MAGYAR NEMZETI BANK

REPORT ON THE BALANCE OF PAYMENTS

2020

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 enables 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.

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

This Report is based on information pertaining to the period ending 22 June 2020.

Summary

In 2020 Q1, Hungary's four-quarter net lending rose to 1.2 percent of GDP, with a simultaneous decline **in net external debt** to a historical low of **6.3 percent of GDP**. The **current account deficit stabilised at 0.8 percent of GDP:** the impact of the **mild decrease in net exports** due to slowing industrial production and the decline in tourism was offset by a **lower deficit on the income balance**. As in Hungary, net lending also expanded in most of the Visegrad countries, but **the external position of the Hungarian economy continues to be one of the largest in the region**.

According to the real economy approach, **the increase in net lending was primarily attributable to the expansion of the transfer balance**. The **decline in the trade surplus** resulted from a **lower balance of services** as well as a **larger goods deficit**. In Q1, the coronavirus pandemic still only affected developments in foreign trade to a limited degree: the **fall in tourism** and the impact of **declining goods exports** due to the slowdown in industrial production were mitigated to some degree by favourable developments in the terms of trade. The **rise in the transfer balance surplus** was primarily attributable to an **increase in the absorption of EU funds**. Hungary's external position was improved by the **declining income account deficit**, which was due to foreign-owned companies' lower profits, while the interest balance stabilised at a low level.

The financing side also indicated that **four-quarter net lending was shifting into positive territory** as a result of a **decline in net external debt** and **significant FDI inflows**. The net **debt liabilities** of the economy **fell considerably**, with the **corporate sector as the main contributor**, while the indicators for the state and the banking sector remained practically unchanged. **In addition to the outflow of funds, revaluation and the increase in GDP also considerably reduced the net external debt.** As a result of these factors, **net external debt dropped to a historical low of 6.3 percent of GDP**, while the country's **gross external debt amounted to 50.2 percent of GDP**. Hungary's short-term external debt rose to EUR 19.3 billion, with the banking sector as the main contributor. In parallel with the decline in the external debt of the state (due to FX bond maturity and repurchase), **foreign exchange reserves** also decreased, but continue to **significantly exceed the level expected and deemed safe by investors**.

In terms of the savings of sectors, **the private sector was the main contributo**r to the increase in net lending. The **general government deficit remains low**, as the impacts of the pandemic were only slightly felt in Q1. **Households'** decelerating consumption growth is attributable to the pandemic, resulting in a **rise in financial savings** against the background of still strong income outflows during the quarter. In the case of **companies**, the decline in inventories and the income increasing effect of the improving terms of trade were reflected **in a decrease in net borrowing** as well. In Q1, **households' government securities holdings continued to expand**, albeit at a slower pace, **primarily due to a rise in holdings of MÁP+**.

In the **special topic** presented in the **Report on the Balance of Payments, we summarise the effects of the 2008–2009 global financial crisis on the trade balance**, which may help to better understand the potential effects of the coronavirus pandemic. **It took approximately three years for the Hungarian economy to recover** from the aftermath of the crisis **regarding its trade balance**, but the constantly rising foreign trade in terms of GDP turned to stagnation. The GFC **impacted the balance of services less than the balance of goods**, while **this effect may be reversed in the current crisis**. It is important to point out that, in terms of external balance after 2008, **the decline in exports** lowered the deficit of the income balance **via the deteriorating profits of foreign-owned companies**. Furthermore, the **declining oil prices** typical seen in times of crises generally cause trade balances in oil importing countries to grow. In sum, the **trade balances of EU member states** showing a considerable deficit before the GFC **started to improve** after 2008.

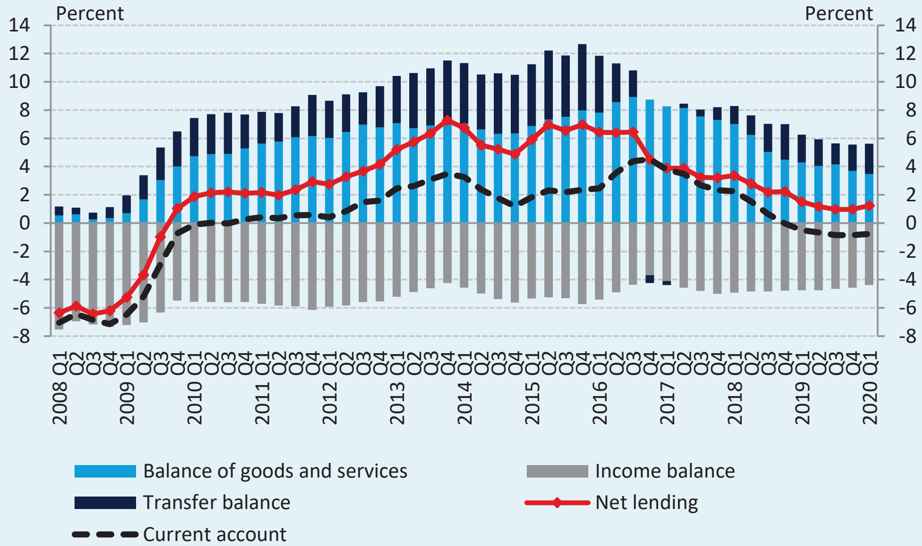
Contents

1. Real economy approach

According to the real economy approach, Hungary's four-quarter net lending rose to 1.2 percent of GDP in 2020 Q1, while the current account deficit stabilised at 0.8 percent of GDP. The impact of the coronavirus pandemic was already felt in the developments underlying the external balance indicators. The slight increase in net lending is primarily attributable to a rise in the surplus of the transfer balance, owing to increasing EU fund absorption, as well as to a mild decline in the income balance deficit. The lower trade surplus was mainly the result of a services balance surplus, which was smaller than previously. Net exports decelerated growth less than before, and at the same time the significant decline in export and import volumes was attenuated by favourable developments in the terms of trade. The developments in export and import growth in Q1 also already reflected the March impact of the pandemic. The net lending of the Hungarian economy remains high in a regional comparison.

In 2020 Q1, Hungary's four-quarter net lending according to the real economy approach rose slightly, to 1.2 percent of GDP, while the current account deficit stabilised at 0.8 percent of GDP (Chart 1). According to unadjusted quarterly data, net lending in Q1 amounted to EUR 569 million, which was a result of the decline in the current account balance to practically zero, and thus the net lending was exclusively attributable to the surplus of EUR 567 million on the capital account. The improvement in net lending is primarily related to the rise in the transfer balance, although the change in the income balance also made a contribution, while the goods and services surplus declined.

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

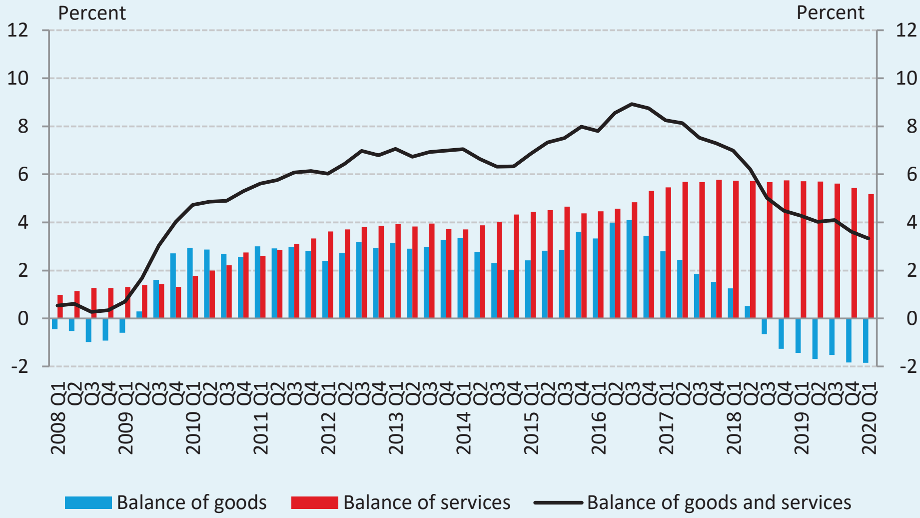


** Income balance: earned income, income on equity and income on debt.*
Transfer balance: sum of the capital account and other primary and secondary income.
Unless otherwise indicated, the source of the charts is the MNB.

1.1. Trade balance

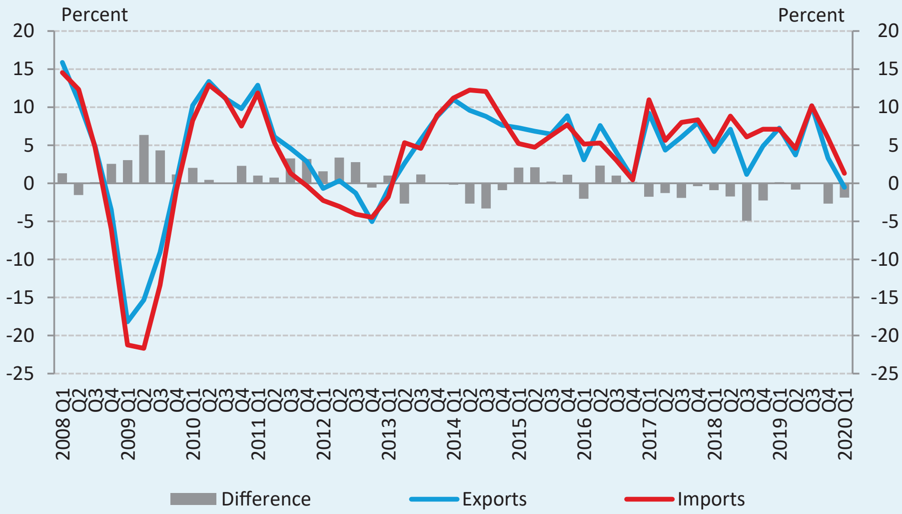
The trade surplus shrank in 2020 Q1, mainly due to a decrease in the goods balance and – to a lesser degree – to the decline in the services surplus due to the pandemic (Chart 2). The downward trend in the trade balance since early 2017 seemed to stop in 2019 Q3, but the balance then fell again in 2020 Q1. The *services balance* continues to be a major contributor to the trade surplus, although the surplus of the former dropped from the level of nearly 6 percent observed in previous quarters to below 5.4 percent by 2020 Q1. This was because tourism and transportation services, which represent a considerable weight within the services balance, already declined in March, which may explain the more subdued development of the services balance compared to previous periods. The *goods balance* as a proportion of GDP reduced the trade balance to a greater degree than in the previous quarter, as its four-quarter deficit exceeded EUR 2.7 billion. The Q1 deficit, which partly reflects the negative impact of the pandemic, may still have been offset to some extent by the favourable goods exports in January and February, when exports of machinery and means of transport, which have a considerable weight in goods exports, as well as of pharmaceutical products, still expanded at a pace higher than the average of previous years.

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



Although it was well below the figures for previous quarters, import growth in 2020 Q1 continued to exceed export dynamics (Chart 3). Nevertheless, growth rates for both exports and imports dropped off sharply in Q1, possibly due to the impacts of the pandemic which were already felt in Hungary in March. Annual real export growth turned negative, with weakening external demand, factory shutdowns in Hungary and the fall in vehicle industry exports possibly playing a role. The decline in export dynamics entailed a slowdown in imports as well, and import-intensive investment also fell, while household consumption decreased only slightly, presumably due to the stockpiling of food and other consumer goods that was typical in the initial phase of the pandemic.

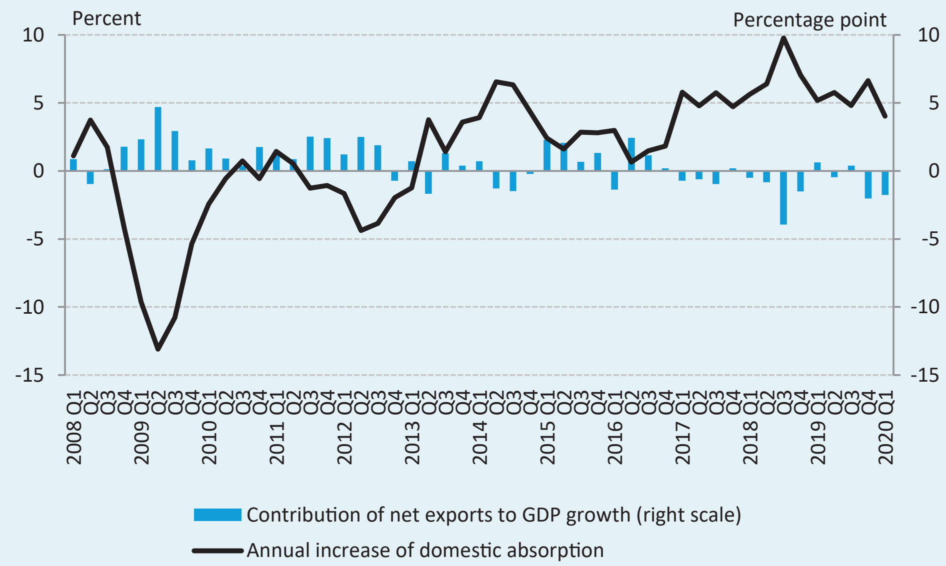
Chart 3: Annual real growth in exports and imports



Source: HCSO and MNB.

The annual growth rate of domestic absorption decelerated compared to the previous quarter, while net exports restrained growth to a lesser degree than in the previous quarter (Chart 4). In 2020 Q1, household consumption growth decelerated slightly while investment slowed significantly, possibly owing to the temporary effects of the coronavirus pandemic on economic prospects. The fall in investment observed in Q1 is primarily attributable to the downturn in public sector investment, but corporate sector investment also contributed to it. Within the latter, there was a significant decrease in investment in machinery, especially in the manufacturing of vehicles, which has a significant weight, and the services sector also recorded a smaller decline. In line with the slowdown in the annual growth of domestic absorption items, the contribution of net exports to growth in 2020 Q1 restrained economic growth to a lesser degree than in the previous quarter.

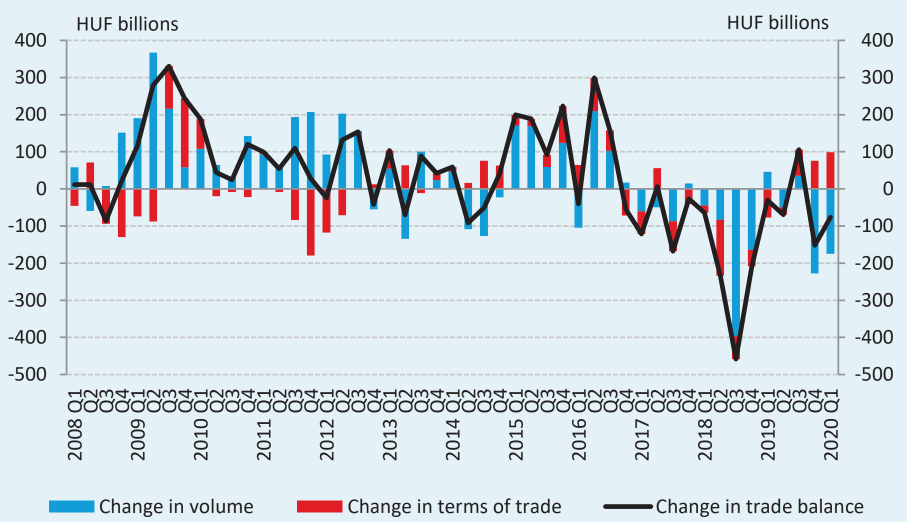
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

In 2020 Q1, the change in volume was the main contributor to the decline in the trade balance, whereas the change in the terms of trade partly offset this. Both export and import volumes were significantly lower in 2020 Q1 than in the previous periods. The volume of exports fell to a low level unseen since 2013, while the drop in the production of highly import-intensive export sectors was reflected in the decline in imports. At the same time, global demand concerns related to the pandemic resulted in a fall in the prices of energy, including oil in particular, and thus in an improvement in the terms of trade, which partially offset the negative impact from the change in volume (Chart 5).

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

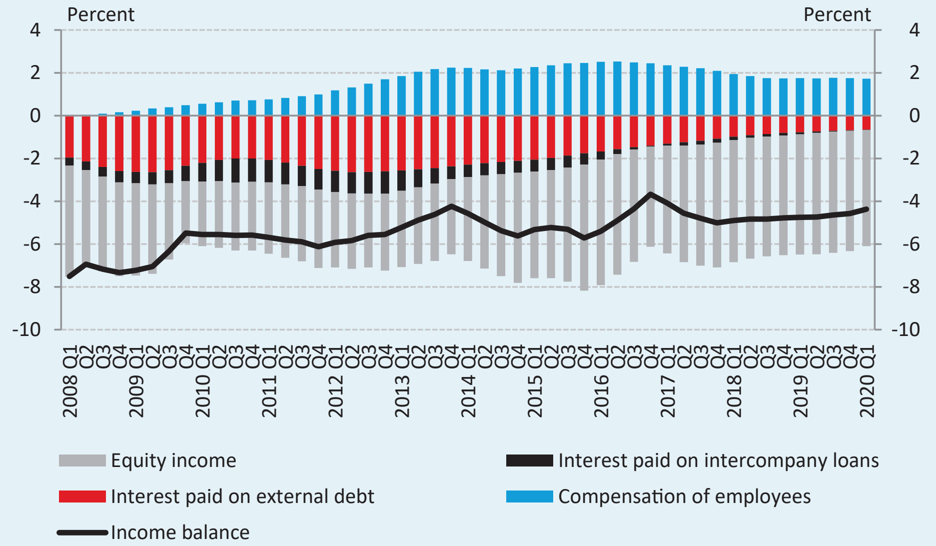


Source: HCSO.

1.2. Income balance

The income balance deficit kept declining in 2020 Q1, primarily due to the lower profit of foreign-owned companies (Chart 6). The four-quarter deficit on the income balance dropped to 4.4 percent of GDP in Q1, in relation to the decrease in the income related to equity of foreign-owned companies (due to the effects of the pandemic), which represents the greatest weight within the income balance. Net interest expenditure related to foreign and intercompany loans stabilised at a very low level (below 0.7 percent of GDP). Compensation of employees from abroad declined slightly compared to the previous quarter, presumably in connection with the increased unemployment in the countries that receive guest workers.

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

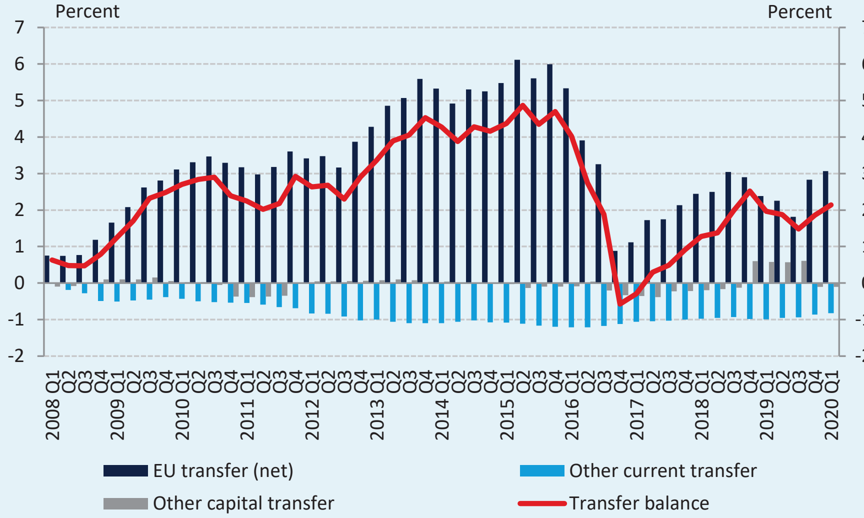


** Income balance: earned income, income on equity and income on debt.*

1.3. Transfer balance

The rise in the transfer balance surplus mainly reflected the increasing absorption of EU funds. In early 2020, the transfer balance surplus expanded to 2.1 percent of GDP, contributing significantly to maintaining Hungary's favourable external balance position (Chart 7). Four-quarter EU fund inflows corresponded to 3.1 percent of GDP, while other current transfers impaired the transfer balance to a lesser degree than before, as the compensation of employees working abroad for short periods may have already declined due to the pandemic, and in conjunction with that, the amount of taxes and contributions paid abroad may have also decreased within the other current transfers item.

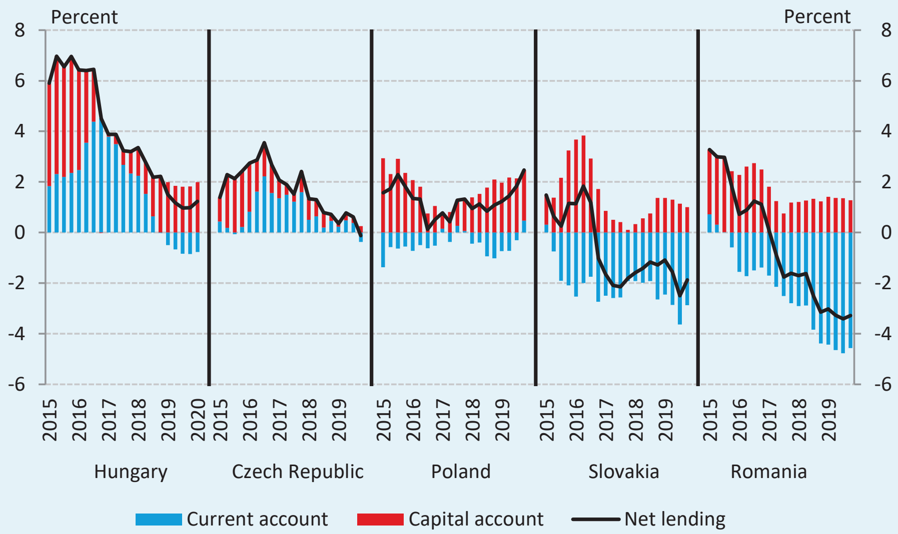
Chart 7: Four-quarter developments in transfer balance items (four-quarter values as a percentage of GDP)



1.4. Regional comparison

The net lending of the Hungarian economy remains significant in a regional comparison and exceeds the average for the region (Chart 8). The favourable balance position is supported by the considerable surplus on the capital account, while the current account balance is near the average of the region. External balance indicators have typically declined in the countries of the region since 2016, due to the decrease in capital account balances between the two EU budget cycles as well as declines in the countries' current account balances. At end-2019, the four-quarter current account deficit typically declined in the countries of the region. In Romania, however, it still exceeds 3 percent of GDP, while in Slovakia the deficit is around 2 percent of GDP. By contrast, in the Czech Republic the previous current account surplus turned into a slight deficit, while Poland already recorded a modest current account surplus. In the case of Hungary, the four-quarter current account deficit is more than offset by the surplus on the capital account, and thus Hungary's net lending is the second highest in the region, behind Poland.

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



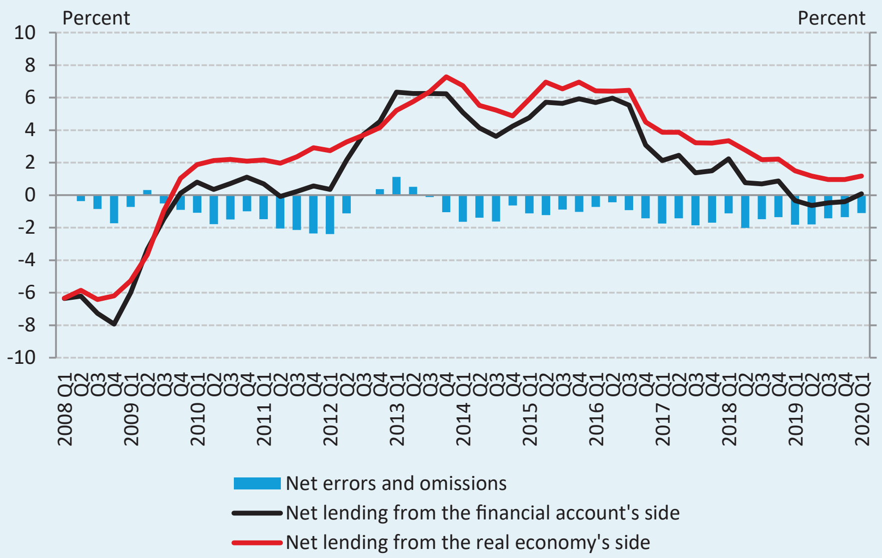
Sources: MNB and Eurostat.

2. Financing approach

In Q1, in line with real economy developments, the four-quarter net lending calculated on the basis of the financial account rose slightly. Regarding transactions in Q1, FDI inflows exceeded the decline in debt liabilities (related to companies), and thus Hungary's net external debt increased moderately. As a result of companies' significant foreign asset accumulation, the sector's net debt outflows amounted to EUR 1 billion. The net external debt of the general government and banks resulting from transactions remained practically unchanged.

According to financing data, the four-quarter net lending of the economy rose considerably, moving into positive territory in 2020 Q1 (Chart 9). It is important to mention that, in parallel with this, the four-quarter net lending according to the real economy approach also expanded significantly. Based on four-quarter rolling values, the combined current and capital account balance showed a major surplus, while – on the basis of the financing items – the net outflow of foreign funds was around EUR 0.1 billion.[1] In Q1, the balance of errors and omissions declined to close to 1 percent of GDP, meaning that the error on the balance of payments is slightly below the levels typical in the previous quarters.

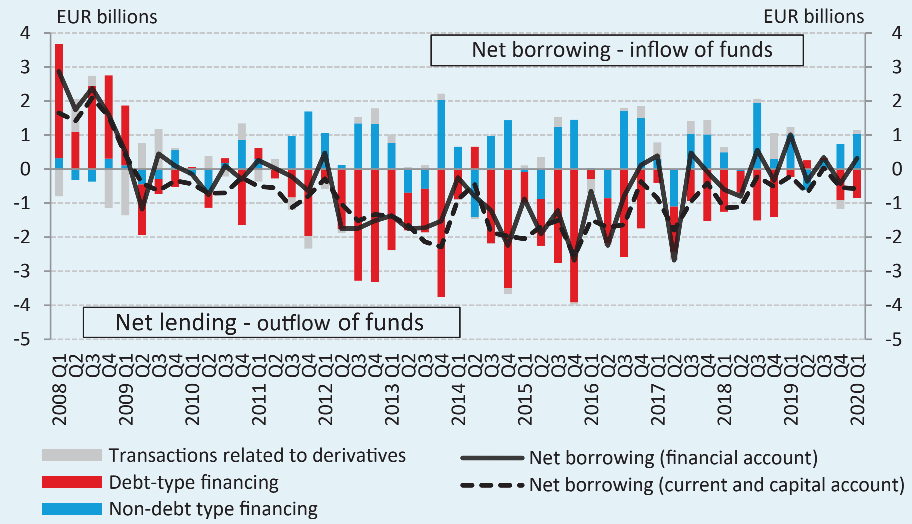
Chart 9: Two types of net lending and 'Net errors and omissions'
(four-quarter values as a percentage of GDP)



Although on the basis of the financial account first-quarter net borrowing increased slightly compared to the previous quarter, it was considerably lower than the value observed in the same period of the previous year. Accordingly, the four-quarter figure turned into moderate net lending (Chart 10). Outflows of debt liabilities were around EUR 0.8 billion, whereas inflows of non-debt liabilities increased compared to the previous quarter and exceeded EUR 1 billion. As a result of the above, net borrowing calculated on the basis of the financial account amounted to around EUR 0.3 billion in Q1.

[1] 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 the 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'.

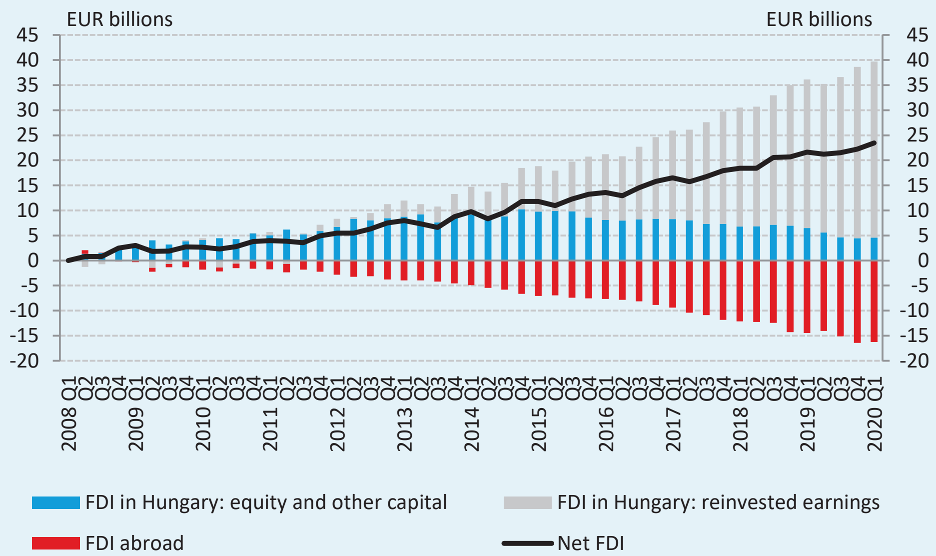
Chart 10: Structure of net lending (unadjusted transactions)



2.1. Non-debt liabilities

There was a major increase in FDI in Q1, which continued to be primarily linked to foreign-owned companies' reinvested earnings (Chart 11). Based on data excluding capital-in-transit transactions and asset portfolio restructuring, the net FDI stock increased by nearly EUR 1.2 billion as a result of transactions in Q1. Foreign-owned companies' direct investment in Hungary expanded by more than EUR 1.1 billion, while Hungarian companies' investment abroad fell by nearly EUR 0.1 billion. The significant decline in foreign-owned companies' equity-type liabilities was related to the dividends of a multinational company. In parallel with that, the expansion in reinvested earnings was similar to that of the same period of the previous year.

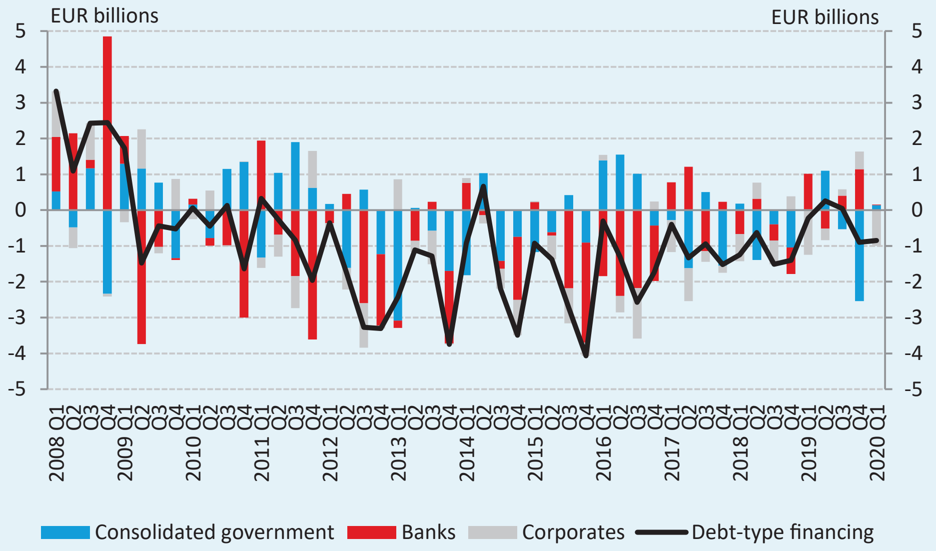
Chart 11: Developments in FDI excluding capital-in-transit transactions (cumulative transactions)



2.2. Debt liabilities

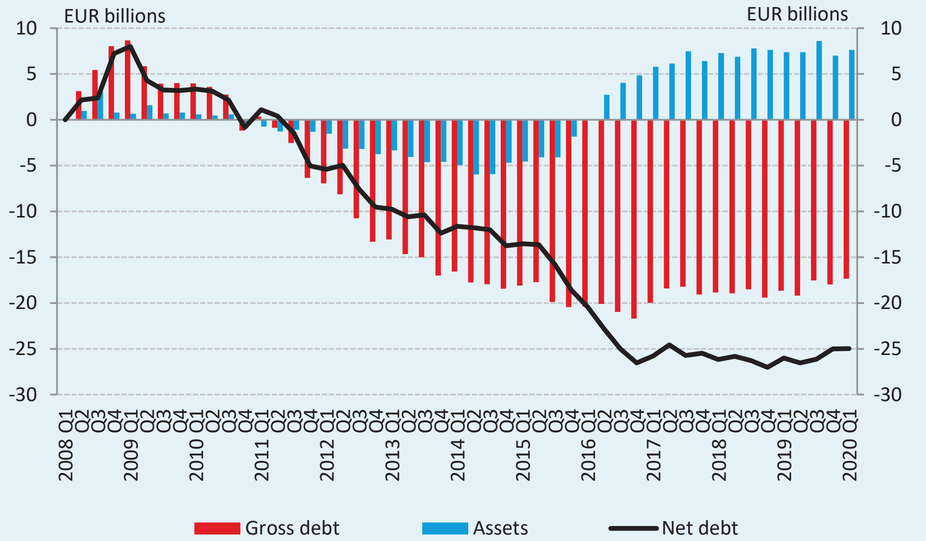
In Q1, as a result of transactions, the stock of debt liabilities fell considerably, related to the debt outflows of the corporate sector (Chart 12). The net external debt of the consolidated general government and the banking sector resulting from transactions remained practically unchanged. The decline in the corporate sector's net external debt was primarily the result of a major expansion in foreign assets, while foreign liabilities increased only slightly.

Chart 12: Developments in net debt-type financing by sector



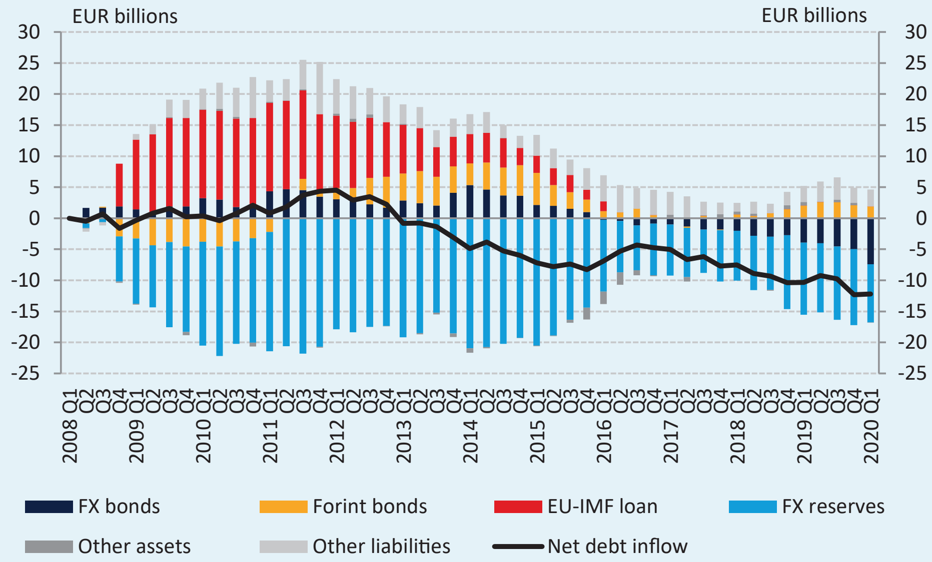
The foreign liabilities and assets of the banking sector increased to a similar degree, and thus the sector's net debt remained practically unchanged in Q1 (Chart 13). Banks' short-term external debt expanded by some EUR 1.3 billion, while their long-term debt declined by nearly EUR 700 million as a result of transactions.

Chart 13: Developments in the banking sector's external debt and receivable (cumulative transactions)



The external debt liabilities of the consolidated general government including the MNB remained almost unchanged during the quarter (Chart 14). Non-residents' FX bond holdings maturing in Q1 and the FX bond repurchase in January reduced both foreign liabilities and the foreign exchange reserves. Consequently, these factors did not affect the net indicator. The state's foreign exchange spending usual in this period of the year (EU contribution) and newly arising ones (expenditure related to the containment measures) reduced the foreign exchange reserves, and thus resulted in a rise in net external debt. At the same time, the decline in non-residents' long-term HUF-denominated government securities holdings improved the debt indicator.

Chart 14: Breakdown of the change in the net external debt of the consolidated general government including the MNB (cumulative transactions)



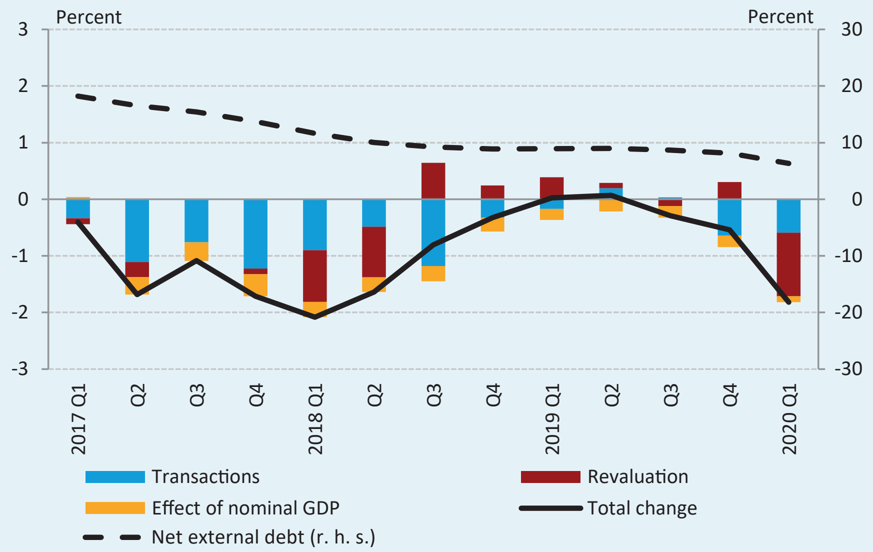
3. Developments in debt ratios

As a result of a sustained rise in foreign assets, Hungary's net external debt continued to decline, falling to below 7 percent of GDP in Q1, while gross external debt amounted to 50.2 percent of GDP. In addition to transactions, revaluation effects and nominal GDP growth contributed to the slight decline in net external debt to a greater and lesser degree, respectively. In terms of sectors, the debt outflows of companies and the improvement in the general government indicator (related to revaluation) contributed to the decline in net external debt. Corresponding to the net indicator, gross external debt fell slightly, owing to a decrease in the gross external debt of the general government. Short-term external debt rose by EUR 1.6 billion to EUR 19.3 billion, with a larger contribution by the banking sector and smaller contributions by the general government and corporate sector. Foreign exchange reserves declined in Q1 primarily as a result of the FX bond repayment and repurchasing by the state in January aimed at reducing external debt. Nevertheless, the reserves continue to significantly exceed the level expected and deemed safe by investors.

3.1. Developments in net and gross external debt

In 2020 Q1, net external debt fell sharply again; in addition to the decline resulting from transactions, revaluation effects and GDP growth also contributed to a greater and lesser extent, respectively. The net external debt-to-GDP ratio amounted to 6.3 percent at end-March and was 1.8 percentage points lower than its end-2019 value. Outflows of debt liabilities resulted in a 0.6-percentage point decrease in the net external debt-to-GDP ratio, while revaluation effects improved the indicator by 1.1 percentage point. The latter was also supported by the higher FX reserves stemming from revaluation due to the weakening of the exchange rate of the forint as well as by the repricing of government securities holdings as a result of the increase in yields. Although net external debt is positive, some of it is in forints, and thus as FX assets already exceed FX liabilities at the level of the whole economy, the depreciation of the exchange rate of the forint – including the weakening of the forint seen during the quarter under review – improves the net debt indicator. The increase in nominal GDP resulted in a slight decline in net external debt (Chart 15).

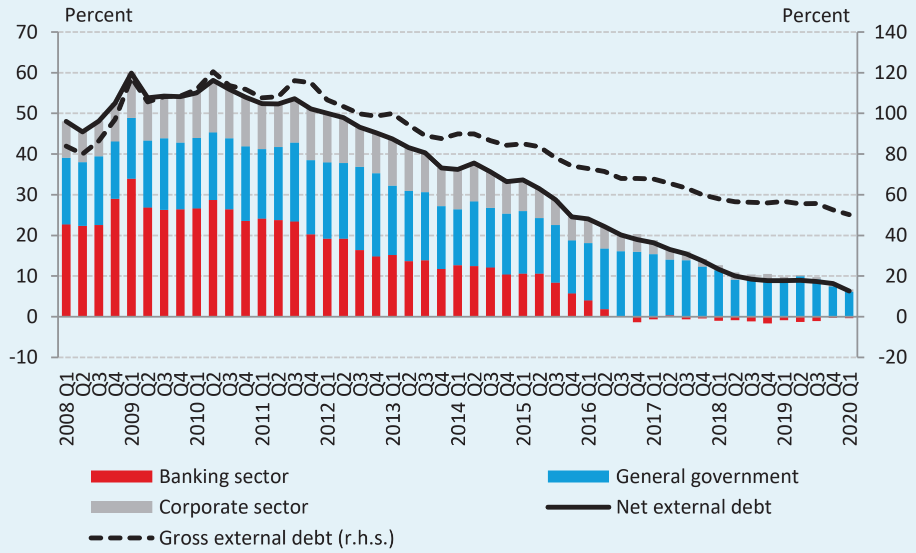
Chart 15: Components of the change in net external debt (values excluding intercompany loans as a percentage of GDP)



The continued improvement in the debt-to-GDP ratio was supported by corporate sector debt outflows and the decline in the debt of the general government related to revaluation (Chart 16). The general government's net external debt fell by 1.3 percent of GDP, mainly owing to the revaluation of holdings, while the rise in international reserves due exchange rate changes and the repricing of government securities in view of an increase in yields also improved the indicator. Net external debt of corporations was down by 0.4 percentage point: the effect of debt outflows occurring in parallel with a stronger expansion in receivables was offset to some extent by the revaluation of the sector's FX loans due to an exchange rate effect. Against the backdrop of similar increases in foreign assets and liabilities, banks' net external debt remained practically unchanged during the quarter.

Following a larger decline at end-2019, Hungary's gross external debt-to-GDP ratio continued to fall in Q1, reaching 50.2 percent of GDP at end-March. The decrease in the indicator was primarily the result of a decline in the external liabilities of the general government, with this effect somewhat reduced by an increase in the gross debt of the private sector. The increase in the gross liabilities of the banking sector, which was mainly related to client deposits, added 0.2 percentage point to the gross external debt-to-GDP ratio. The corporate indicator rose by 0.3 percent of GDP during the quarter, while the sector's loans outstanding increased. By contrast, improvement in the debt ratio was supported by the gross external debt-to-GDP ratio of the general government falling by 2.9 percentage points, which reflected the impact of the Q1 FX bond repayment and FX bond repurchase. In addition to transactions, the revaluation of the outstanding debt – due to the weakening of the forint – was also reflected in the increase in gross external debt, which was only slightly offset by the effect of the increase in yields via the price changes of government securities.

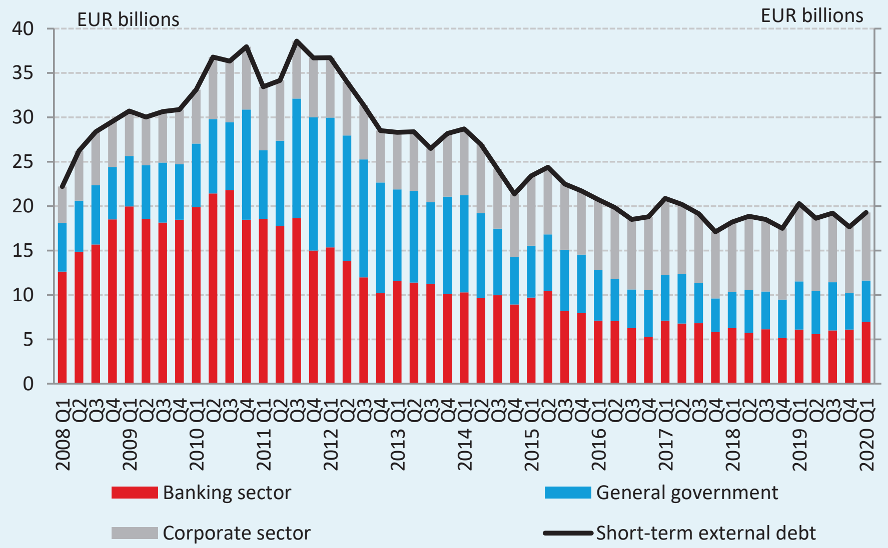
Chart 16: Breakdown of net external debt by sectors and gross external debt (as a percentage of GDP, excluding intercompany loans)



3.2. Changes in short-term external debt

At the end of 2020 Q1, following a rise of EUR 1.6 billion, short-term external debt amounted to EUR 19.3 billion (Chart 17). The increase in short-term external debt was mainly related to the banking sector, but – to a lesser degree – the indicator for the general government and companies also rose. In what is presumably a temporary development, the short-term external debt of the banking sector expanded by nearly EUR 880 million, amounting to EUR 7 billion at the end of the quarter, in which the end-March impact of the financial market tensions related to the coronavirus may also have played a role. The short-term external debt of the general government grew by EUR 550 million, partly as a result of the shortening of the maturities of the FX bonds expiring in March 2021, and partly as a result of the increase – due to the strengthening of the exchange rate of the US dollar – in margin accounts, which hedge the US dollar exposure with euro, and this increase was only partly offset by the impact of the FX bond repayments in January and February. Corporations' short-term external debt rose by EUR 190 million, mainly due to the sector's borrowing of commercial loans.

Chart 17: Developments in short-term gross external debt based on residual maturity



3.3. Foreign exchange reserves and reserve adequacy

Compared to end-2019, the level of FX reserves declined by EUR 2.6 billion in 2020 Q1, and amounted to EUR 25.8 billion at end-March. The following main factors affected the changes in reserves:

- The *net FX financing of the Government Debt Management Agency* (ÁKK) reduced the reserves by EUR 2.5 billion in total. At the same time, the maturity of FX bonds was neutral in terms of the Guidotti-Greenspan indicator. A USD bond matured in January, amounting to approximately EUR 0.9 billion at the exchange rate prevailing at the time of repayment. In January, the ÁKK purchased USD bonds worth around EUR 1 billion in a repurchase auction. In addition, a euro bond of EUR 0.8 billion also matured in January. The margin stock placed with the ÁKK added some EUR 0.2 billion to the reserves.

- The change in the stock of the forint liquidity providing FX swap instrument decreased the reserve level by nearly EUR 0.5 billion. As a result of the liquidity expansion early in the year, central bank O/N deposits significantly exceeded the target value of at least HUF 300–500 billion foreseen by the MNB for Q1, to which the central bank reacted with a cautious reduction of the swap stock.

- Starting from March, in addition to the usual expenditures (e.g. FX interest payment), the equipment purchases by the government that were related to managing the health crisis and were paid in foreign currency were also reflected in the reserve reducing impact of the *FX transactions of the Hungarian State Treasury*.

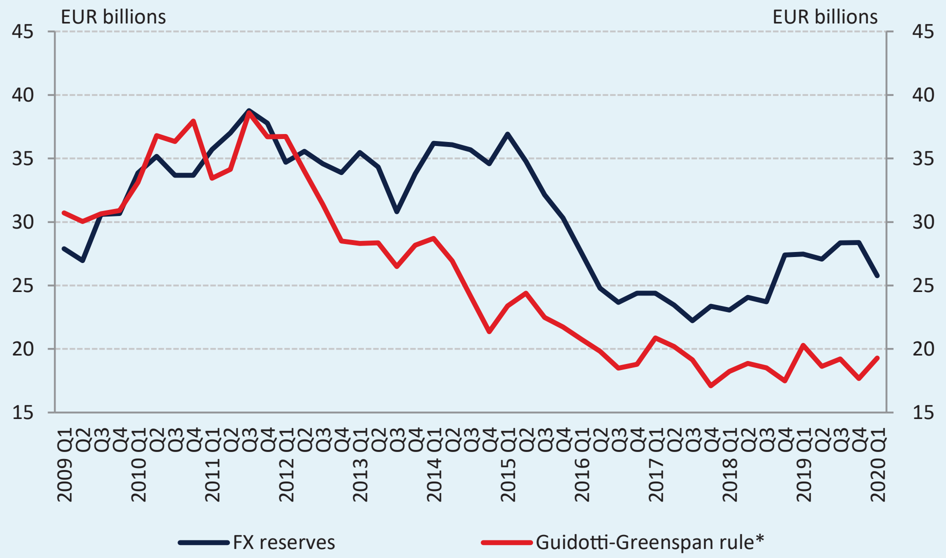
- The reserve increasing effect of *EU funds*, which are the most important among the reserve increasing factors, was EUR 0.6 billion, resulting primarily from agricultural subsidy programmes and to a lesser extent from the payment by the European Commission of the performance-based invoices of the 2014–2020 EU budget cycle.

- In addition, the reserves were also increased by revaluations of other currencies stemming from their strengthening against the euro as well as by the revaluation of gold expressed in euro.

At the end of 2020 Q1, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 6–7 billion. At end-March 2020, international reserves and short-term external debt amounted to EUR 25.8 billion and EUR 19.3 billion, respectively. Compared to the level of EUR 10 billion at end-2019, reserve adequacy compared to short-term external debt declined in 2020 Q1, but the leeway above the

Guidotti-Greenspan indicator, which is closely followed both by the central bank and investors, was still significant, amounting to EUR 6.5 billion at end-March (Chart 18). As a result of an increase in FX reserves, reserve adequacy leeway started to increase again in Q2.

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



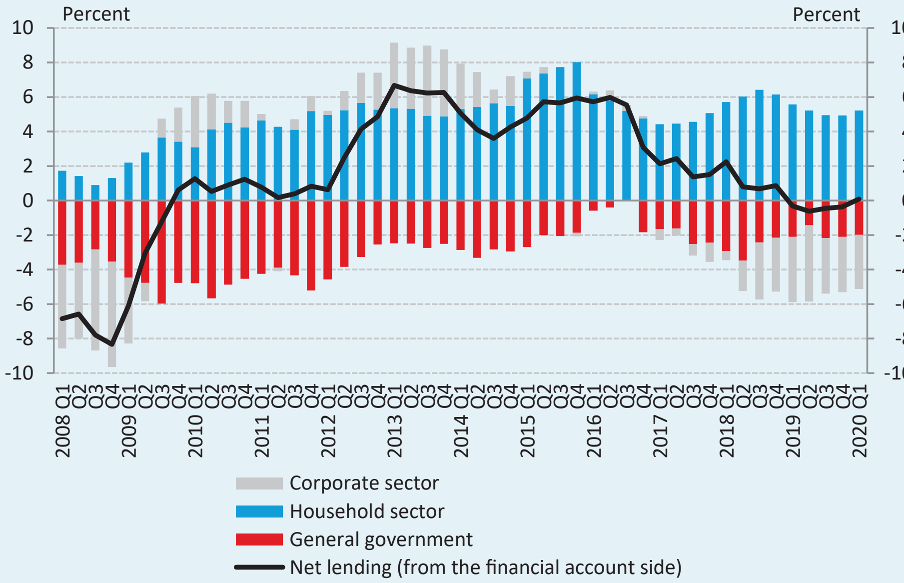
** Guidotti-Greenspan rule: short-term external debt based on residual maturity.*

4. Sectors' savings approach

The increase in net lending was primarily attributable to the higher savings position of the private sector, while the net borrowing of the state stabilised at a low level. In relation to the income outflows, which were strong at the beginning of the year, households' net savings position increased considerably. Households' holdings of government securities continued to increase during the quarter, which was mainly attributable to purchases of the long-term MÁP+ securities.

Based on the sectors' savings developments, households and companies were the main contributors to the rise in the net lending of the Hungarian economy (Chart 19). Both the increase in households' net savings and the decline in corporate net borrowing resulted in an improvement in the external balance position. In addition, as a result of more restrained public investment in Q1, the four-quarter net borrowing of the general government stabilised at a low level: the deficit level remained around 2 percent of GDP, which can be deemed moderate. In line with the decline in consumption dynamics at the end of the quarter due to the pandemic, households' financial asset accumulation continues to be high, which – together with the deceleration in lending – supported an increase in net financial savings. In the case of companies, the inventory level, which was lower than one year ago, and the income increasing effect of the declining oil prices were reflected in the decrease in net borrowing as well.

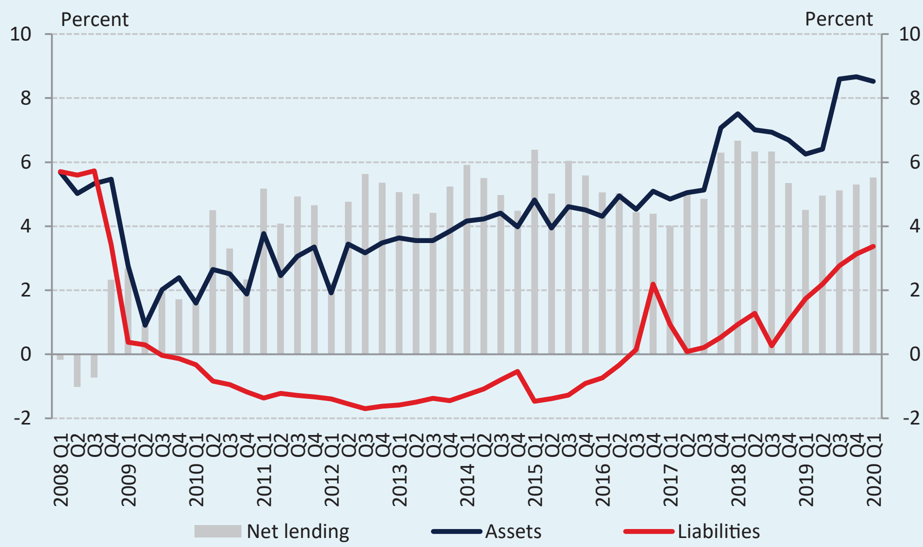
Chart 19: Net lending of specific sectors (four-quarter values as a percentage of GDP)



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

Households' net financial savings according to seasonally adjusted underlying trends rose to above 5 percent of GDP in Q1 (Chart 20). Early in the year, there was a further upswing in households' credit demand, mainly due to the growing popularity of prenatal baby support loans, while real estate loans also expanded considerably. As a result, households' net borrowing increased to 3.5 percent of GDP in Q1. The outflow of still dynamically expanding prenatal baby support loans may have partly added to financial assets as well, and thus may have had an impact on the still historically high level of financial asset accumulation.

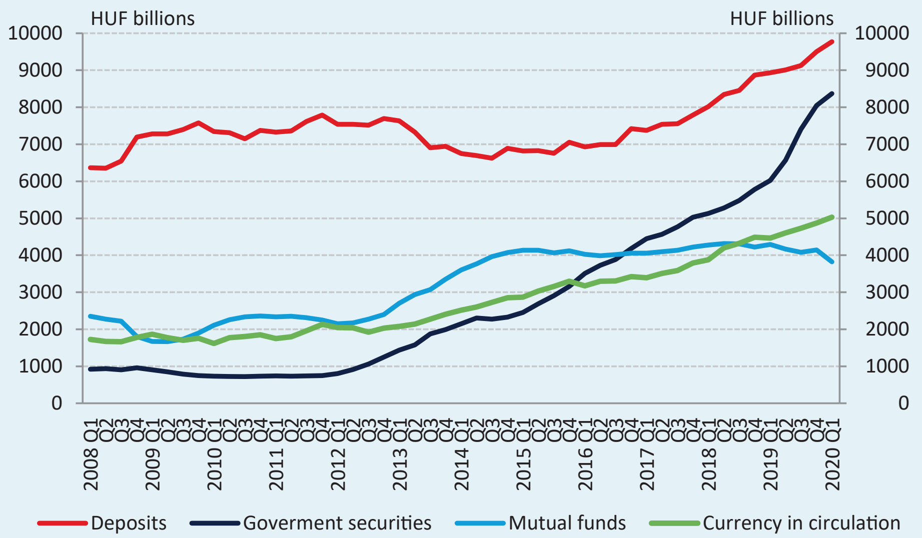
Chart 20: Net lending of households (seasonally-adjusted, revised* values, as a percentage of GDP)



**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.*

At the end of Q1, with mounting uncertainty about the pandemic, households increased their cash and current account deposit holdings (Chart 21). As the effects of the coronavirus pandemic strengthened, households accumulated considerable cash reserves: instead of the usual decline in cash holdings in Q1, holdings of banknotes and coins grew by some HUF 160 billion. The increase in current account deposits also significantly exceeded the figure for the same period of the previous year. As uncertainty rose, sales of long-term, risky mutual fund shares, which suffered a serious price loss in Q1, accelerated. Purchases of retail government securities slowed down: holdings of MÁP+, the new government security, increased considerably, but there was also a major decline in the holdings of shorter-term securities. Nevertheless, households' government securities holdings rose by HUF 300 billion and continued to contribute to the reduction of Hungary's external vulnerability.

Chart 21: Developments in households' key financial assets



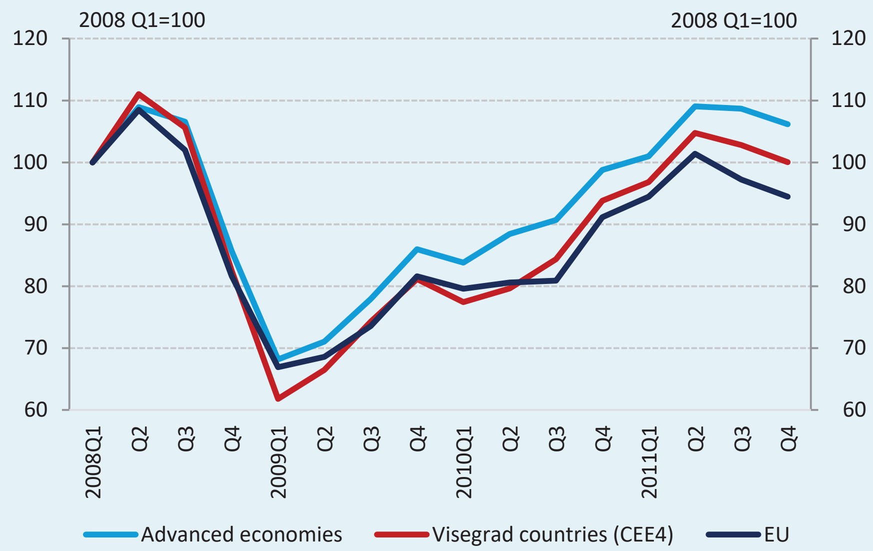
5. Crisis and trade – experiences of the 2008–2009 crisis

The Covid-19 pandemic has dealt a major blow to external trade. Revisiting the effects of the previous crisis over a decade ago may be helpful in mapping out the potential impacts. It took almost three years to overcome the negative impacts of the 2008 crisis on external trade, and the previously upward trend in the trade-to-GDP ratio turned into stagnation. In this respect, the virus may change the future path of global trade once again, in a direction that is presently unclear. While the 2008 crisis impacted trade in services to a lesser degree than trade in goods, the current situation could be quite different. As an important development in terms of external balance, the post-2008 drop in exports reduced the income deficit through the declining profits of foreign-owned companies. In addition, the decline in oil prices typically seen in times of crisis improves the balance of trade of energy-importing countries. Overall, the current account balance of the EU countries formerly exhibiting significant deficits generally improved as a result of the 2008 crisis.

In the current circumstances, the impacts of the 2008–2009 crisis may provide some guidance as to the developments to be expected in external trade. Covid-19 has triggered significant changes in the economies, also affecting trade. Although the extent and the dynamics of the changes vary across countries, revisiting similar experiences from the past may be helpful. A relatively recent example is the financial and economic crisis of 2008–2009 that had major impact on trade, a review of which could provide important lessons as to the effects of the Covid-19 pandemic.

Currently, there are several additional factors influencing the speed of the recovery. After the 2008 crisis, it took almost 3 years for the economies to return to the earlier export levels, which means a relatively slow, prolonged recovery. The global economy hit the low point of the crisis in 2009 Q1 and then generally started to recover after that. The euro-area debt crisis in 2011–2012 made the recovery more difficult for the EU countries. However, the speed of the recovery now depends not only on the level of development, the economic resilience and the monetary and fiscal impulses characteristic for the particular region, but also on the timing of the coronavirus outbreak and the length of the resulting standstills in the manufacturing and services sectors. As the virus peaks or will reach its peak at different times around the world, the impacts on industrial production and supply chains will also spread across different time frames. Currently, it is extremely difficult to gauge the durability of the Chinese and European recoveries or to tell when the virus will die down in North and South America, the Middle East and India. A possible second wave of Covid-19 poses further significant uncertainties.

Chart 22: Exports by regions



Source: IMF.

The 2008 crisis also resulted in considerable changes in the export of goods and services: the upward trend in export-to-GDP ratios that had lasted for four decades came to an end after 2008. The question is how the coronavirus-induced crisis will impact exports as a percentage of GDP, also reflecting globalisation changes: prolonged lockdowns and shorter supply chains may reduce export-to-GDP ratios and extend the recovery period as well. The 2008 crisis primarily caused a demand shock without changing the supply chains. By contrast, the current crisis has disrupted the supply chains and could result in a supply shock. The supply chains of the developed economies may see major changes: the developed countries that used to rely on a specific emerging region for supplies will try to diversify imports to a greater extent or rely on their own economies for the necessary raw materials, semi-finished products and spare parts. At the same time, the developing regions will also face challenges due to the changing supply chains. Among the regions, the countries of Europe, the Middle East and Africa (EMEA) have reached the highest level of integration in the global supply chains overtaking Latin America and Asia, and the highest level of resilience thanks to reliance on diversified products and suppliers for their relatively import-intensive economies. The countries of Asia and South America are disadvantaged partly due to less diverse imports (limited to few products) necessary to support exports and the relative scarcity of trade partners, which makes it difficult to face the challenges resulting from the transforming supply chains.

Chart 23: Export of goods and services around the world as a percentage of GDP

Source: World Bank.

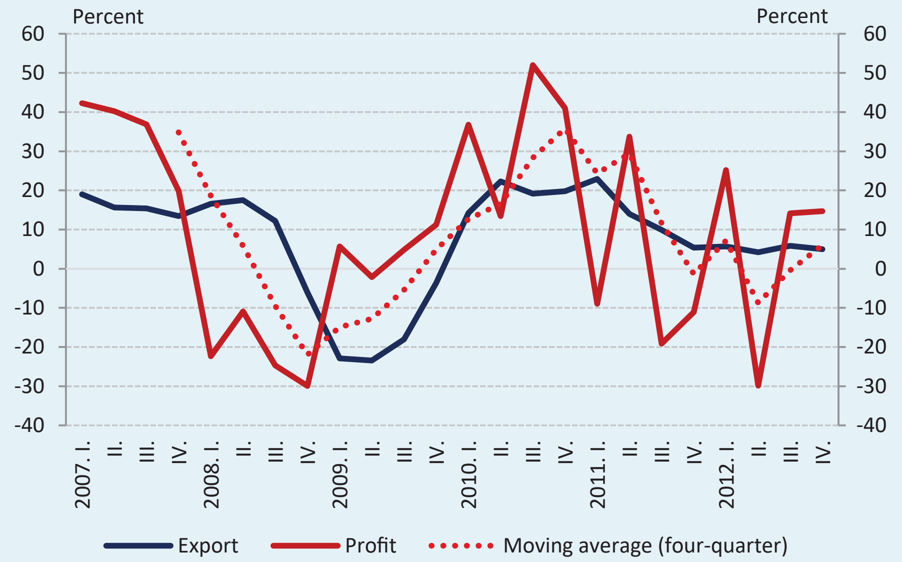
Trade in services is generally less impacted by recession and capable of mitigating the effects of crises, although the current situation is quite different. The crisis resilience of services is well illustrated by the 2008 financial crisis, when exports of goods dropped more dramatically than exports of services in the developed economies. The current crisis, however, may influence the services sector to a much greater extent. As a result of curfew restrictions, the impact on the services sector may be more prolonged and more extensive than on the manufacturing sector for fear of infection in the concerned countries. The more developed the economy, the greater the weight of services in terms of economic growth within the country. Due to the pandemic, however, it is precisely this sector that may take significantly longer to recover and therefore it is possible that, in contrast to the past, the services sector may not mitigate, but rather aggravate the impact of crisis and prolong the recovery period.

Chart 24: Annual growth of export of goods and services in developed countries

Source: ITC, UNCTAD, WTO.

In 2008, the drop in exports reduced the income deficit and improved the current account balance, due to the declining profits of foreign-owned companies. Export dynamics play a dominant role in the profitability of foreign-owned companies. In the 2008 crisis, declining exports led to a significant fall in the balance of profit, which determines the income deficit in the region. Accordingly, declining exports as a result of the coronavirus may reduce the income deficit and, *ceteris paribus*, improve the current account balance in the region this time as well.

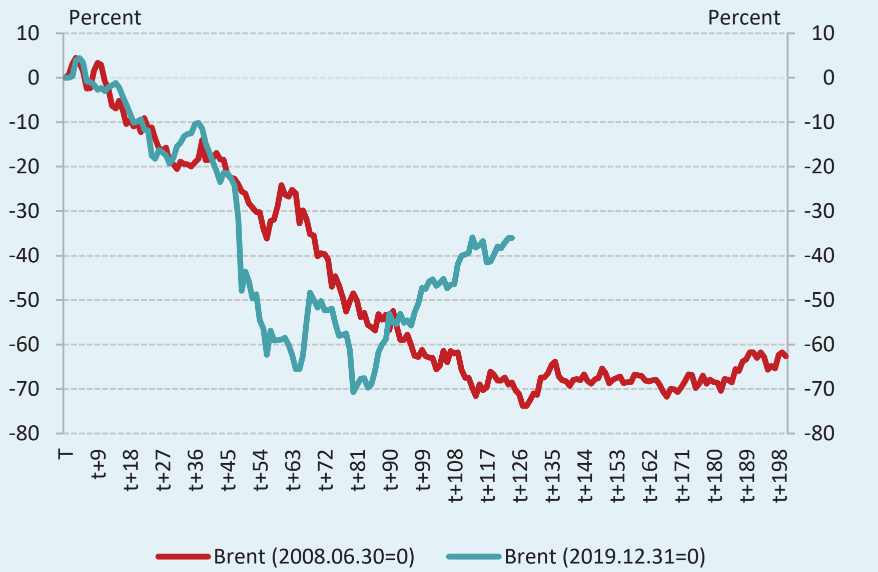
Chart 25: Average annual growth of profits earned by foreign-owned companies in relation to shares and exports in the Visegrad Countries



Source: Eurostat.

Due to lower demand, oil prices tend to fall in crisis, leading to better terms of trade and an improved current account balance. In the current crisis, oil prices dropped more rapidly, but also seemed to rebound much faster than in 2008. The current rise in oil prices has been supported by positive market sentiment as market participants anticipate an end to the previous oversupply based on improving demand and the larger-than-expected supply drop, but the outlook (second wave of the virus) remains highly uncertain. A recovery in demand is also challenged by the tensions between the USA and China.

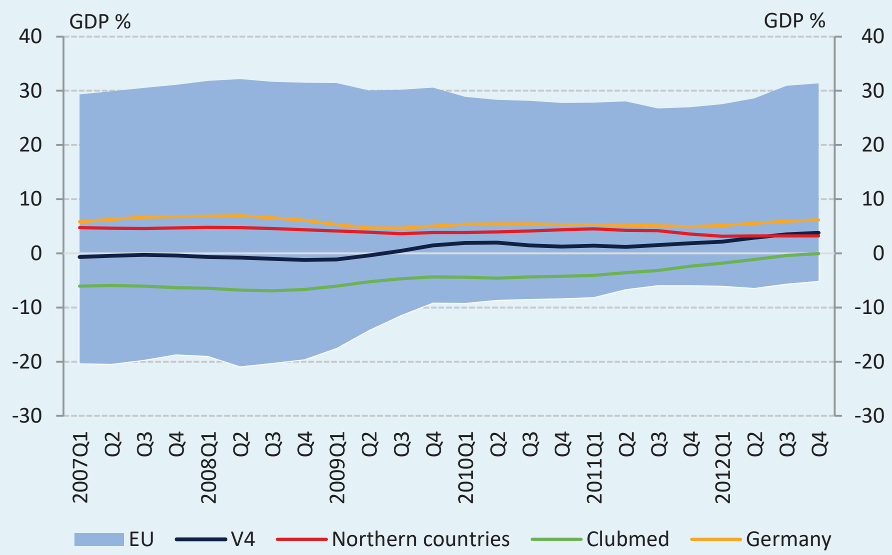
Chart 26: Brent oil price changes in 2008 and in the current crisis



Source: Bloomberg.

As a result of the 2008–2009 crisis, the trade-to-GDP ratio rose significantly in the EU Member States. In some countries which previously had excessive deficits, such as the Mediterranean countries, the ratio improved permanently, almost entirely eliminating the earlier current account balance deficits. In other EU Member States, e.g. in Germany and the northern countries, the steady current account surplus persisted in spite of the crisis. Net exports may be shaped by opposite forces in the wake of the virus: on the one hand, temporary halt in production and health protection related costs could indicate a higher deficit, the extent of which in the current account balance may be reduced by additional declines in the income deficit and favourable terms of trade resulting from lower oil prices. The Visegrad Countries weathered the 2008 crisis with more favourable trade surplus than any other groups within the EU.

Chart 27: Balance of trade in EU Member States and groups of countries



Source: Eurostat.

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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