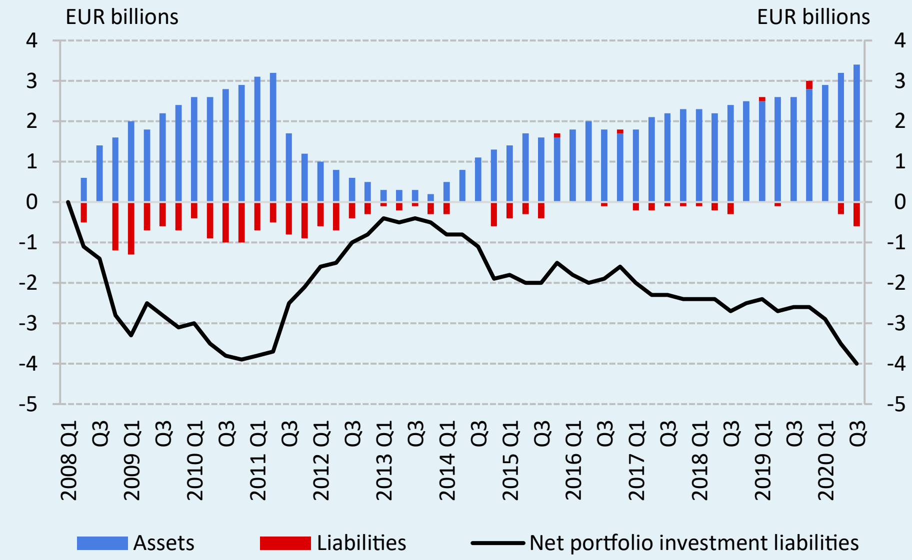
Net FDI continued to expand, which was primarily a result of the reinvestment of income, while equities were slightly reduced by dividend disbursements (Chart 11). Based on data excluding capital-in-transit transactions and asset portfolio restructuring, net FDI inflows amounted to EUR 0.2 billion in Q3. Once again FDI growth was primarily attributable to reinvested earnings, while both equities and intercompany loans declined slightly.

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



Net portfolio equity investments continued to decline, falling by EUR 520 million in Q3 against the background of stronger investment abroad and lower portfolio liabilities. Despite the net FDI inflow, outflows were still observed in the case of non-debt liabilities, which is attributable to the continued net outflow of portfolio investments due to two factors. Firstly, non-residents' stock investments in Hungary are declining, dropping by nearly EUR 280 million in Q3. Secondly, residents' investments abroad increased by some EUR 240 million, which is mainly reflected in the growth in equity and to a lesser degree in the increase in mutual fund shares. The underlying reason may have been that domestic investors considered the falling stock market prices as favourable entry points, and thus already boosted the value of their foreign investments for the second quarter.

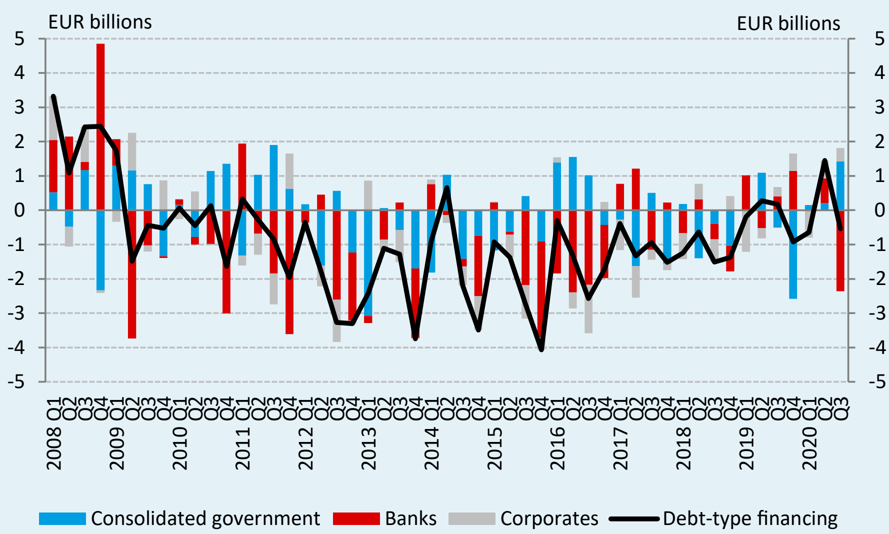
Chart 12: Developments in net portfolio equity and mutual fund share liabilities (cumulative transactions)



2.2 Debt liabilities

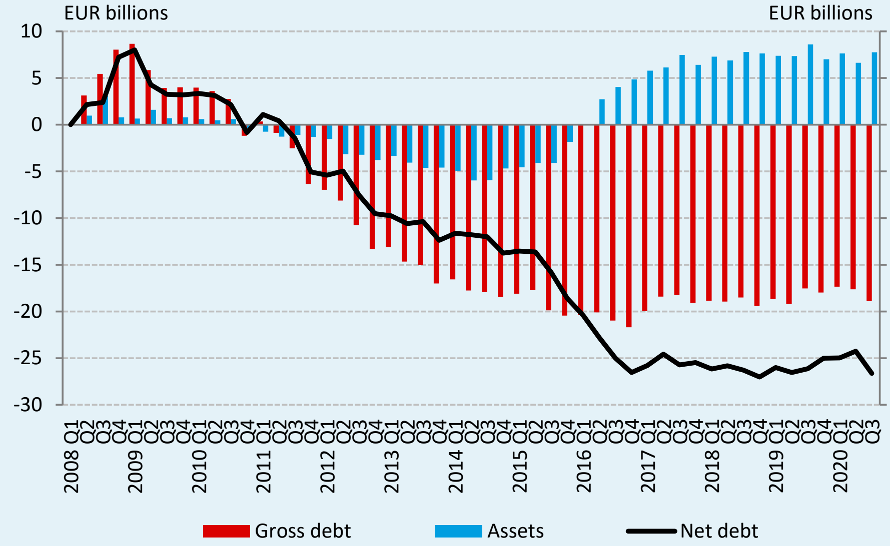
In terms of its external liabilities, the Hungarian economy became a net repayer again in Q3, which mainly materialised in the banking sector as a result of the liquidity originating from the central bank (Chart 13). In Q3, the net external debt of banks as a result of transactions declined by some EUR 2.4 billion, while the indicator for the general government including the MNB increased by EUR 1.4 billion. A significant role in the contrasting developments in the indicators for the two sectors was played by the FX liquidity provided temporarily for the banking sector at the end of the quarter, which added to the indicator of the consolidated general government, while reducing the indicator of banks by EUR 1.1 billion. Corporations' net external debt increased slightly during the quarter, as foreign assets declined.

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



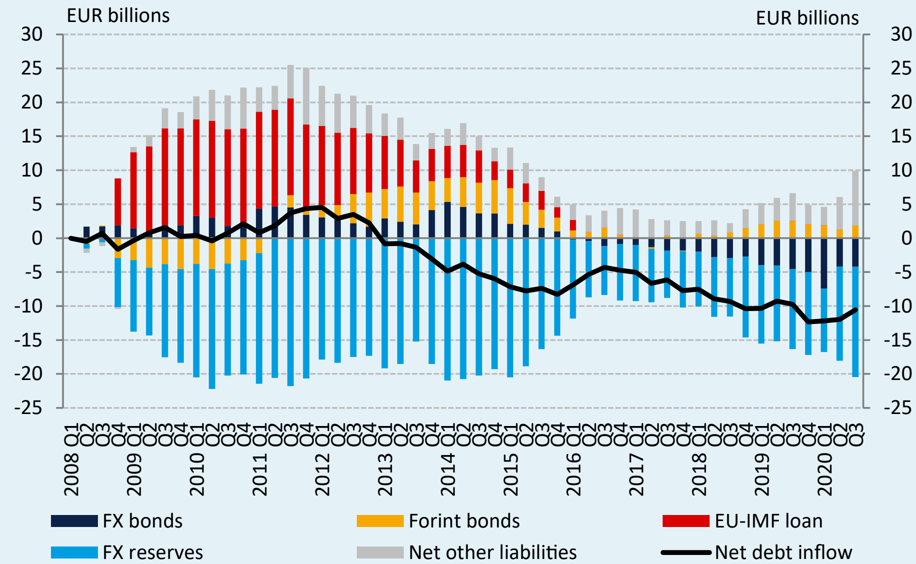
The foreign liabilities of the banking sector declined, while its assets increased. Accordingly, both sides contributed to the decline of EUR 2.4 billion in the sector's net external debt (Chart 14). In addition to the expansion in central bank FX liquidity, the increase in households' deposits as a result of the pandemic may also have contributed to the substantial fall in banks' net liabilities. The decline in net liabilities was reflected not only in the expansion in assets but also in the decrease in banks' external debt, affecting the sector's short- and long-term liabilities to similar degrees.

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



The net external debt liabilities of the consolidated general government including the MNB increased by EUR 1.4 billion during the quarter, with a major part played by the FX liquidity provided to banks at the end of the quarter (Chart 15). The rise in the net indicator was attributable to the fact that foreign investors increased their role in the market of HUF-denominated government securities during the quarter, purchasing bonds with a value of nearly EUR 600 million. At the end of the quarter, the net external debt of the general government including the MNB was temporarily increased by EUR 1.1 billion by the FX liquidity provided to the banking sector. Without using this facility, net external debt of the consolidated general government would have increased by a mere EUR 300 million. In Q3, the value of FX bonds issued by the state was JPY 62 billion, which increased the external liabilities and FX reserves as well by some EUR 500 million, and thus it did not influence the net indicator. The absorption of EU transfers reduced the net external debt of the economy during the quarter.

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



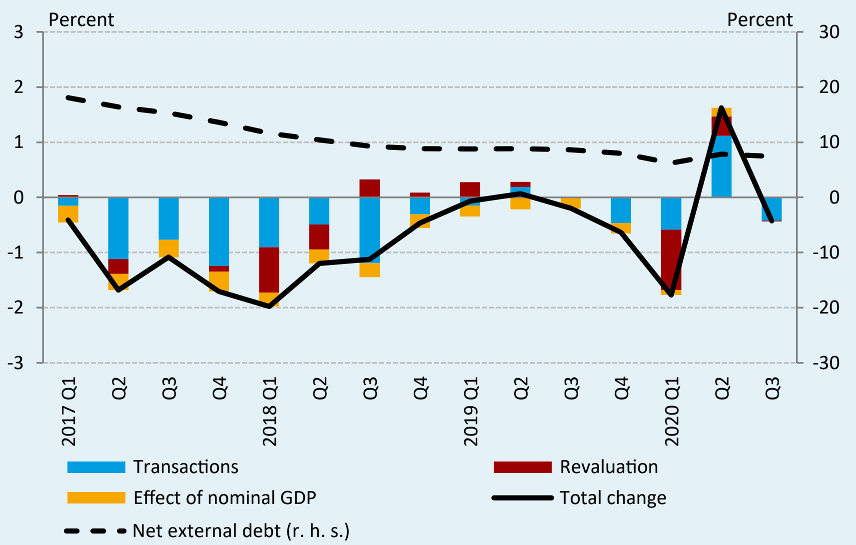
3 Developments in debt ratios

Following a temporary rise in the previous quarter, net external debt declined to 7.4 percent of GDP by end-September. The 0.4-percentage point improvement in the debt indicator was primarily due to the net outflow of debt liabilities of the banking sector, which was partly offset by the debt inflows of the general government consolidated with the MNB and of the corporate sector. The decline in the banks' debt indicator was also attributable to the central bank euro liquidity providing swap facility at the end of the quarter, which – reducing the FX reserves of the MNB – contributed to the rise in the net external debt of the state. Gross external debt advanced to 56.2 percent of GDP, with the FX bond issuance of the state, a rise in non-residents' HUF-denominated government securities holdings and the central bank's FX liquidity providing swap facility as contributors. Foreign exchange reserves grew to a slightly greater degree than short-term external debt, and thus the level of FX reserves continues to significantly exceed the level expected and deemed safe by investors.

3.1 Developments in debt indicators

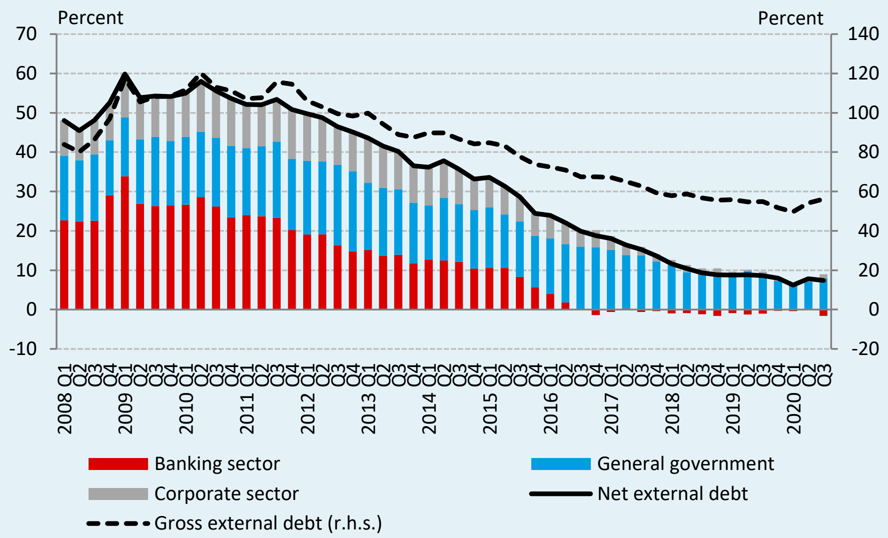
Following a temporary rise in Q2, net external debt declined in line with the debt outflow observed in Q3. The net external debt-to-GDP ratio improved by 0.4 percentage point from end-June, amounting to 7.4 percent at end-September. The fall in debt was related to transactions, while the stabilisation of GDP in nominal terms did not result in any material change in the indicator, and the revaluations stemming from exchange rate and yield changes offset the effects of one another. There are two factors behind the latter: the end-September forint exchange rate, which was weaker than in the previous quarter (due to the larger revaluation of foreign exchange receivables, which exceeded the FX liabilities), resulted in a decrease in net external debt. This impact was offset by the fact that – due to a decline in yields – the government securities held by non-residents reached higher price levels, increasing the debt stock (Chart 16).

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



The improvement in the debt-to-GDP ratio occurred because the increasing net external debt of the general government and companies was more than offset by the fall in the debt ratio of the banking sector (Chart 17). The net external debt of the consolidated general government including the MNB rose by 1 percent of GDP, which was primarily related to the temporary FX reserve reducing effect of the use of the central bank euro liquidity providing swap facility at the end of the quarter. In addition, the increase in non-residents' HUF-denominated government securities holdings also pointed to a rise in net external debt. The JPY-denominated bonds worth EUR 0.5 billion issued by the state added to both the FX reserves and foreign liabilities, thus leaving the level of net external debt unchanged. The central bank's end-of-quarter swap transaction facilitated the improvement in the external debt indicator of the banking sector: the short-term FX liquidity provided to banks contributed to the decline in debt-type foreign liabilities of the sector, while its receivables increased at the end of Q3. The 0.3-percentage point rise in the net external debt-to-GDP ratio of companies was primarily attributable to the decline in foreign assets, while the external liabilities of the sector increased slightly as a result of a rise in commercial loans and a decrease in loans with maturities over one year.

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



In Q3, Hungary's gross external debt increased to 56.2 percent of GDP. The rise in the indicator was mostly related to the consolidated general government including the MNB and to a lesser extent to the corporate sector, while the debt indicator of the banking sector improved. The increase in the gross external liabilities of the state was attributable to the JPY-denominated bond issuance in September as well as to a rise in non-residents' HUF-denominated government securities holdings. In addition, the central bank euro liquidity providing swap facility, for the financing of which the MNB may use its repoline agreements with international organisations as well, also contributed to the rise in the debt indicator. The decline in the private sector's gross external liabilities was related to the decrease in the debt stock of the banking sector, which was partly attributable to the temporary effect of the foreign exchange obtained through the swaps, and which was slightly offset by a rise in corporations' external liabilities. In addition to transactions, revaluation of the outstanding debt – due to exchange rate weakening and price changes related to declines in yields – also contributed to the increase in gross external debt.

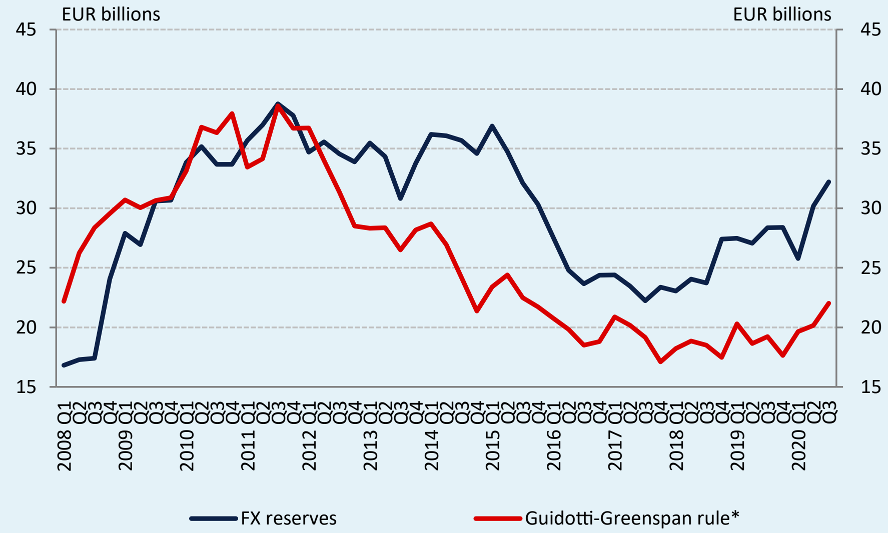
3.2 Foreign exchange reserves and reserve adequacy

The level of FX reserves rose to EUR 32.2 billion by end-September 2020. The development of reserves was affected by various factors, the most important of which were the following:

- ***The reserve-increasing effect of EU funds was nearly EUR 1.2 billion,*** resulting primarily from the payment of performance-based invoices of the 2014–2020 EU programming period and to a lesser degree from agricultural subsidy programmes.
- The ***Government Debt Management Agency*** **(*ÁKK*) issued four new series of JPY-denominated government securities with a total nominal value of EUR 0.5 billion**, which was partly offset by the repayment of the CNY-denominated government security maturing in July as well as the impact of the bond repurchases carried out during the period.
- **During Q3, the *forint liquidity providing FX swap facility*** contributed to the decline in reserves and at the end of the period the *euro liquidity providing swap tenders* had the same effect. Nevertheless, for the financing amounting to a total EUR 1.1 billion of the tenders the **MNB could also use its *repo framework agreements with international organisations***.
- In addition, the FX reserves were slightly reduced by *the usual FX transactions of the Hungarian State Treasury*.

At the end of 2020 Q3, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 10.2 billion. At end-September 2020, international reserves and short-term external debt amounted to EUR 32.2 billion and EUR 22 billion, respectively. The rise in short-term external debt was related to the increase in debt based on original maturity, while the debt whose maturity became shorter declined. Similarly to the end-June level, reserve adequacy compared to short-term external debt remained outstanding: **the leeway above the Guidotti–Greenspan indicator,** which is closely followed by both the central bank and investors**, amounted to EUR 10.2 billion at end-September (Chart 18).**

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



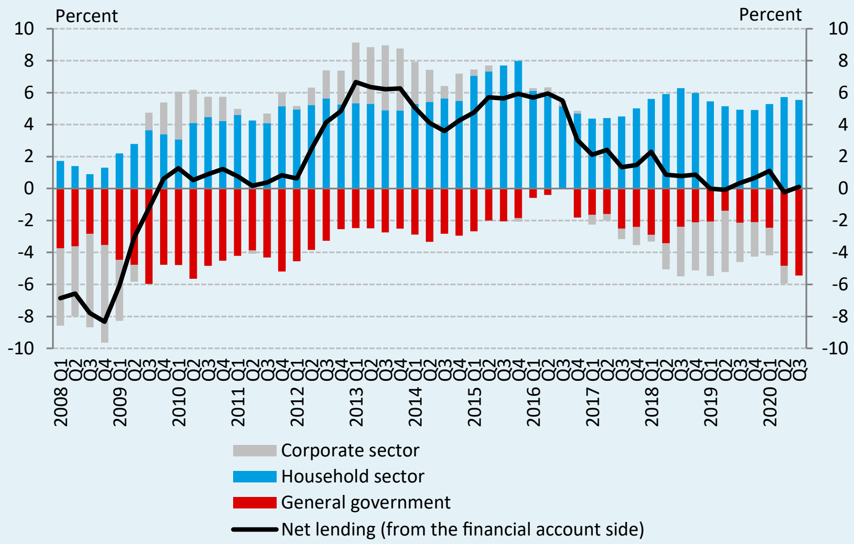
** Guidotti–Greenspan indicator: short-term external debt based on remaining maturity..*

4 Sectors' savings approach

Looking at the balance positions according to the savings of sectors, the general government deficit continued to increase, the effect of which was offset by a further rise in the net financial savings of the private sector. The containment and economy protection measures as well as the decline in tax revenues were the main causes of the strong increase in the deficit. Households' net savings can still be considered high in spite of the declining gross components, while corporate net borrowing fell to zero. Amid increasing uncertainty due to the pandemic situation, most of households' savings continued to flow into liquid assets, but in parallel with that holdings of listed shares and mutual fund shares also increased further, following the drop in prices early in the year. The increase in retail government securities holdings accelerated in Q3 as a result of the purchases of MÁP+ securities.

According to the developments in the sectors' savings, the high deficit of the general government was offset by the further improving position of the private sector, and thus no major change took place in net lending (Chart 19). The four-quarter figure of the budget deficit rose to above 5 percent of GDP as a result of the decline in tax revenues due to the downturn in the economy, the costs of the containment measures and the economy protection expenditures. In relation to the decrease in domestic absorption, households' four-quarter net savings were at a high level, while corporate net borrowing declined significantly, which, on the whole, resulted in a rise in the private sector's net financial savings.

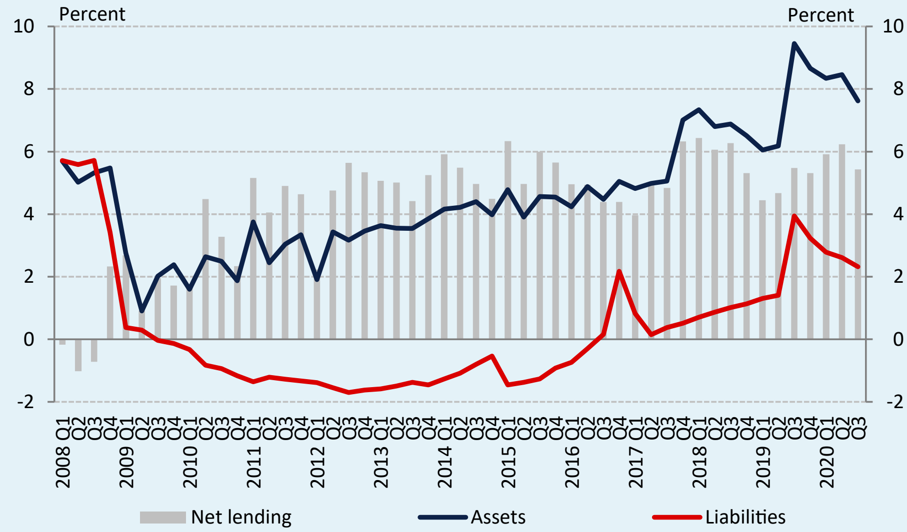
Chart 19: Net lending of specific sectors* (four-quarter values as a percentage of GDP)



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

While the gross components declined, households' net financial savings were down in Q3, although they can still be considered high (Chart 20). As in the previous quarters, the dynamics of households' financial asset accumulation are mainly determined by developments in lending. A significant portion of the increase in borrowing as a result of the introduction of the prenatal loan is reflected – presumably temporarily – in financial assets. Accordingly, the decline in the dynamics of net borrowing decelerated the expansion in financial assets as well in the past quarters. Increasing cautiousness due to the pandemic may have had an impact on the more restrained expansion in lending to households. In spite of the decline that took place in Q3, households' net financial savings are still considered high, in line with the income prospects, which became more uncertain in view of the pandemic, and the consumption restraining effect of the containment measures (for more details see the special topic in the Report).

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

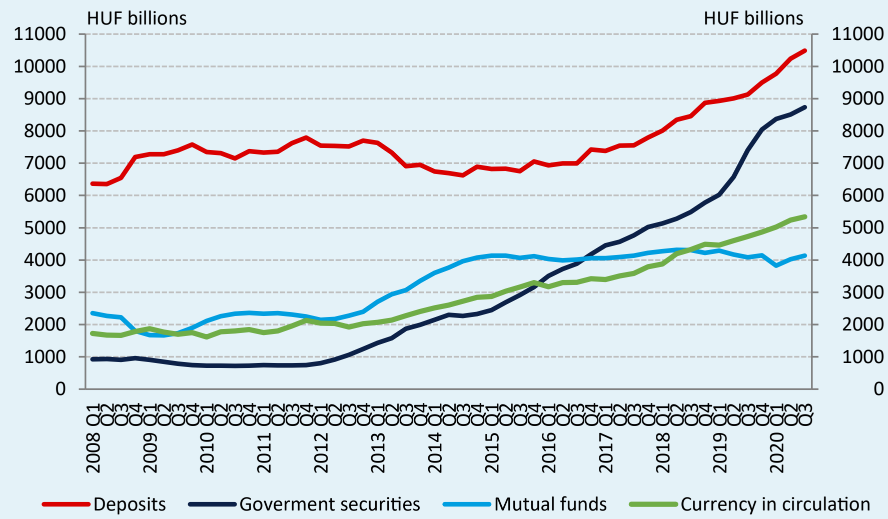


** Figures showing underlying trends, adjusted for the impact of pension savings, the early repayment scheme and the real yield payment, the indemnification of the depositors of liquidated mutual savings banks as well as the forint conversion and settlement. Time series adjusted separately.*

Savings held in liquid financial assets expanded further amid the uncertainty created by the pandemic situation, and the increase in government securities also accelerated (Chart 21). The coronavirus pandemic had a significant impact on households' asset allocation decisions in Q3 as well. Households' demand continues to be seen for liquid forms of savings: the increase in transferable deposits exceeded HUF 200 billion, which is nearly twice as much as the figure for the same period of the previous year. The demand for cash was at a level similar to the one in the third quarter of the previous year, despite the extremely high cash accumulation in the previous months. Demand for forms of investment requiring longer-term commitment was determined by developments in prices: the increase in holdings of listed shares and mutual fund shares, which suffered serious price losses as a result of the pandemic, continued in Q3 as well, as significant amounts of savings flowed into both listed shares and mutual fund shares.

Households' government securities purchases accelerated slightly compared to the previous quarter. The popularity of the MÁP+, a government security introduced in the summer of last year, was unbroken: holdings expanded by nearly HUF 600 billion in Q3. The decline in the shorter-maturity 1MÁP securities decelerated to some extent, while PMÁP securities also decreased by HUF 180 billion. On the whole, households' government securities holdings increased by approximately HUF 220 billion, thus continuing to contribute to financing the state from domestic sources.

Chart 21: Developments in households' key financial assets



5 Household savings in the time of pandemic

Changes in household savings are examined in more detail in the special topic. In view of the pandemic, various factors restrained the growth in the consumption of domestic households. As a result, in spite of a decline in expansion in income, the sector's net financial savings-to-GDP ratio increased in Q2. Within consumption, the increase in demand for durables came to a halt in the past months, and thus its impact impairing the current account balance moderated. Households' financial savings were typically higher in Q2, according to EU countries' experiences as well. In the euro area, this growth was primarily attributable to the 'forced savings' due to the containment measures, whereas the contribution of the precautionary motive due to the higher risk of unemployment was lower. The development that due to the pandemic situation the surge in the budget deficit was partly offset by the rise in households' financial savings was of the utmost importance in the countries of the region as well. Looking at the structure of savings, more liquid savings were typically preferred in the countries of the region. Following the return to normal in Q3, real economy developments may again result in a rise in household savings at end-2020 due to the reintroduction of the restrictive measures regarding movement.

This special topic in the Report on the Balance of Payments focuses on developments in household savings, because at the outbreak of the pandemic it was not clear whether – as a result of the crisis – households' financial savings would increase as happened during the crisis in 2008 or the fall in incomes due to the sudden drop in external demand and employment would not allow this. In the previous crisis, the net financial savings of households were also increased by the fact that the previous significant borrowing turned into repayment. At the same time, borrowing by households remained subdued in the past years. Accordingly, after the previous crisis, 'forced savings' related to the loans could not add to net financial savings this time. Moreover, the prenatal loans, with their favourable conditions, may have rather had a contrasting effect (which, at the same time, facilitates the attenuation of 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 put the domestic developments in an international and regional context.

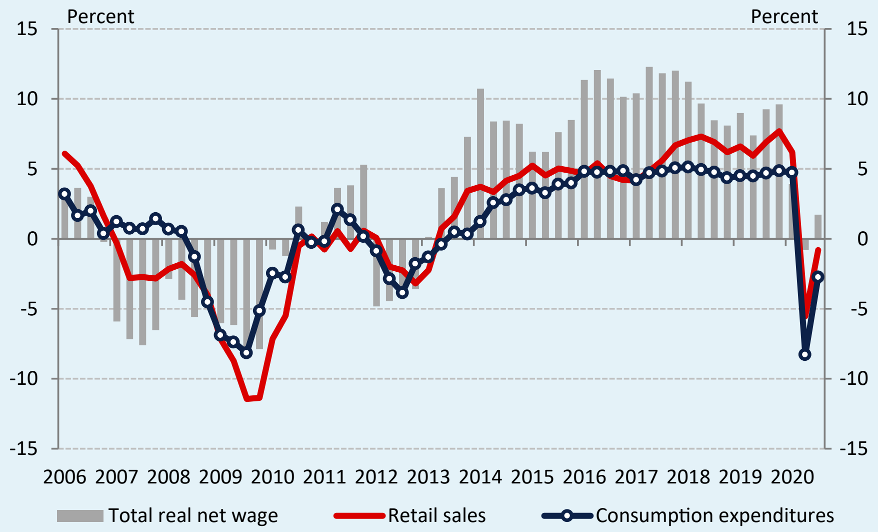
5.1 Real economy developments

As a result of the pandemic, various factors restrained the increase in households' income and consumption. At the time of the first wave of the coronavirus pandemic in the spring, the containment measures aimed to slow down the expansion of the illness and the voluntary shop closings significantly narrowed households' opportunities to spend, which reduced household consumption from the supply side. At the same time, companies dismissed some of their employees due to the slack demand (which was exacerbated by the absence of foreign tourists as well), while wage growth also decelerated, and the decline in the net wage bill as a result of the two factors restrained household consumption from the demand side (Chart 22). In view of these developments, retail sales contracted in Q2, and as the restrictions – due to their nature – affected the services based on human relations (e.g. catering, tourism, entertainment) more strongly, the drop in consumption was even greater, which represents a significant change compared to the previous crisis. In 2008 and 2009, the rate of expansion in consumption declined to a lesser degree than in retail trade, which may also have been due to the fact that demand for services, which is responsible for most of the difference between the two indicators, was impacted by a smaller decline, presumably because of the relatively better position of those using them.

Consumption fell to a greater degree than income, resulting in an increase in households' savings. The impact of the pandemic was reflected in the data for Q2, when the real net wage bill declined by nearly 1 percent year on year (following an expansion of some 9 percent in 2019). In parallel with that, however, in Q2 the volume of households' consumption expenditure declined considerably, by more than 8 percent, compared to the same period of the previous year. Accordingly, the expansion in consumption, which fell significantly short of income, was reflected in the increase in households' financial savings.

After the trends returned to normal in Q3, real economy developments may entail a rise in household savings again at end-2020. Following containment of the first wave of the pandemic, with the easing of restrictions, both retail sales and consumption expansion rebounded sharply (which, as we will see, was also perceived in the decline in financial savings). Nevertheless, the restrictions (e.g. on movement) that were reintroduced because of the second wave of the pandemic may reduce household consumption again, resulting in a repeated rise in households' savings in Q4.

Chart 22: Annual real growth in the main indicators of households' income and consumption

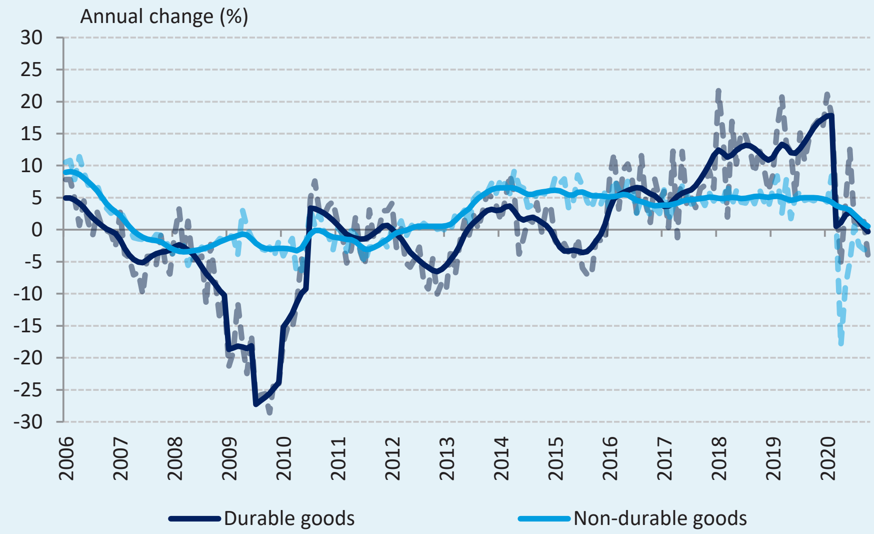


Source: HCSO.

Examining the developments in retail sales in more detail, the pass-through of the effects of the pandemic in the spring restrained demand for both durable and non-durable products. Both the accelerating increase since 2016 in the consumption of durables and the steadily expanding sales of non-durable articles were brought to an end by the pandemic emergency and the lockdowns that affected retail trade as well. The containment measures had a temporary impact – of various degrees – on all types of shops. Following the spring low, the lifting of restrictions entailed a pick-up in the sales of both durable and non-durable products, which is being decelerated by the arrival of the second, autumn wave of the pandemic.

The increase in demand for durables came to a halt in the past months, and thus its negative impact on the current account balance weakened. The degree of the downturn seen in the spring of 2020 in the annual growth of durables was similar to that of the 2008 crisis, but in contrast to the previous crisis, all this resulted in a standstill in growth and not a decline in turnover. This is attributable to the fact that this time the fall took place from a higher base: while in the pre-2008 period, which was burdened by tightening measures and worsening income prospects, the expansion in retail sales was on a decelerating path, prior to the pass-through of the pandemic in the spring of 2020 the favourable income position of households allowed for a major rise in turnover. As the import content of the consumption of durables – such as motor vehicles, parts, furniture, household appliances – is high, a deceleration in sales improves the current account balance. The – less drastic – drop in the volume of the sales of non-durables seen in the spring is also a result of the lockdowns. In this product group, the decline in the volume of consumption was primarily attributable to the low demand for fuel and a drop in the sales of apparel, which was offset to some extent by the relatively stable demand for food and pharmaceuticals. On the whole, as during the previous crisis, the volume of sales of non-durables declined to a lesser degree than that of durables.

Chart 23: Retail sales by main product groups (annual volume index, percent)

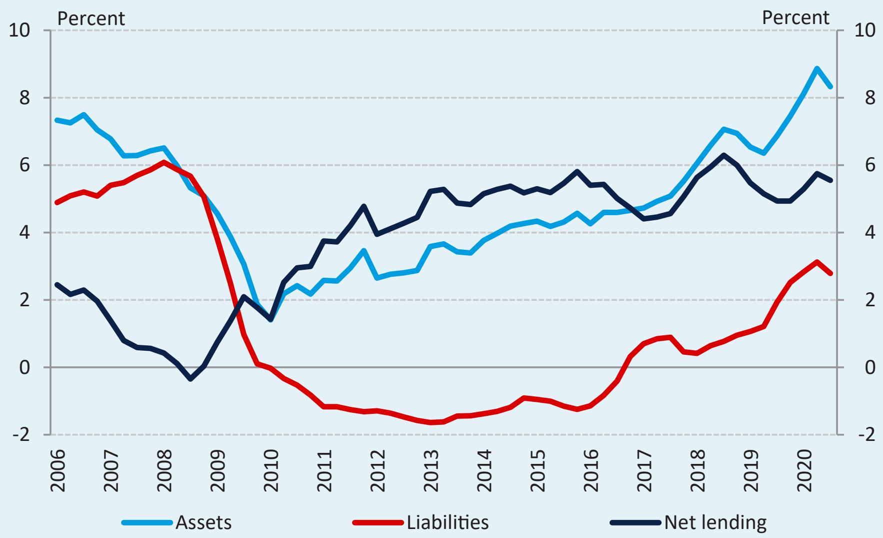


Source: HCSO.

5.2 Developments in savings

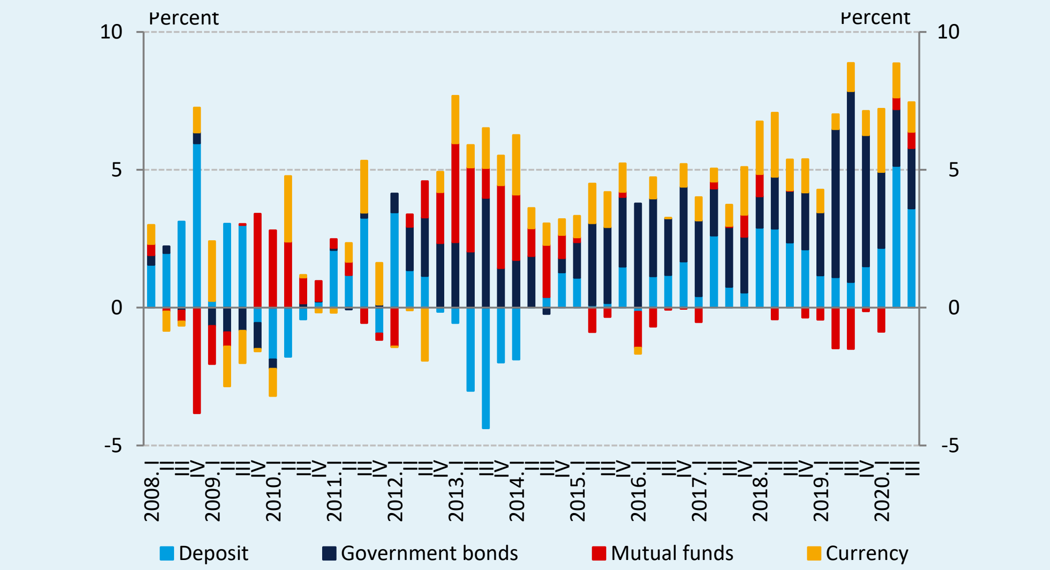
In Q2, which was strongly impacted by the coronavirus, households' net financial savings increased further, followed by a slight decline in Q3, with growth expected again in Q4. As a result of the aforementioned factors (restrictive measures affecting the economy, precautionary motives, etc.) and a decline in nominal GDP, households' four-quarter net financial savings as a proportion of GDP increased sharply in 2020 Q2. Looking at the gross components of savings, the further rise in net borrowing was mainly attributable to the prenatal loans, a large portion of which, however, may also have temporarily been reflected in the expansion in financial assets, and thus it presumably did not have any major impact on net financial savings. In connection with the trends in Q3 it is worth highlighting that the normalisation of economic activity in the summer months slightly reduced households' net lending, at the same time leading to net lending that corresponded to the average of previous years. It is worth noting that – based on the experiences of the first wave – the sector's financial savings are expected to increase again in Q4, which is affected by the second wave of the virus.

Chart 24: Households' net financial savings and their components (four-quarter data as a percentage of GDP)



As a result of the pandemic, households turned from longer-term savings towards short-term ones. Prior to the outbreak of the pandemic, households' portfolio decisions were determined by the low deposit rates and the significant yield advantage of government securities. The high liquidity and the low opportunity cost increased the demand for sight deposits and cash in the case of short-term savings. At the same time, the yield advantage of government securities resulted in a decline in mutual fund shares and a rise in government securities in the case of longer-term savings. The picture changed to some extent after the outbreak of the pandemic. Although there was a surge in demand for cash in the spring, for the remaining part of the year the expansion of cash in hand was in line with the previous years. The rise in short-term savings was primarily related to sight deposits; in the middle of the year, the placement of sight deposits by households was several times higher than the same period of the previous year. Although the demand for government securities was stable during the whole year, their relative weight within total financial savings declined. Nevertheless, in spite of the slowdown, households' demand was stable, reconfirming the retail government securities strategy. It is also important that presumably in view of the price movements that took place as a result of the crisis, households increased their savings held in listed shares by some HUF 250 billion in the first three quarters of 2020. This is nearly three times more than households' savings placed in similar instruments between 2017 and 2019. The presumed underlying reason for this is that households may have considered the negative effect of the crisis on stock exchange prices as being a temporary phenomenon, and thus they may have deemed it a good entry point for purchasing shares.

Chart 25: Seasonally adjusted transactions in the main financial assets as a percentage of GDP



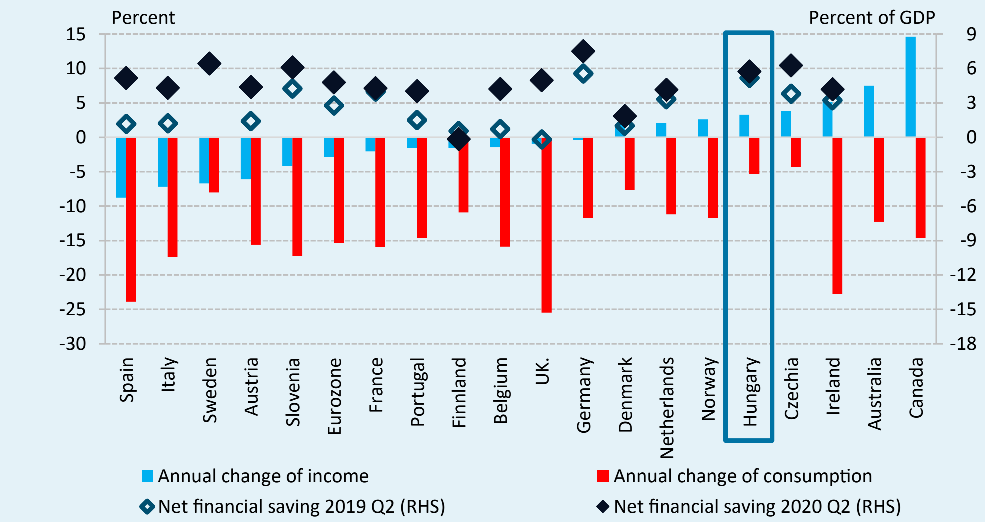
Note: The data series presented are according to underlying trends.

Compared to the 2008 financial crisis, the impact of the pandemic on the structure of households' financial savings was similar in the short run, but much different in the longer run. The financial crisis reached Hungary in 2008 Q4, and households reacted to it by accumulating liquid assets – just like in the current crisis. In 2009, however, the drastic fall in income prospects and the stoppage of borrowing resulted in a downturn in financial asset accumulation. In relation to the collapse of prices, the adjustment affected mutual fund shares in the first round, and then the government securities holdings of the household sector also started to decrease. These trends suggest that due to a fall in incomes, households started to use their reserves, which was reflected in a decline in cash in hand and deposits from 2009 H2, but the adjustment in the demand for mutual fund shares also pointed to this direction. **By contrast, at the time of the 2020 pandemic the level of financial savings remained high, and in parallel with the preference for liquid financial assets, demand for government securities, which represent a longer-term commitment, also persisted**, which was mostly attributable to the MÁP+ and is considered a favourable trend in terms of the external vulnerability of the economy as well.

5.3 International trends

In parallel with a decline in consumption, net financial savings of households in EU countries typically increased in Q2. The fall in economic growth in view of the coronavirus pandemic significantly restrained the expansion in the household sector's disposable income in every EU country. While the increase still continued in Hungary in Q2, incomes fell in several countries. At the same time, in terms of savings it is also important to emphasise that in the countries of the European Union the sector's consumption expenditure also declined, to an even greater degree (by more than 15 percent year on year; to the largest degree in the countries hit the hardest by the pandemic, e.g. in Italy, Spain or Great Britain). As a result of the two trends, the value of households' four-quarter net financial savings as a percentage of GDP rose considerably (Chart 26). **Hungarian households' savings rate increased only slightly in a European comparison, but this is partly attributable to its previously high level.** Loan repayment also contributed significantly to the rise in the net indicator in several countries. In Great Britain, for example, during the 3 months of the lockdown households roughly repaid as much of consumer loans as much they had borrowed in total in the previous 12 months.[3]

Chart 26: Changes in households' disposable income and consumption expenditure, and the sector's net financial savings as a percentage of GDP



Source: Eurostat.

The rise in financial savings in the euro area is primarily attributable to 'forced savings', whereas caution and the factors that generally influence consumption only play a minor role. The surge in household savings in mid-2020 may have been caused by two main factors: the uncertainty around future incomes may have grown due to the upturn in unemployment, which is typical in crisis periods, and by the strengthening of precautionary motives it may have contributed to the increase in savings. In addition to that, however, the containment measures also strongly narrowed households' consumption possibilities, which may have resulted in unintended, forced savings as well. Similar developments were observed in Hungary during the 2008 crisis, when the tightening in the possibilities of borrowing and the rise in loan repayment as a result of the obligation to pay the instalments led to a partly forced rise in net financial savings. According to the analysis by the European Central Bank,[4] however, the usual variables available for economic developments (e.g. changes in income and the size of future unemployment expected by households, as the most suitable indicator for identifying the precautionary motive) were able to explain only a smaller part of the surge in financial savings in the euro area. Therefore, presumably the aforementioned forced savings played the largest role in the increase. Nevertheless, it may turn out only over the longer term whether the level of financial savings will return to the previously typical level following the lockdowns, which are expected to cease to exist in parallel with the introduction of the vaccine.

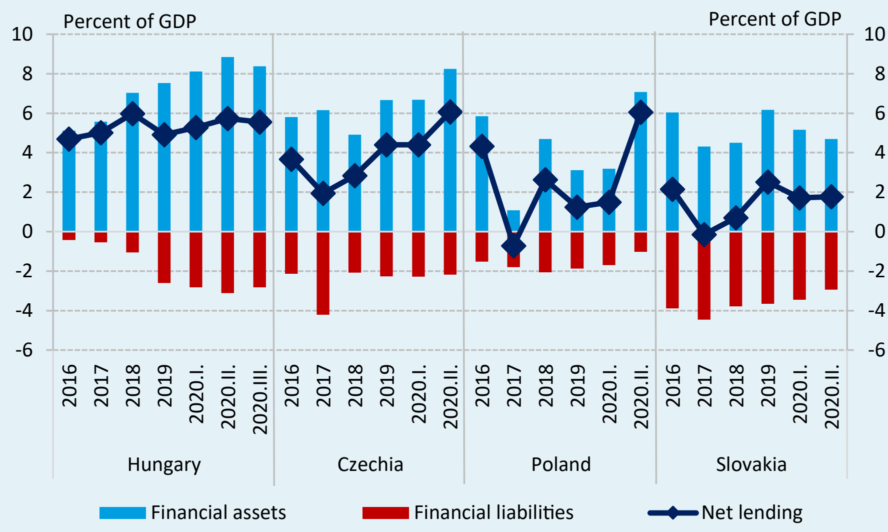
5.4 Regional experiences

Switching to the experiences of the countries of the region, in addition to the budget deficit, which rose sharply in all the countries due to the pandemic situation, one important development in the countries of the region is that the major increase in deficit was partly offset by a rise in households' financial savings. Developments in the net financial savings of households in the region were affected tangibly by the economic restrictions and precautionary considerations related to the coronavirus, but their direction and strength varied across countries. In Hungary, the household sector's four-quarter

3 https://www.thisismoney.co.uk/money/saving/article-8790533/Household-saving-hit-time-high-coronavirus-lockdown.html
4 For more details, see: ECB Economic Bulletin, 6/2020.

net financial savings rate as a percentage of GDP in 2020 Q2 and Q3 (5.7 and 5.5 percent of GDP, respectively) was slightly higher and continued to be rather stable compared to the beginning of the year, but in Q2, for which the latest figures are available in the region, the Czech and especially the Polish rates rose considerably (to 6.1 and 6.0 percent of GDP, respectively). By contrast, compared to the 2019 figure, the Slovak savings rate was lower (below 2 percent of GDP) in both Q1 and Q2 (Chart 27).

Chart 27: Net financial savings in the countries of the region and their components (as a percentage of GDP)



Source: Eurostat.

In terms of the structure of savings, typically the most liquid forms of savings were preferred in the countries of the region, while declines in borrowing contributed to a greater degree to the increase in net financial savings only in Poland and Slovakia. According to four-quarter transaction data, shifts towards more liquid forms of savings (bank deposits and cash) as a result of the pandemic were typical of the majority of the Visegrád countries (while in Slovakia the increase in deposits did not accelerate, and the expansion rate of cash came to a halt in Q2). **The expansion rate of securities was persistently high in Hungary in H1, before it decelerated in Q3, but as a percentage of GDP it still significantly exceeded the stagnation or minimal expansion observed in the other Visegrád countries.** The expansion in liabilities (mainly borrowing) continued steadily during the year in Hungary and the Czech Republic, while in Slovakia it already continued at a slightly lower pace in Q2 than before. In Poland, however, credit expansion decelerated more strongly, contributing to a rise in net lending in Poland that exceeded that of the region.

List of Charts

Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

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