



REPORT ON THE BALANCE OF PAYMENTS



2019
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, 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 developments 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 under the general guidance of Barnabás Virág, Executive Director for Monetary Policy and Economic Analysis. Contributors: Anna Boldizsár, Gabriella Csom-Bíró, Zsuzsa Nagy-Kékesi, Balázs Kóczyán, Péter Koroknai, Dániel Simon and Balázs Sisak. The Report was approved for publication by Márton Nagy, Deputy Governor.

This Report is based on information pertaining to the period ending 20 June 2019.

Summary

In 2019 Q1, **based on four-quarter data, the net lending of the economy and the current account surplus amounted to 2.1 percent and 0.1 percent of GDP, respectively.** External balance indicators continue to be **more favourable than the levels typical in the countries of the region.** As a result of further outflows of debt-type liabilities, **the indicators reached new historical lows, as external debt ratios declined.** Together with the continued increase in households' government securities holdings, these developments **further reduced Hungary's external vulnerability.**

According to the real economy approach, in conjunction **with a decline in the trade balance** and lower absorption of EU transfers, the transfer balance also fell slightly. The goods balance continues to be **determined by strong domestic demand,** but in Q1 **the utilisation of previously accumulated inventories resulted in a significant improvement in the trade balance.** Consequently, the balance **declined to a smaller degree than previously,** and **export growth once again exceeded import growth.** In addition, the contribution of net exports to growth became positive again, although its impact was offset by the deteriorating effect of the terms of trade on the trade balance. The dynamic growth in imports is primarily attributable to buoyant corporate investment activity, which improves the long-term growth capacity of the economy. As a result of **the decline in interest paid to abroad, the deficit on the income balance continued to fall.**

The annual external position calculated **on the basis of the financing side** shifted to **net borrowing in early 2019. This borrowing was driven by net FDI fund inflows of EUR 1.5 billion,** which significantly exceeds the figures for the same period of previous years. During the quarter, the **net debt-type liabilities of the economy fell by nearly EUR 1 billion:** in contrast to the reduction of government and corporate debt, the net external debt of the banking sector rose. The **decline in the net external debt of the general government** is the result of the absorption of EU funds and primarily the decline in non-residents' government securities holdings. In addition to the outflow of funds, **the growth in nominal GDP also contributed to the decline in external debt indicators,** which is favourable in terms of external vulnerability. Accordingly, **the net external debt-to-GDP ratio decreased to a historical low of nearly 8 percent, while gross external debt fell to below 57 percent of GDP,** mainly as a result of the declining dependency of the state on external funding. The country's **short-term external debt amounted to EUR 19.3 billion,** mainly as a result of adjustment following banks' year-end balance sheet optimisation and a dollar bond maturity that became short-term. Thus, the March level of **FX reserves** was at EUR 27.5 billion, which **continues to substantially exceed the level expected and considered safe by investors.**

In terms of developments in savings, **the net position of the private sector declined,** while **the net borrowing of the government decreased further.** The **rise in corporate funding requirements** may primarily be attributable to **the high investment activity** and wage outflows. In parallel with the significant rise in wages, growth in household consumption also accelerated in early 2019, leading to **a decline in households' net financial savings.** Nevertheless, the net saving position of the sector remained significant. In the quarter under review, **households' holdings of government securities continued to expand.** In addition, **vulnerability risks** were also **reduced** by the fact that households preferred to purchase **long-term securities.**

In our special topic, we discuss the relevant aspects of **the export performance of the Hungarian economy** in terms of external vulnerability and competitiveness. The **export market share of the Hungarian economy exceeds the value following from the size of the domestic economy,** but at the same time its **growth in the past years was below the average of the region,** which was also attributable to the fact that the export market share had already increased significantly in Hungary in the 1990s. Similar to the other countries of the region, **Hungarian goods exports have a high import content;** therefore, the domestic added value of exports is low. Nevertheless, **the indicator has improved in the recent years,** which is almost unique in the EU. Hungary's foreign trade performance is among the leaders in Europe in some very important sectors: **the ratio of exports of high-tech products and services to total exports is also outstanding** in Hungary. The **geographical orientation** of goods and services exports **can be considered relatively concentrated, but the decline in the concentration of goods exports indicates an improvement in the diversification of exports** as well as a decrease in exposure to external developments, which can be considered a **favourable trend** in terms of external vulnerability and competitiveness.

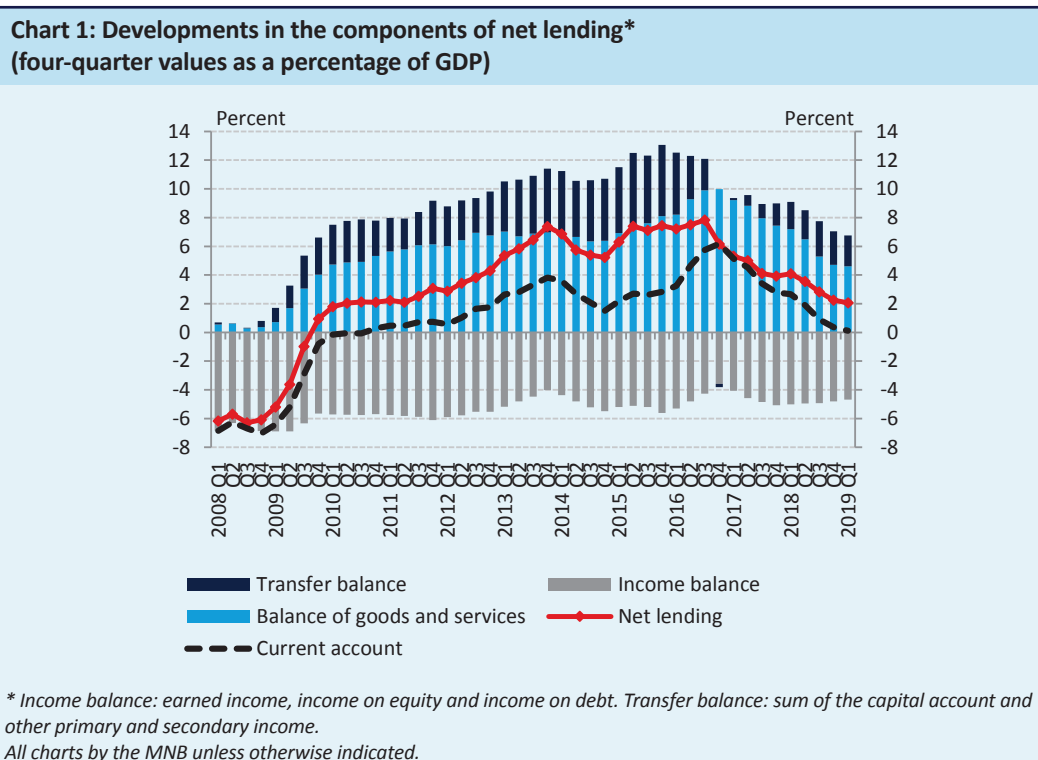
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1 Real economy approach

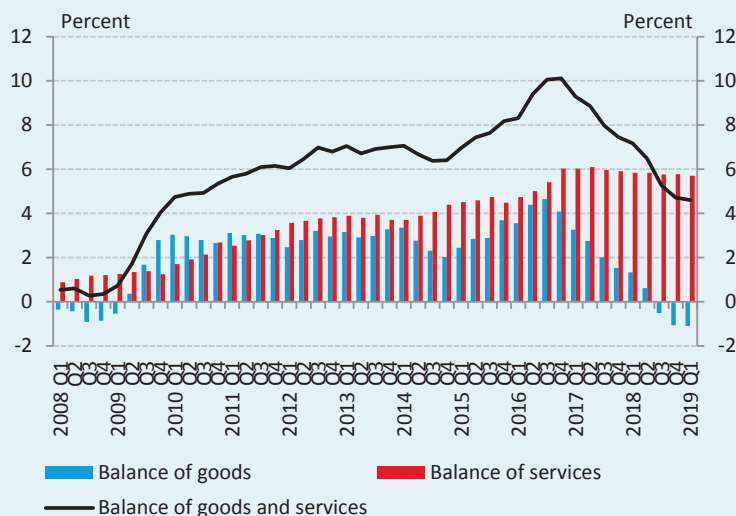
Based on the real economy approach, in 2019 Q1 the four-quarter net lending of the Hungarian economy and the current account surplus amounted to 2.1 percent and 0.1 percent of GDP, respectively. These values still exceed the levels observed in the countries of the region. The decline in net lending is attributable to the decrease in the trade balance, while the transfer balance also fell slightly in parallel with lower absorption of EU transfers. It was a determinant in foreign trade developments in early 2019 that while exports expanded increasingly, the pace of growth in imports was only subdued. This was attributable to the utilisation of previously accumulated inventories. At the same time, the ensuing trade surplus was roughly offset by the balance-impairing effect of the deterioration in the terms of trade. On the whole, the decrease in the trade balance was less significant than before. The income balance deficit continued to decline as a result of the fall in interest expenditure paid to abroad.

In 2019 Q1, according to the real economy approach Hungary's four-quarter net lending and the current account surplus amounted to 2.1 percent and 0.1 percent of GDP, respectively (Chart 1). According to seasonally unadjusted quarterly figures, net lending in Q1 amounted to EUR 1.2 billion, as a result of surpluses of more than EUR 0.3 billion and nearly EUR 0.9 billion on the current account and capital account, respectively. The smaller decline in the four-quarter balance of the current account and net lending took place in conjunction with a slight decrease in the trade surplus and the transfer balance.

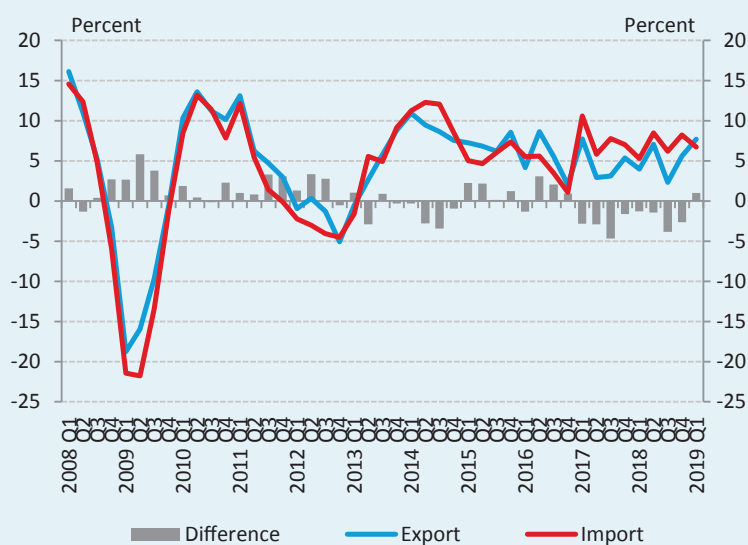


1.1 Trade balance

Trade surplus declined only slightly at the beginning of 2019, and thus its size is still significant (Chart 2). The decline in the trade balance which started at the beginning of 2017 continued in 2019 Q1 as well, although at a slower pace than in the previous periods. As a result, the trade surplus amounted to 4.6 percent of GDP at the end of the period under review. The 0.1-percentage point decline in the four-quarter trade balance as a proportion of GDP was attributable to similar decreases in the goods balance and the services balance. The services surplus still amounts to nearly 6 percent of GDP, and thus – as the goods deficit stabilised around 1 percent – the services sector plays a major role in the trade surplus and the current account surplus, while exports of services only account for 20 percent of total exports.

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

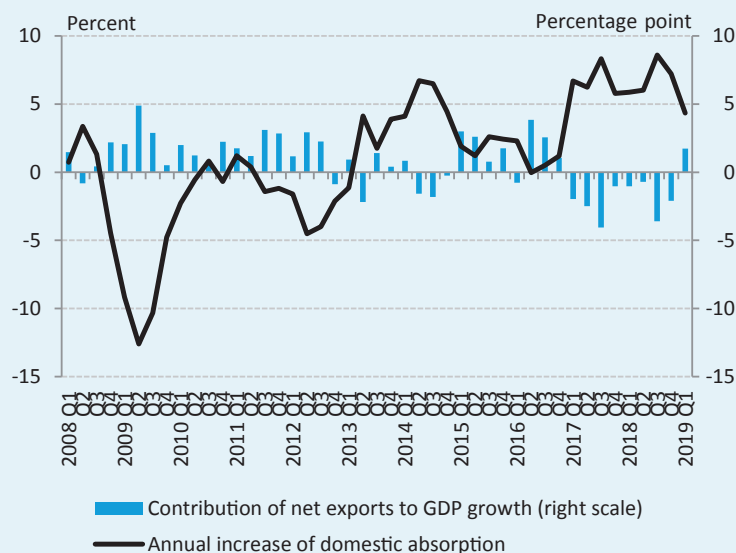
In early 2019, while exports accelerated, the growth rate of imports decelerated. As a result, the difference between the annual real growth rates of exports and imports became positive for the first time since 2016 (Chart 3). Following a slowdown in 2018 Q3, which was presumably attributable to changes in rules affecting the automotive industry segment, the real growth rate of exports accelerated considerably. The main contributor to exports of machinery and transport equipment, which have a considerable weight in exports, was the highly dynamic road vehicle exports, but the expansion in exports of pharmaceutical products also exceeded the average of previous years. Due to the significant import content of exports, the growth rates of exports and imports shifted in similar directions in the previous quarters. However, a major change took place in 2019 Q1, as in spite of the significant acceleration in the growth rate of exports, the growth rate of imports actually slowed down. As a result of the rise in consumption and the increase in capacity-expanding investment, imports have been growing by 5–8 percent, i.e. relatively steadily, in annual terms for nearly two years, and this trend continued in 2019 Q1 as well. The absorption of GDP in Q1 may explain the differences in dynamics: namely, at the beginning of 2019, the accumulation of inventories was very low, i.e. the high export growth and compared to that the relatively low import growth was partly attributable to the utilisation of previously accumulated inventories.

Chart 3: Annual real growth in exports and imports

Sources: HCSO, MNB.

Due to the decline in inventories, the annual growth rate of domestic absorption decelerated considerably in early 2019, and, in line with that, the contribution of net exports to growth turned positive again after two years (Chart 4). In 2019 Q1, both household consumption and the investment of the sectors accelerated, while the decline in inventories significantly restrained domestic absorption and thus economic growth as well (the contribution of inventories to growth was -4 percentage points in Q1). At the same time, through the higher exports and lower imports, the utilisation of inventories significantly improved the contribution of net exports to growth. Accordingly, net exports once again had a positive impact on growth for the first time since 2016.

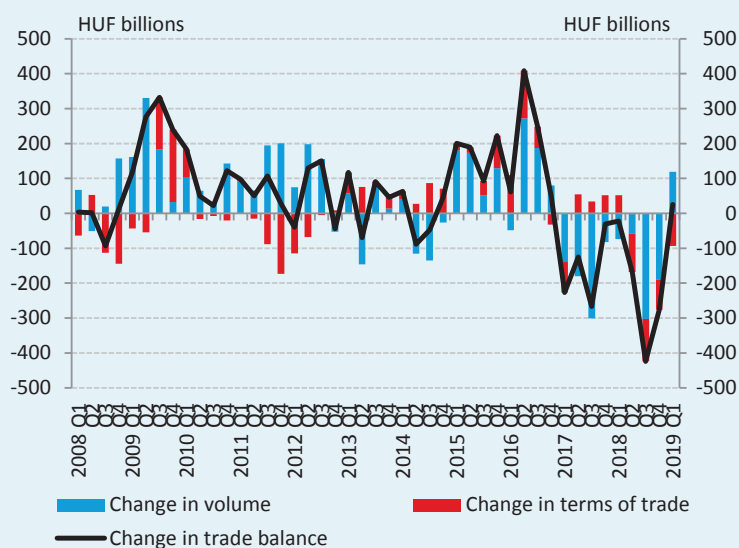
Chart 4: Annual growth rate of domestic absorption and contribution of net exports to GDP growth



Source: HCSO.

The favourable developments in the trade surplus in 2019 Q1 were attributable to the change in volume, while the change in the terms of trade still had a negative impact on the balance. As a result of the rise in oil prices during 2018, the deterioration in the terms of trade resulted in a major worsening of the trade balance, and this effect reduced the trade surplus by some HUF 100 billion in annual terms in early 2019 as well. However, as a result of the developments described above, in line with the positive contribution of net exports to growth, the change in volumes roughly offset this effect, in contrast to the developments seen in the past two years (Chart 5).

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

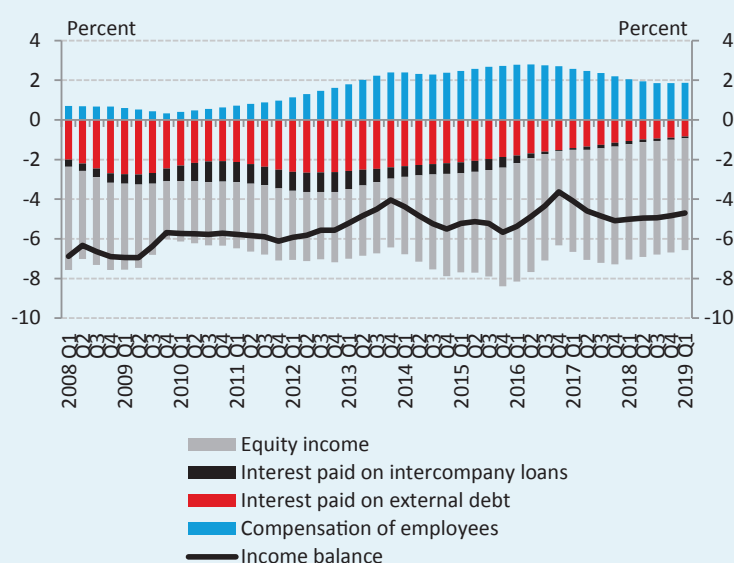


Source: HCSO.

1.2 Income balance

The income deficit declined further in early 2019, which is mainly attributable to the decrease in interest expenditure paid to abroad (Chart 6). In 2019 Q1, the income deficit fell to 4.7 percent of GDP. Within the income balance, the largest item is the profit to foreign-owned companies, which still shows a deficit of around 5.7 percent of GDP. The surplus of the compensation of employees, which reduces the deficit of the income balance, became stable in the past quarters, following the decline observed since 2016. By contrast, in parallel with the decrease in external debt ratios, net interest paid on foreign loans and intercompany loans continued to decline (the sum of these two items is already less than 1 percent of GDP, compared to nearly 4 percent in 2012), thus also resulting in an improvement in the income balance as a whole.

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

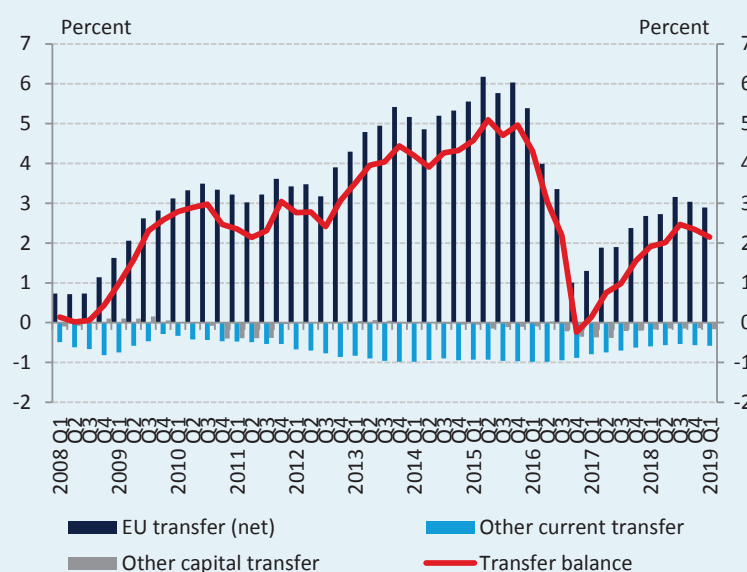


* Income balance: earned income, income on equity and income on debt.

1.3 Transfer balance

In 2019 Q1, in line with the slight decline in the absorption of EU funds, the surplus of the transfer balance declined (Chart 7). The absorption of EU funds was relatively high (nearly EUR 1 billion) in early 2019 as well, but fell slightly short of the value observed one year earlier. Accordingly, the four-quarter absorption of EU transfers was lower. Nevertheless, net EU transfer absorption, which amounts to close to 3 percent of GDP annually, continued to significantly contribute to sustaining Hungary's favourable external balance position. The balance of other current transfers and other capital transfers remained practically unchanged during the quarter.

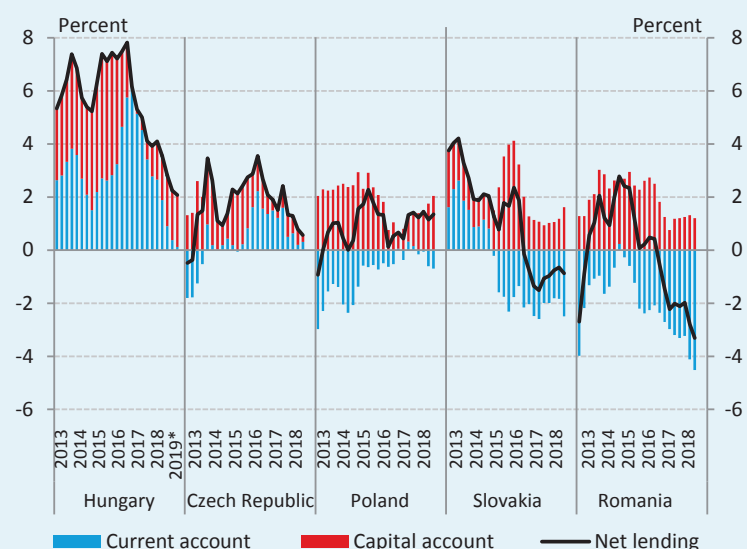
**Chart 7: Four-quarter developments in the items of the transfer balance
(four-quarter values as a percentage of GDP)**



1.4 Regional outlook

The net lending of the Hungarian economy is still outstandingly high among the countries of the region, and in contrast to the surplus in Hungary, the current account balance shows a deficit in most of the countries of the region (Chart 8). In the past quarters, external balance indicators typically declined in the countries of the region. As a result, the four-quarter current account deficit in Romania already exceeds 4 percent of GDP, while in Poland the deterioration in the current account balance was broadly offset by an improvement in the capital account (presumably related to EU transfers). Some improvement in both indicators was observed only in Slovakia, but it is worth considering that the current account shows a significant deficit of around 2 percent of GDP in this country as well. Accordingly, in spite of the decline observed in Hungary, the net lending of the Hungarian economy still considerably exceeds the level typical of the region, which is attributable to the high services balance and capital account.

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



Sources: MNB, Eurostat

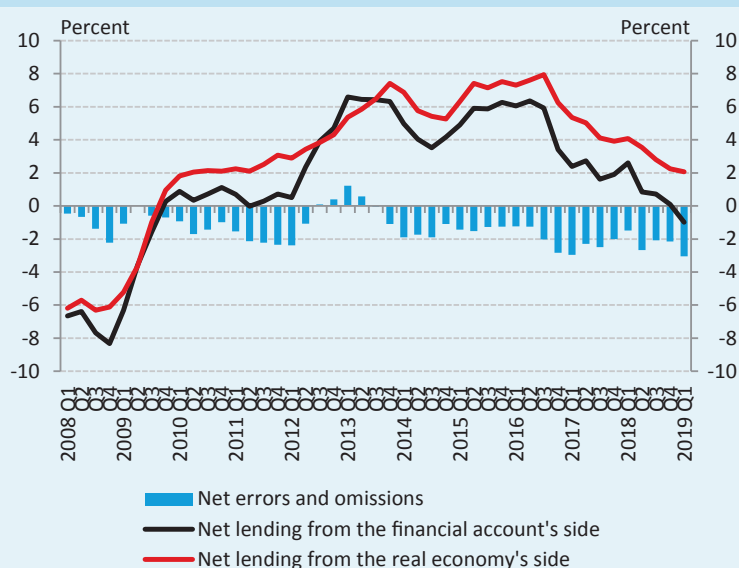
*2019 Q1 data are available only for Hungary.

2 Financing approach

The four-quarter net borrowing calculated on the basis of the financial account amounted to 1 percent of GDP in Q1. Against the background of a decline in the outflows of debt-type liabilities and continuous, significant inflows of non-debt liabilities, the quarterly indicator turned into net borrowing in the third quarter of last year, before starting to increase gradually. In Q1, net FDI funds increased by EUR 1.5 billion, which significantly exceeds the figures for the same period of previous years. During the quarter, debt-type liabilities fell by EUR 1 billion, as a result of the contrasting effects of the debt reduction of the general government and companies and the temporary rise in the net external debt of the banking sector. The increase in banks' net external debt was related to a strong rise in short-term liabilities, which is explained by the adjustment of the balance sheet optimisation at the end of the year. The decline in the net external debt of the general government primarily results from the decrease in non-residents' government securities (mainly discount treasury bill) holdings.

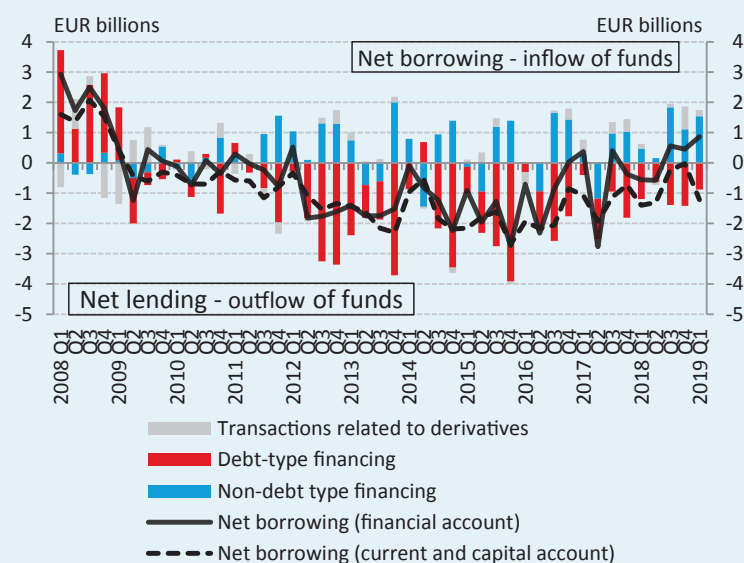
In 2019 Q1, four-quarter net lending according to financing data turned into net borrowing (from the close-to-zero value of the previous quarter) and amounted to 1 percent of GDP (Chart 9). By contrast, four-quarter net lending calculated on the basis of the real economy approach showed a surplus in spite of the decline, i.e. despite the surplus of the current and capital accounts, the financing items indicate inflows of foreign funds.¹ As there was a significant difference in the rates of decline for the two indicators, the balance of errors and omissions increased considerably, and thus it already exceeds 2 percent of GDP, which is the usual value according to experience.

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



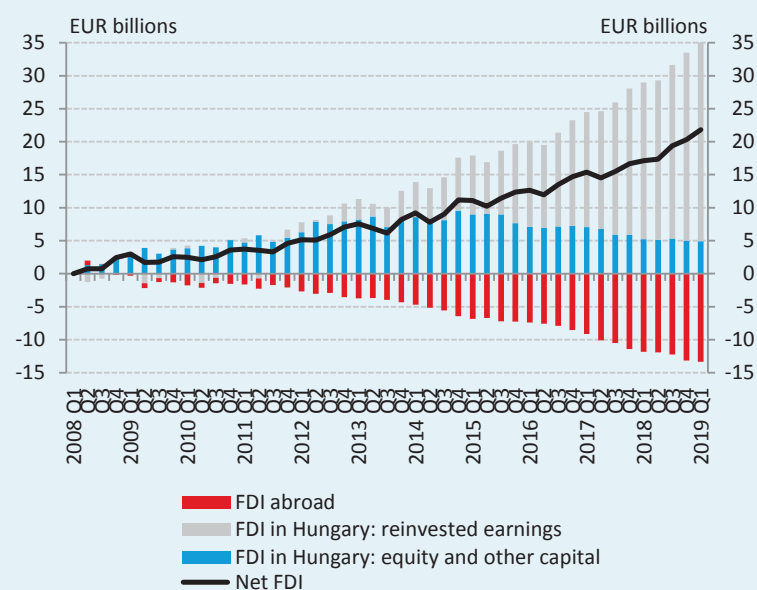
The sizable increase in the four-quarter value of the net borrowing calculated on the basis of the financial account was attributable to the fact that 2019 Q1 data also showed significant inflows of funds (Chart 10). The inflow of funds was related to a large rise in non-debt liabilities, and in parallel with that the outflow of debt-type liabilities declined to below EUR 1 billion. Non-debt liabilities increased by more than EUR 1.5 billion, which is a value similar to those observed in the previous quarters but is much higher than in the same periods of the previous years.

¹ Trends in the balance of payments can also be analysed by examining the financing of real economy transactions. Indeed, the financial account shows what types of transactions were used by resident economic agents to finance transactions in the real economy that had an effect on net financial worth. 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 rate, as indicated by the category 'Net errors and omissions'.

Chart 10: Developments in the structure of external financing (unadjusted transactions)

2.1 Non-debt liabilities

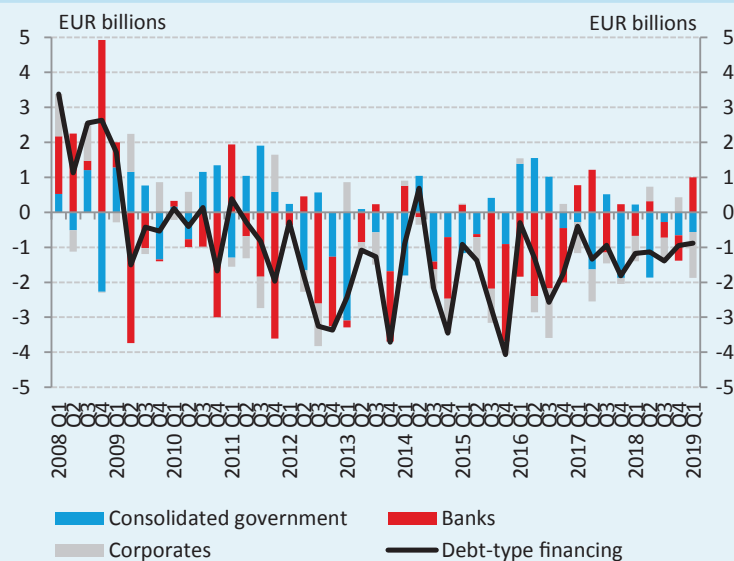
FDI-type funds increased by nearly EUR 1.5 billion, i.e. to a much larger extent than in the same periods of the previous years (Chart 11). Based on data net of capital-in-transit transactions and the restructuring of the asset portfolio, foreign direct investments once again rose to a greater degree in Q1. There was some slowdown in Hungarian companies' investments abroad in spite of the fact that a large Hungarian bank significantly increased its investments abroad. The growth in foreign companies' investments in Hungary was attributable to a rise in reinvested earnings, while intercompany loans extended by foreign companies declined further.

Chart 11: Developments in FDI without capital-in-transit transactions (cumulative transactions)

2.2 Debt liabilities

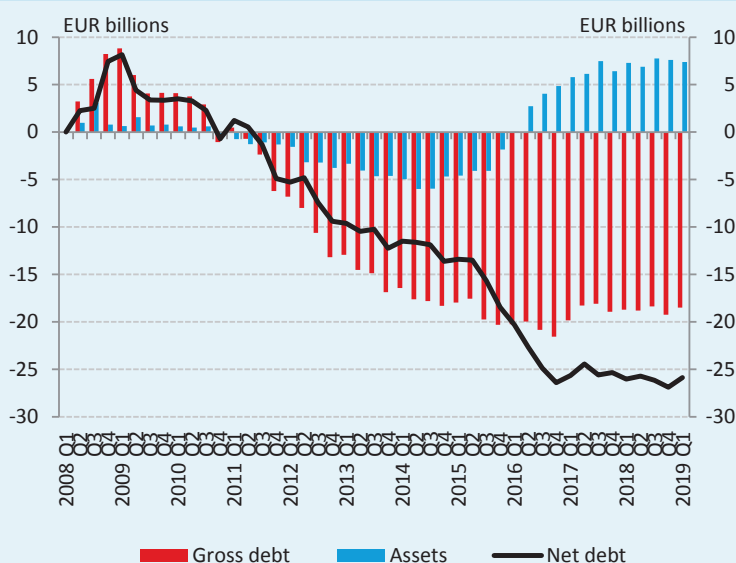
Outflows of debt liabilities declined to some extent in Q1, which was related to the general government and – to a larger degree – to companies (Chart 12). As an adjustment of the year-end balance sheet optimisation, banks increased their net liabilities vis-à-vis the rest of the world by the significant amount of nearly EUR 1 billion, while the corporate sector and the general government reduced their net external debts to a greater and to a lesser extent, respectively. The decline in the corporate sector's net indicator was attributable to an expansion in foreign assets, and – although to a smaller degree – external liabilities also increased in parallel with that. Banks' rising net external debt is partly attributable to the fact that following a decrease in Q4, the external debt returned to the previous level.

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



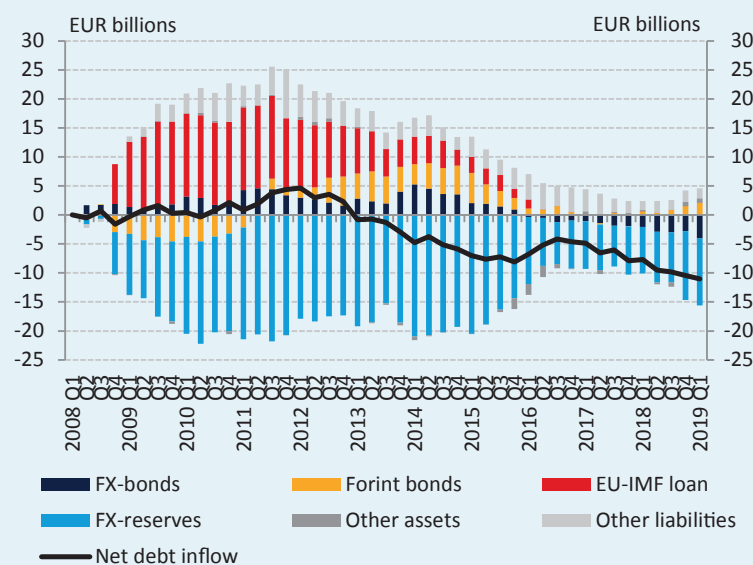
Banks' net debt inflow resulting from transactions was around EUR 1 billion in the quarter under review, which was primarily related to the rise in the sector's external liabilities (Chart 13). The main contributor to the rise in banks' net external debt was the increase in liabilities, but the slight decline in banks' foreign assets also contributed to the rise. Liabilities increased by EUR 750 million, while assets fell by some EUR 250 million. The increase in banks' gross external debt was almost entirely attributable to a rise in originally short-term liabilities.

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



The decline in the external debt liabilities of the consolidated general government including the MNB was primarily attributable to the decrease in the sector's external liabilities (Chart 14). The net external debt of the consolidated general government including the MNB fell by more than EUR 500 million, which is a result of a decrease in external liabilities, the impact of which was partly offset by the drop in FX reserves as a result of transactions.² Non-residents' government securities holdings declined considerably in the quarter under review: the rise in non-residents' long-term HUF-denominated government securities was offset by a decline in FX bonds and short-term HUF-denominated government securities. The repayment of FX bonds maturing in the quarter did not affect the net external debt, but reduced both the gross external debt and the FX reserves. As this was partly financed from an increase in households' government securities holdings, (self-)financing from domestic sources reduced the foreign-owned and FX ratios within government debt.

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



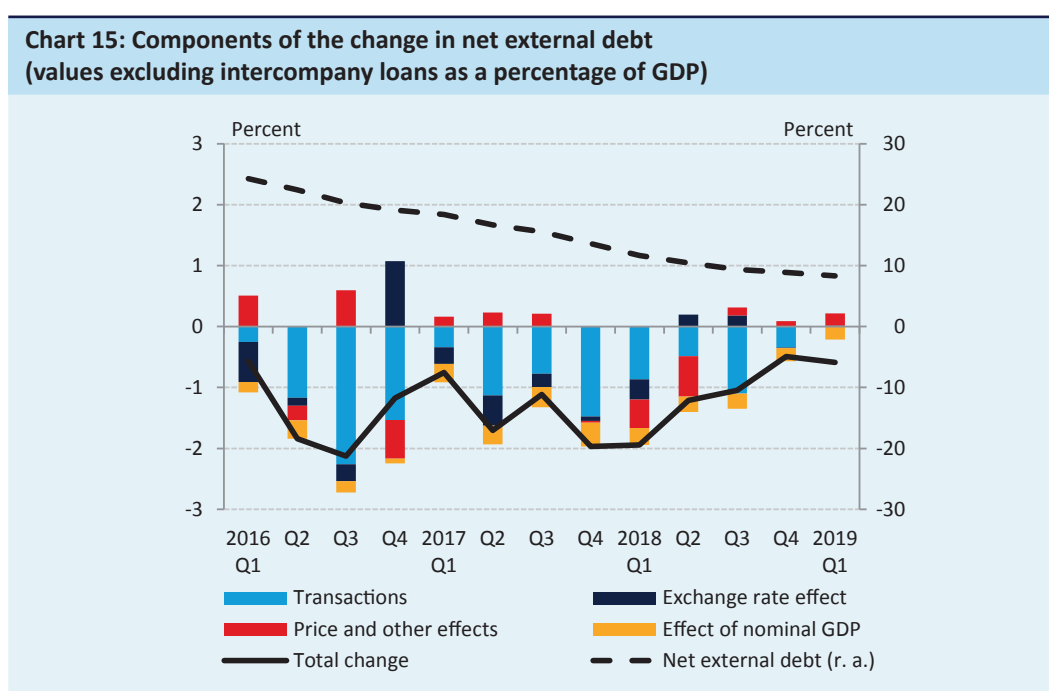
² The level of FX reserves, however, rose during the quarter as a result of revaluation effects (for more details see Chapter 3.3).

3 Developments in debt ratios

Hungary's net and gross external debt continued to decline in 2019 Q1. The net indicator sank to 8.3 percent of GDP, while gross external debt stood at 56.8 percent of GDP at the end of the quarter. The decline in net external debt was attributable to the debt outflow as well as a rise in nominal GDP. These effects, however, were offset somewhat by an increase in the debt ratio due to a fall in yields. The corporate sector played a larger role in the decline in net external debt, whereas the general government played a smaller role, while the net external debt of the banking sector grew due to the adjustment of the year-end balance sheet optimisation. In 2019 Q1, the short-term external debt of the country rose by EUR 2.1 billion to EUR 19.3 billion, mainly due to the adjustment following the balance sheet optimisation and a US dollar bond maturity that became short-term. Nevertheless, FX reserves continue to significantly exceed the level expected and considered safe by investors.

3.1 Developments in net and gross external debt

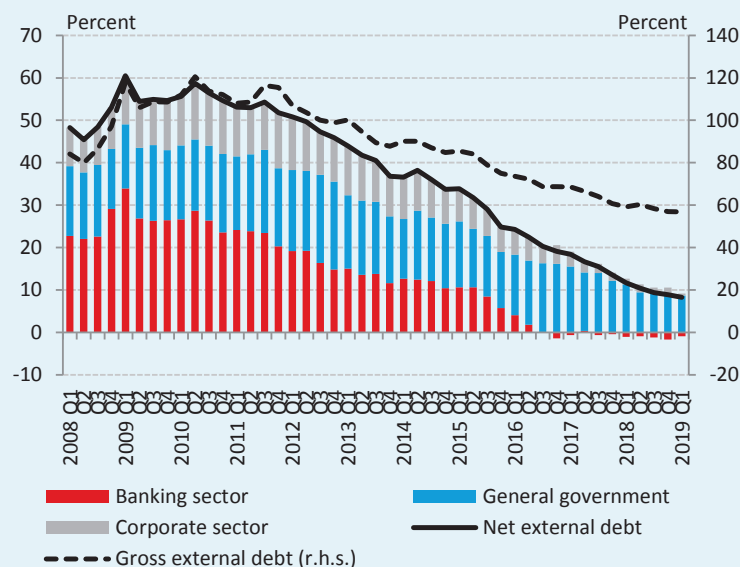
In 2019 Q1, net external debt of the economy continued to decline, as the indicator sank by more than 0.5 percentage point to 8.3 percent of GDP. Outflows of debt-generating liabilities as well as the rise in nominal GDP contributed to the decline in the indicator (Chart 15). Hungary's net external debt amounted to 8.3 percent of GDP. The decrease was mainly attributable to the outflow of debt-generating liabilities, which resulted in a 0.6-percentage point decline in the outstanding net external debt as a proportion of GDP. In addition, the expansion in nominal GDP reduced the debt ratio by 0.2 percent of GDP. At the same time, the revaluation of stocks added to the indicator: the fall in yields raised the figure by 0.2 percent of GDP.



The decline in net external debt was mainly driven by companies and to a lesser degree by the general government (Chart 16). Net external debt decreased to the largest degree, dropping by more than 1 percent of GDP, in the case of the corporate sector. The decline in the sector's net external debt-to-GDP ratio was mainly the result of the larger increase in companies' foreign assets compared to the increase in liabilities. Following the balance sheet optimisation at the end of the year, banks' net external debt increased. As a result of the decline observed for companies, the net external debt of the private sector decreased further and amounts to -0.4 percent of GDP. While according to transaction data the decline in the net external debt of the general government was attributable only to the sector's liabilities, the slight decline in the case of the stock data was the result of the fact that the decrease in the sector's external assets was more than offset by the decrease in the external liabilities of the state.

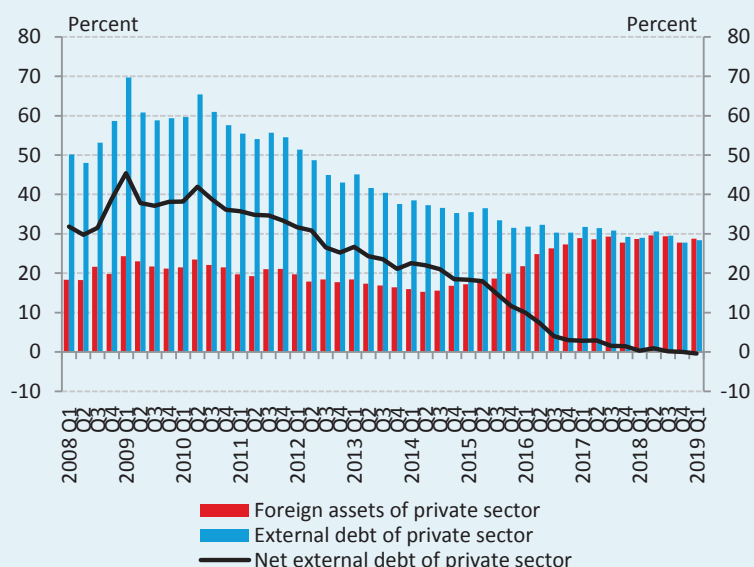
Following a slight decline, Hungary's gross external debt-to-GDP ratio stood at 56.8 percent of GDP in 2019 Q1. Looking at the developments by sector, the decline is explained by the decrease in the liabilities of the general government (non-residents' discount treasury bill and FX bond holdings). Based on transaction data, the gross external debt of the general government decreased only slightly in nominal terms, as the stock indicator was increased by the decline in yields. The gross external debt of the private sector, and within that of companies and the banking sector as well increased by 0.3 percent of GDP. The rise in the gross external debt of the private sector was primarily attributable to the increase in corporations' commercial credit outstanding as well as the correction of banks' external debt that is typical in Q1 following the year-end balance sheet adjustment.

Chart 16: Net external debt in a sectoral breakdown and gross external debt (as a percentage of GDP, excluding intercompany loans)



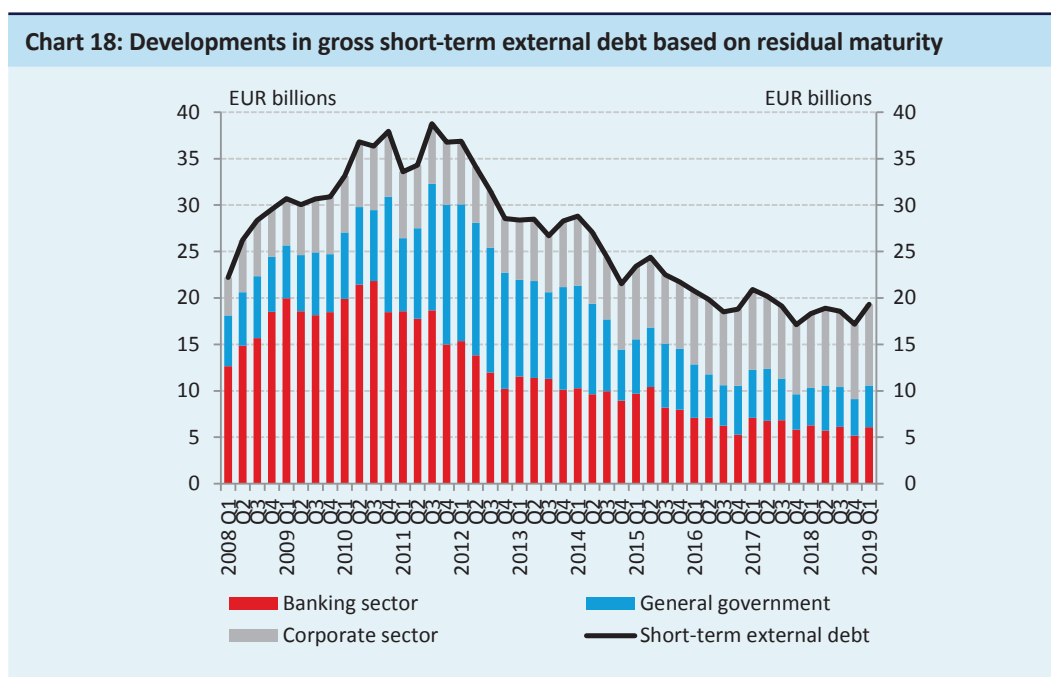
Primarily as a result of an increase in companies' assets, the net external debt of the private sector declined further in Q1 (Chart 17). The rise in foreign assets amounting to nearly 1 percent of GDP was the main contributor to the decline in the net external debt of the private sector. This effect was partly offset by the growth in the external debt of both the banking and corporate sectors. On the whole, as a result of the decline, the net external debt of the private sector is already negative, reaching -0.4 percent of GDP at the end of the quarter.

Chart 17: Developments in the private sector's external assets and liabilities (as a percentage of GDP)



3.2 Developments in short-term external debt

At the end of the first quarter of 2019, following a rise of EUR 2.1 billion, short-term external debt amounted to EUR 19.3 billion (Chart 18). All the three sectors played a role in the increase in short-term external debt:³ the growth is mainly attributable to the banking sector and to a lesser degree to the corporate sector and the general government. The short-term external debt of the banking sector was up by EUR 0.9 billion, which is mainly due to the adjustment following banks' year-end balance sheet optimisation. The rise of EUR 0.6 billion in the short-term external debt of the general government was mainly attributable to the increase in the debt that became short-term, and within that to the fact that one dollar bond's maturity became shorter than one year. At the same time, the increase in amortising debt was partly offset by the decline in originally short-term external debt, which is partly related to a decline in non-residents' discount treasury bill holdings. Corporations' short-term external debt increased by EUR 0.7 billion, which is mainly attributable to the rise in commercial loans.



3.3 Developments in foreign exchange reserves and reserve adequacy

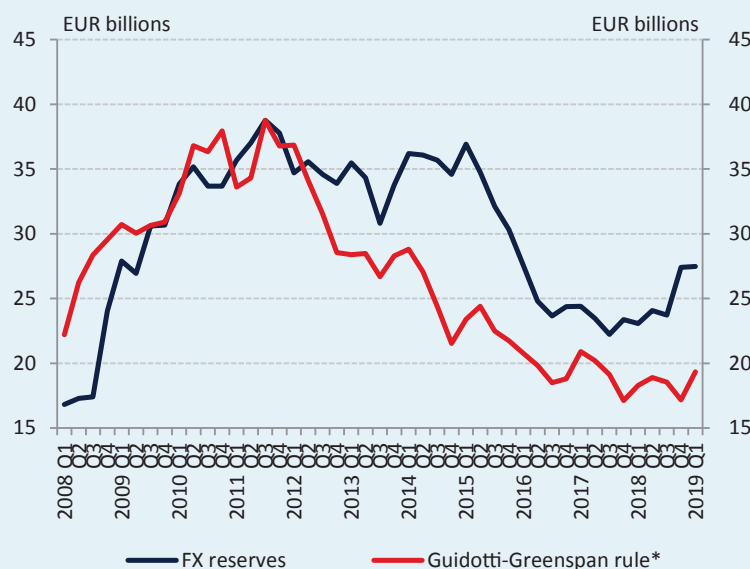
In 2019 Q1, the level of FX reserves rose slightly; the reserve reducing effect of items belonging to government debt financing was offset by the inflow of EU transfers. At end-March 2019, international reserves amounted to EUR 27.5 billion, representing an increase of EUR 70 million compared to the end-2018 level. The following main items influenced the changes in FX reserves:

- *EU funds* in excess of EUR 800 million received during the quarter constituted the main reserve-increasing item. In addition, some of the growth in reserves resulted from the *revaluation effect* of more than EUR 300 million of FX assets other than the euro and of gold expressed in euro as well as a change in the *mark-to-market deposit related to the hedging purpose swap transactions of the Government Debt Management Agency (ÁKK)* in a value of EUR 100 million.
- Of the *public foreign currency expenditures*, the ÁKK's net FX financing was the most significant factor. A euro bond with a value of some EUR 800 million matured in January. In February, the ÁKK repurchased US dollar bonds worth nearly EUR 200 million of the ones maturing in January 2020, and a US dollar bond matured in March with a value of around EUR 450 million – as a result of previous repurchases.

³In general, short-term external debt means external debt that is short-term according to residual maturity.

In parallel with the modest increase in foreign exchange reserves, short-term external debt rose by the end of Q1, but foreign exchange reserves still considerably exceed the level expected by investors (Chart 19). Based on the Guidotti–Greenspan rule, which is closely followed by both the central bank and investors, the foreign exchange reserves of EUR 27.5 billion at the end of March 2019 exceed the level of short-term external debt, which amounts to EUR 19.3 billion. In parallel with the slight rise in FX reserves, short-term external debt grew by some EUR 2.1 billion from the end-2018 level. Based on the Guidotti rule, FX reserves in 2019 Q1 exceeded the short-term external debt by some EUR 8.2 billion, which still represents a safe level.

Chart 19: Short-term external debt and FX reserves of the Hungarian economy



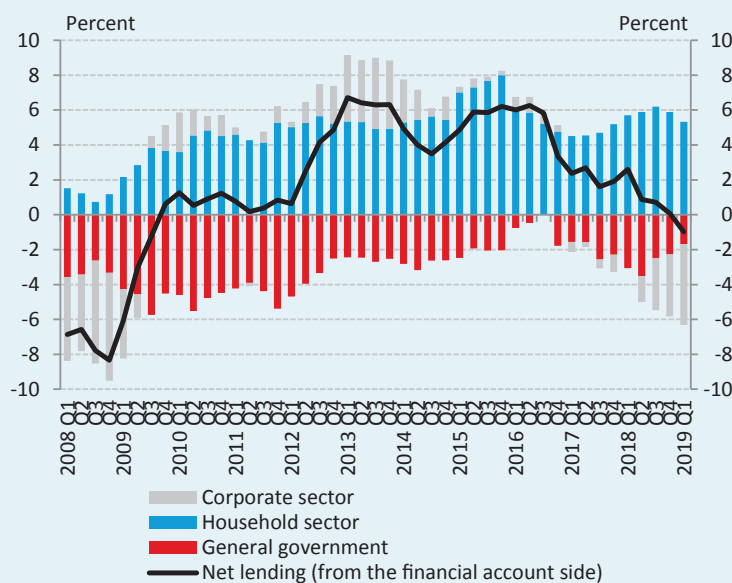
* Guidotti–Greenspan indicator: short-term external debt based on residual maturity.

4 Sectors' savings approach

According to the savings approach, in 2019 Q1 the decline in the net lending of the Hungarian economy was attributable to the decrease in the net position of the private sector, while government net borrowing continued to decline. The expansion in corporate net borrowing was the result of the high investment activity and strong wage outflows. In parallel with the significant wage growth, the increase in household consumption accelerated in early 2019, leading to a fall in households' net financial savings, which was primarily attributable to the lower accumulation of financial assets, while net borrowing was stable. In the quarter under review, households' government securities holdings continued to expand. In addition, vulnerability risks were also reduced by the fact that households preferred to purchase long-term securities.

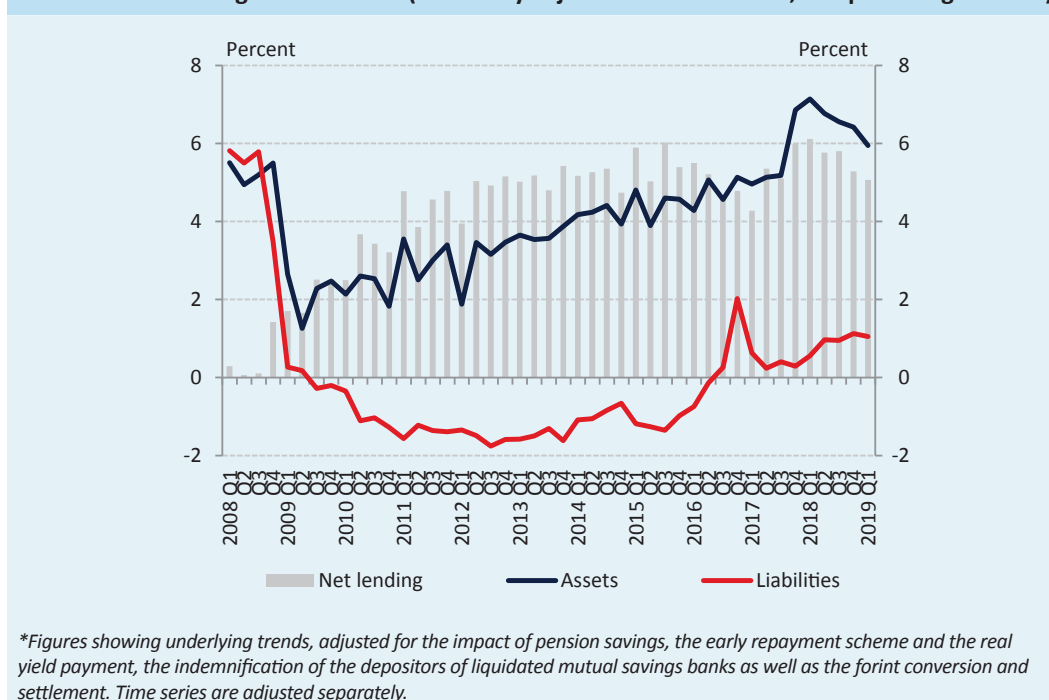
According to the savings of sectors, the four-quarter net lending of the Hungarian economy became negative at the beginning of 2019 (Chart 20). This also means that for the first time since 2009 – mainly due to the corporate sector's increasing investment activity – at the annual level the financial savings of households did not cover the net borrowing of the state and corporations. After a significant decline, the four-quarter government net borrowing amounted to 1.7 percent of GDP. The sharp decline in the budget deficit was primarily attributable to the dynamic growth in revenues from consumption and labour taxes. Corporate net borrowing increased further, due to the rise in investment as well as increasing wage outflows. Households' four-quarter net lending continued to fall, explained by the decreasing but still high gross savings. The still high level of accumulation of financial assets is in line with the strong wage growth, while developments in the net borrowing of households were similar to the previous quarter.

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

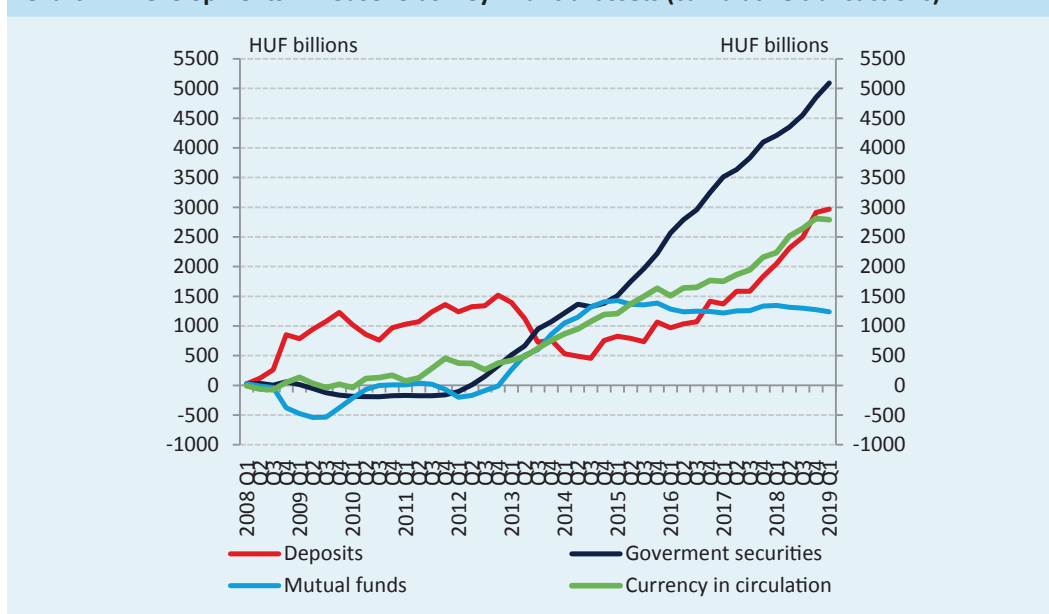


* General government represents the net borrowing according to the financial accounts. Corporate savings calculated as a residual.

Following a slight decrease, households' net financial savings according to seasonally adjusted underlying trends, amounted to 5 percent of GDP in Q1 (Chart 21). Similarly to the previous quarter, households' seasonally adjusted net borrowing was around 1 percent of GDP in Q1, which was attributable to a larger degree to the rise in housing loans and to a lesser degree to the growth in consumer loans. Households' gross accumulation of financial assets according to the underlying trends amounted to 6 percent of GDP in Q1, with the rise in government securities as the main contributor.

Chart 21: Net lending of households (seasonally adjusted revised* values, as a percentage of GDP)

In Q1, government securities holdings grew to the largest degree, while the expansion in liquid assets came to a halt, also partly as a result of the seasonality (Chart 22). The dynamic growth in households' demand for government securities continued in the quarter under review: total holdings exceeded HUF 6,000 billion at the end of the quarter. The household sector's holdings of short-term retail government securities declined slightly, while the rise in the holdings of long-term securities reached a historical high. Accordingly, retail government securities continue to play an important role in financing the state from domestic sources. In line with the seasonality typical of the beginning of the year, households' cash holdings declined, and the expansion in transferable deposits also slowed down. As in the previous quarters, holdings of mutual fund shares, which are less liquid, continued to fall slightly.

Chart 22: Developments in households' key financial assets (cumulative transactions)

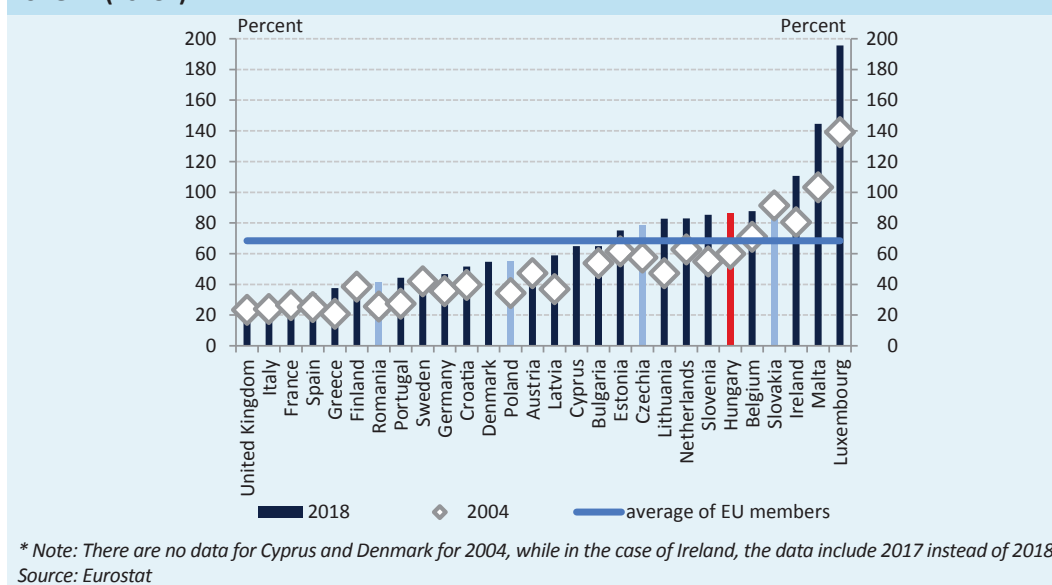
5 Special topic: Characteristic features of Hungarian exports

In the case of small open economies, such as the Hungarian economy, export growth plays an outstanding role when examining sustainable convergence. In the following, we review the aspects of the Hungarian economy's export performance, which is relevant in terms of external vulnerability and competitiveness. According to the available international data, the export market share of the Hungarian economy exceeds the value that would follow from the size thereof; at the same time, in recent years the growth therein fell short of the average of the region. This was also attributable to the fact that Hungary's export market share already rose substantially in the 1990s, as result of the FDI inflow, which was outstanding in the region. Similarly to other countries in the region, Hungary's exports have a high import content, and thus the domestic value added of exports is low; however, almost uniquely in the EU, this ratio has improved in recent years. In a few sectors of key importance, Hungary's external trade performance is in the European vanguard: for example, compared to total exports, the ratio of exports of high-tech products and services is outstanding in Hungary. The geographic orientation of goods and services exports may be deemed relatively concentrated – at the same time, the decline in the concentration ratio of goods exports indicates an improvement in sectoral diversification of export and a decline in the exposure to external developments, which can be regarded as a favourable trend in terms of external vulnerability and competitiveness.

5.1 Role of export performance in the Hungarian economy

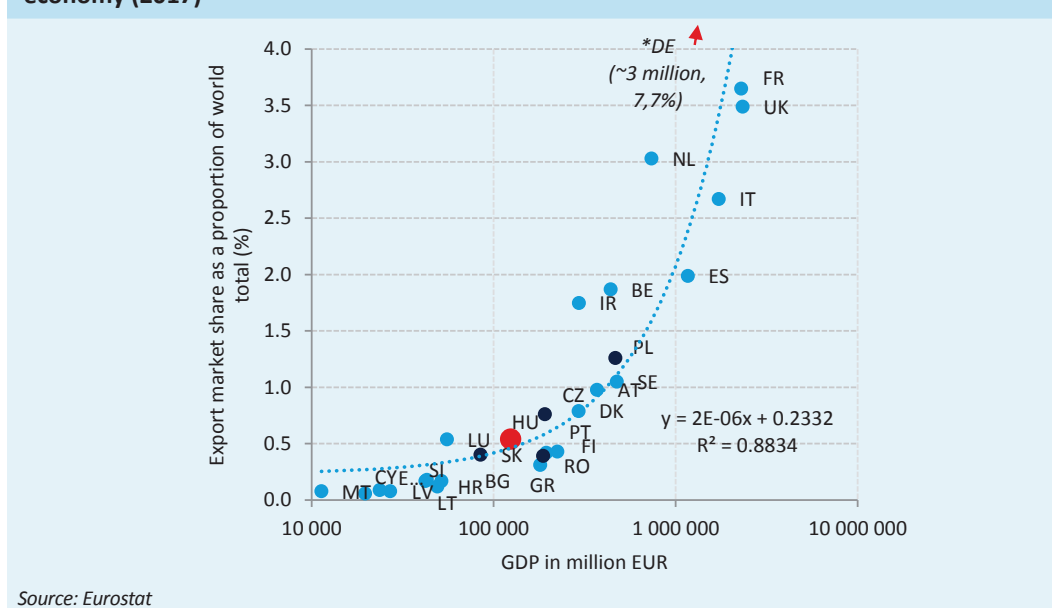
In connection with the recent deepening of trade tensions, Hungary's vulnerability to external developments has increasingly often been a focal point. With this in mind, we examine the trends in Hungary's export performance more thoroughly in this special topic. The impacts of the trade war between the USA and China and the implemented customs measures are also being felt on the European market, which – together with the slowdown in global economic activity and the uncertainties around Brexit – may have negative impact on Hungary's external demand. For the time being, slowing economic growth of Germany – the largest trading partner of the Hungarian economy – has been reflected to a lesser degree in Hungarian industrial and external trade performance, but at the same time this deceleration also represents downside risk. In addition to the extension of the US import duties and the deepening of trade tensions, private sector debt trends in China may also lead to a decline in Chinese demand, which was also reflected in weakening demand for road vehicles. Considering that the Chinese middle class, which has been growing affluent and expanding rapidly, has become the key target group and buyer of German car manufacturers in recent years, further deceleration of car sales in China may have significant negative impact on the output of the global vehicle industry and on developments in industrial exports. As a result of the embeddedness of the Hungarian economy in the vehicle industry value chains, prolonged trade tensions and the slowdown of the Chinese economy may represent a risk for Hungarian industrial production and export performance. International organisations and market analysts emphasise this fact increasingly often, which justifies the analysis of the exposure of Hungarian exports to various external and international developments.

The countries of the region typically belong to the more open countries of the European Union, where export performance is a major contributor to economic growth. For small, open and converging economies, such as Hungary, it is a general phenomenon that as a result of integration into global value chains and the development of the structure of production, the size of the export sector – and thus also its ratio as a percentage of GDP – is steadily increasing. In the countries of the region, accession to EU substantially reduced foreign companies' barriers to entry, as a result of which dynamic growth was observed in the production and sales volume of manufacturing, and particularly of the vehicle industry, as well as a rise in the weight of exports. As a result of this, by 2017 Hungary and Slovakia became more open than the EU average, while Romania and Poland – despite major growth in exports – remained relatively closed economies (Chart 23). This may be attributable to the fact that since these economies are relatively large (they are substantially larger than Hungary, the Czech Republic or Slovakia in terms of their geographical size and population), they are able to satisfy the larger part of the supply chains domestically, and due to economies of scale reasons they may also have broader product structure.

Chart 23: Economic openness of the EU countries measured by export turnover as a percentage of GDP (2018*)

5.2 Developments in export market share

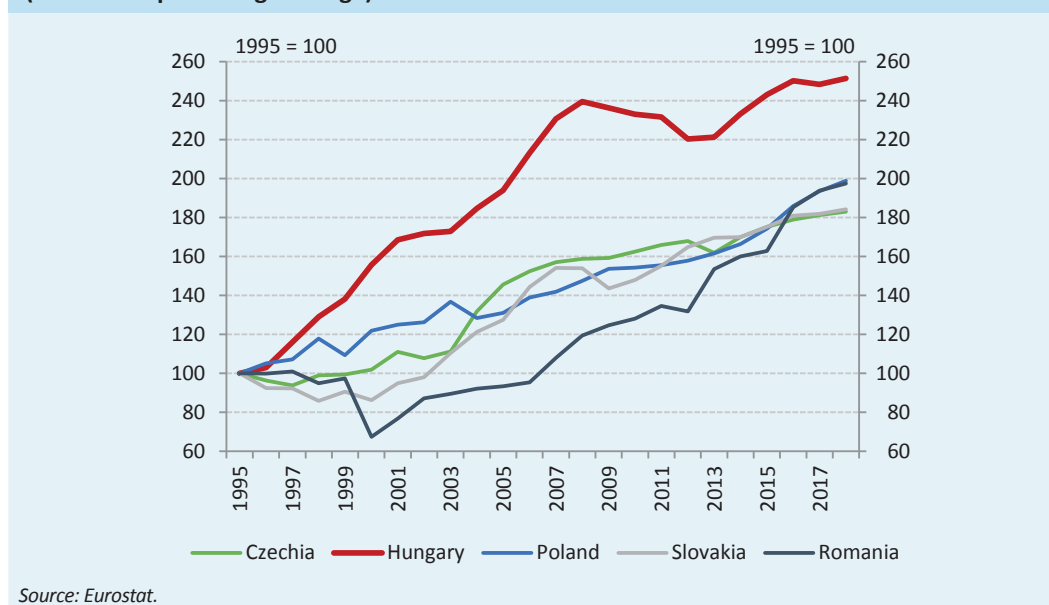
The export market share of the Hungarian economy exceeds the value relative to the size of the economy, expected on the basis of the data of the European countries. The level of an economy's export market share – i.e. the percentage of the value of exports compared to global exports – strongly depends on the size of the economy. The larger an economy is, the more products and services it exports to other countries of the world. Of the European countries, Germany, the Netherlands, Belgium and Ireland have a higher share in global exports than would directly follow from the size of the economy, while France, the United Kingdom or Spain have a lower share. Of the countries of the region, Poland, the Czech Republic and Hungary have a higher export market share than would follow from the correlation between the data, while Romania lags substantially behind this value (Chart 24).

Chart 24: Correlation between the (value-based) export market share and the size of the economy (2017)

The steep rise in Hungary's export market share after the political transition was broken by the decrease caused by the financial crisis. Subsequently, from 2012, the continuously developing new industrial capacities and the strengthening of the role of the services sector boosted the export market share (Chart 25). As a result of the privatisation in the early 1990s and the

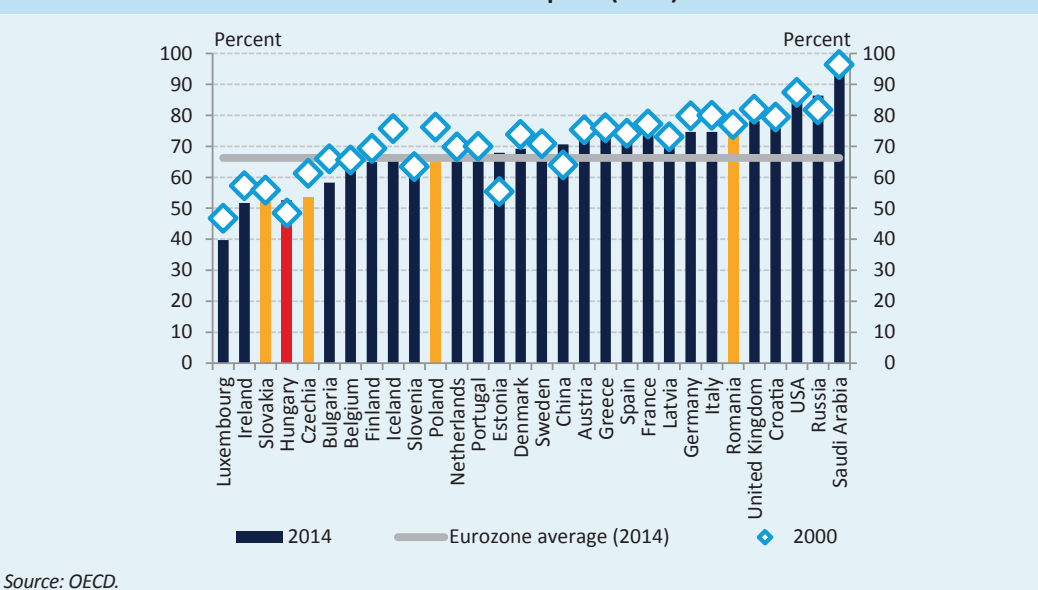
rapid rise in foreign direct investment, many foreign-owned companies commenced production in Hungary, mostly producing for export. As a result of this, in 2008 Hungary's export market share was almost twice as high as the value recorded in 1995, which substantially exceeded the dynamics observed in other countries of the region. From the early 2000s, the export market share rose in all countries of the region, in line with economic convergence with the developed countries, but this trend was then temporarily interrupted by the financial crisis. As a result of the crisis, global external trade declined substantially, which was also reflected in Hungary's exports. From this time on, the development of the Hungarian export market share lagged behind that of the countries of the region. All of this is partly due to the fact that – thanks to the foreign companies producing for export markets – Hungary's export market share had already risen steeply before this, while in the other countries of the region, strong growth in FDI inflows took place in this period, which is also reflected in the higher growth in the export market share. As a result of the new industrial capacities built in recent years (e.g. production by the Mercedes factory), Hungary's export market share once again started to rise from 2012, and starting from 2015 it repeatedly exceeded its former, pre-crisis high on volume basis. In contrast, currently the export market share on a market price basis not only lags behind the regional dynamics, but also the pre-crisis level in Hungary. On the one hand, this may be related to the different historical development of the export market share compared to the region, and on the other hand to Hungary's significant demand for energy imports. The rise in energy and oil prices – which can lead to an increase in the value of imports even if the volume remains unchanged – could have contributed to a larger drop in the volume of export market share than in the volume-based indicator. Looking ahead, in line with the dynamically expanding investments and, particularly with the developing new industrial capacities – such as the BMW factory planned in Debrecen or the construction of the announced battery factories, for example – the export market share is expected to rise.

Chart 25: Developments in the volume of export market share in the region (cumulated percentage change)



The domestic value added of exports is relatively low, although the indicator has improved in recent years (Chart 26). The value added of exports is primarily linked to the level of output and imports used. At present, the Hungarian exporter sectors have a status in the global value chains where during the production of the final goods in Hungary, exporter companies utilise little domestic, own resources. Accordingly, Hungarian exports have high import content, as a result of which the domestic value added of goods exports is low, and thus the growth contribution originating from one unit of the sector's value added is also limited. This phenomenon is even more striking in the countries of the region: in addition to Hungary, the ratio of goods exports' domestic value added also lags behind the euro area average in the Czech Republic and Slovakia. This phenomenon is linked, among other things, to the regional trends in the transformation of the production structure and the appreciation of the role of the vehicle industry. At the same time, the ratio of the domestic value added of goods exports rose between 2000 and 2014, while a decrease can be identified in most of the countries under review. Of the countries of the region, the indicators for Poland and Romania substantially exceed the Hungarian indicator. The higher value of Poland may be attributable to the size of the country, since in terms of its geographic size and population the Polish economy is the many times larger than the other three Visegrád countries, and thus presumably production for the export markets may also rely on the domestic supplier chains to a larger degree.

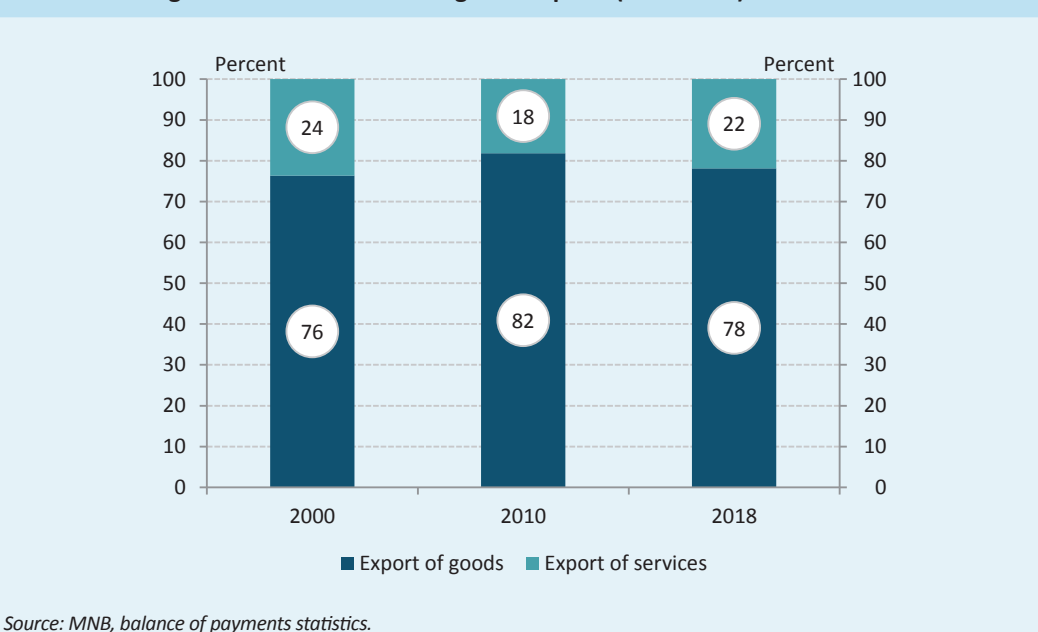
Chart 26: Ratio of domestic value added within exports (2014)



5.3 Special features of goods and services exports

Goods exports dominate the structure of Hungarian exports, while the ratio of services exports hardly exceeds 20 percent (Chart 27). In the first ten years after the millennium, the share of goods exports in total exports rose in the structure of Hungarian exports, which initially related to the expansion of the electronics sector, and later of the vehicle industry. The expansion of the services market linked to globalisation offered a chance for the development of the Hungarian services sector as well, which after 2010 was reflected in the rise of the share of services exports. Although the role of services within exports is low – in 2018 it accounted for roughly 22 percent of exports – it plays a key role in the trade surplus.

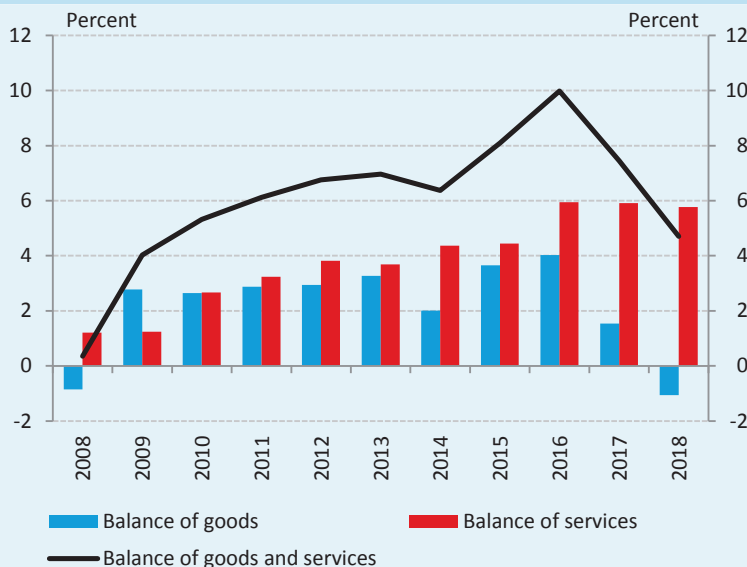
Chart 27: Changes in the structure of Hungarian exports (2000-2018)



Although the bulk of exports is linked to goods, after the crisis – as a result of the structural change in the external trade structure – services became a key factor in the current account surplus (Chart 28). After the outbreak of the financial crisis, the balance of goods as a percentage of GDP developed in line with economy's cyclical trends: by 2016, it rose from the negative pre-crisis value to 4 percent, followed by a renewed decline in the past two years (in conjunction with strong growth in domestic use). At the same time, there was a trend increase in the services balance until 2016, after which it

stagnated at 6 percent of GDP. As a result of the foregoing, the surplus of the services balance still keeps the trade balance high, despite the fact that the level of net goods exports declined to close to zero over the past year and a half.

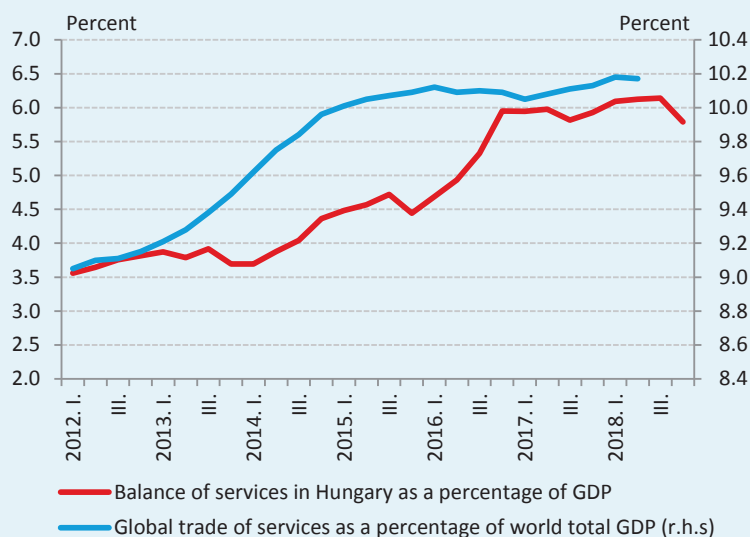
Chart 28: Developments in the balance of trade components (as a percentage of GDP)



Source: MNB, balance of payments statistics.

The rise in the Hungarian services balance signals that the Hungarian economy was able to capitalise on international growth in services trade (Chart 29). After the financial crisis, the increasingly wide-ranging appearance of services in global trade became a general phenomenon, and in addition to traditional services (tourism, manufacturing services on physical inputs owned by others, transportation services), IT and other financial and business services also gained ground in international turnover. In parallel with this, the ratio of services within global GDP rose dynamically between 2012 and 2016. In line with the international trends, Hungary's services balance as a percentage of GDP also rose significantly, albeit, the growth only started in 2014, following the global trends with just a minor delay. In addition, it is apparent that this growth – both globally and in Hungary – has faltered in the past 2 years. The stagnation of the indicators may also be attributable to the fact that, with regard to the use of certain services which were previously unknown and have only recently started to expand strongly, regulation only started in the recent past. Examples of these may include the social services – spreading quickly in line with the global megatrends – such as Uber or Airbnb – which initially rose dynamically, and then the governments, recognising their market significance, tried to align their operation with the existing legal framework.

Chart 29: Services trends in Hungary and globally

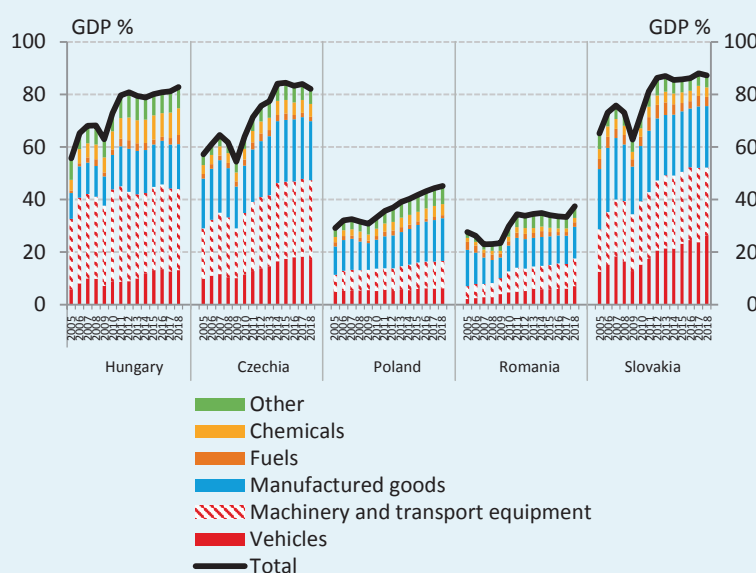


Source: World Bank, MNB balance of payments statistics

5.4 Industry breakdown and concentration ratio of goods exports

The performance of the machinery and transport equipment sector, and particularly that of the vehicle industry, has dominant role across the region in the goods exports of the individual countries (Chart 30). The breakdown of the goods exports of the countries of the region by industry shows a very similar picture. In the case of small, open economies (Hungary, the Czech Republic, Slovakia), exports of machinery and transport equipment (including vehicles) account for 50-60 percent of the GDP-proportionate goods exports, in addition to which the exports of processed goods also represent a significant share, but smaller than the sector first mentioned. In Hungary, the ratio of machinery and transport equipment within total exports exceeds 50 percent, but since 2005, it has seen a major decline (which, as is discussed later, is also reflected in the industry concentration ratio), while the ratio of road vehicles within exports rose, which is in line with the fact that Hungary came to the forefront of global car manufacturing. Meanwhile, in the case of the more closed Polish and Romanian economies, the ratio of machinery and transport equipment to total exports is below 50 percent, and processed industrial goods have a higher weight. This export structure represents a potential source of vulnerability for the Central and Eastern European countries: temporary or prolonged disturbances in the machinery and transport equipment sector may have a significant impact on the countries' (net) exports and economic performance, which was also highlighted by the developments in the third quarter of 2018.

Chart 30: Breakdown of Central and Eastern European countries' exports by industry, as a percentage of GDP



Source: Eurostat, external trade statistics; Note: the breakdown by industry is based on the external trade statistics, and thus the values presented here may differ from the aggregated data, stated in the balance of payments statistics.

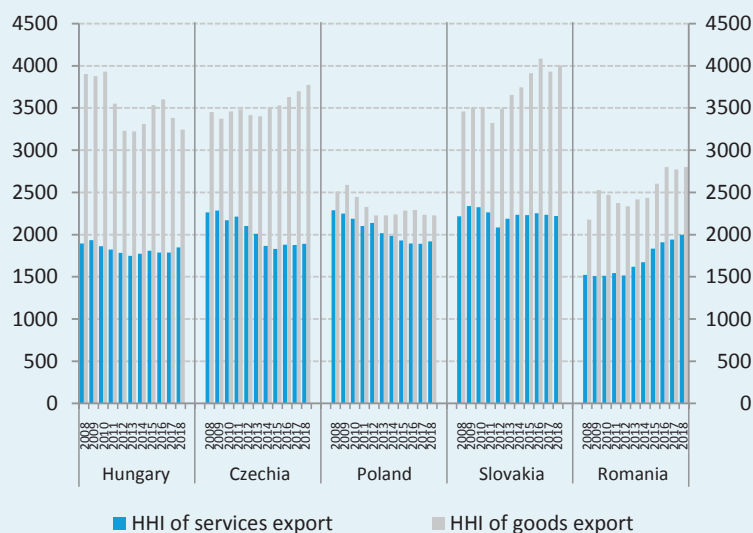
In the region, a more significant decline in the concentration of goods exports can only be identified in Hungary, which implies an improvement in the diversification of exports and a decline in the exposure to external trends (Chart 31). In parallel with the decline in the industry concentration ratio (Herfindahl-Hirschman-index, HHI⁴), which moves together with the export share of machinery and transport equipment, there is a declining risk that an unfavourable development affecting certain sectors could shake the entire economy. On the other hand, the rise in export diversification may indicate that an increasing number of companies or an increasing number of multiproduct companies are able to enter the global market, which may suggest rising productivity and improving competitiveness. Finally, the countries with more diversified trade are also more resilient to the impacts of climate change, which will represent a mounting challenge in the future.⁵ The concentration ratio of Hungarian goods exports, measured by HHI, belongs to the mid-range of the Central and Eastern European countries. In addition, Hungary is the only country in the region that recorded a more significant decline, while the rest of the countries are characterised by stagnation or increases. (Despite the decline, goods exports are more concentrated at the industry level compared to the more closed Polish and Romanian economies). The goods exports concentration of the small,

⁴ The HHI value range is between 0 and 10,000, where 0 signals clean competition and 10,000 monopoly. Nevertheless, a HHI over 2,500 signals high market concentration.

⁵ <http://www.fao.org/3/a-bu414e.pdf>

open economies in the region develops similarly to the ratio of machinery and transport equipment to total exports, where Hungary also registered a decline since 2006. The industry concentration of services exports develops similarly in the countries of the region. The industry concentration of services exports has not changed significantly in Hungary in the past 10 years, while in the case of the Czech Republic and Poland there was a moderate decline, and Romania recorded a minor rise.

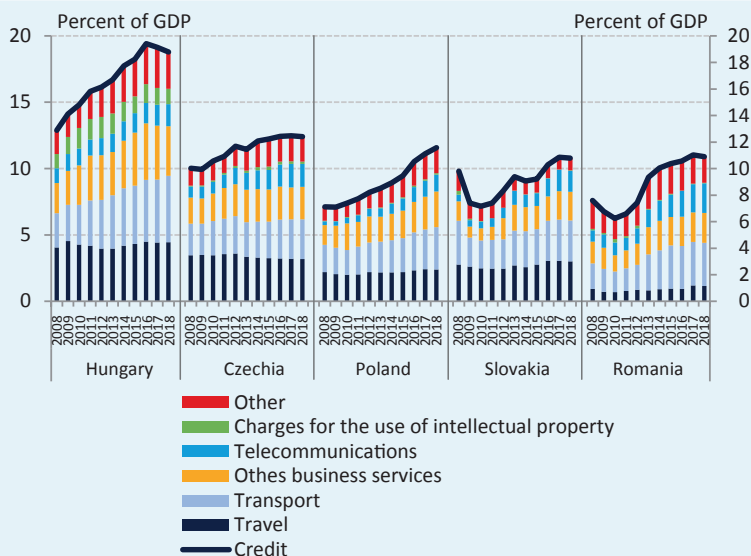
Chart 31: Services and goods exports concentration ratio in the CEE region



Source: Eurostat, external trade statistics, MNB calculations.

Hungary's export revenue from services is outstandingly high, which – similarly to the countries of the region – is essentially attributable to tourism, transportation and shared service centres (Chart 32). As regards services exports as a percentage of GDP in the countries of the region, Hungary recorded the highest value. This was mostly attributable to the fact that after the crisis in Hungary, in line with the growth in the size of transportation companies and the spread of shared service centres – stated under other business services – the value of services exports rose at a fast rate and in recent years it already came close to 20 percent of GDP. The same ratio in the other countries of the region is typically around 10-12 percent of GDP. In addition, tourism also makes a major contribution to services revenues, although in the countries of the region the value of this indicator as a percentage of GDP has not increased since the crisis. Finally, in the case of Hungary, it is also worth mentioning royalty revenues, which contribute to export revenues by more than 1 percent of GDP, while the value of this item is negligible in the region. This is presumably partially attributable to the tax allowance related to royalties, which was tightened from mid-2016, but the regulation will partially enter into force only from 2021.

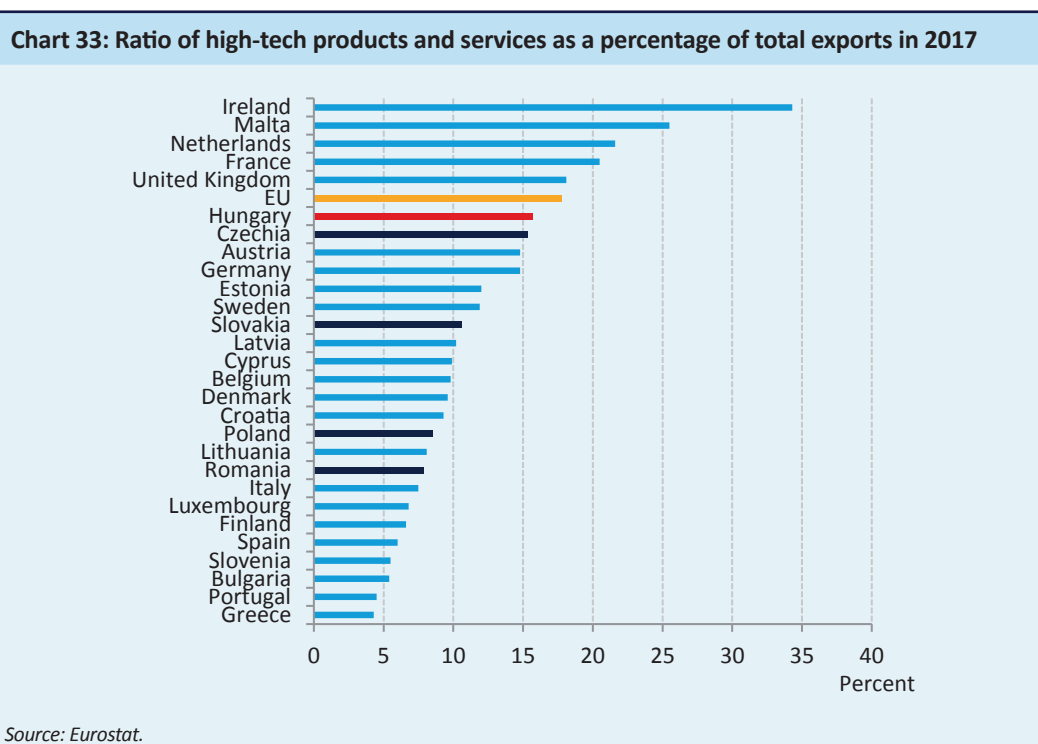
Chart 32: Breakdown of services exports by industry in the countries of the region



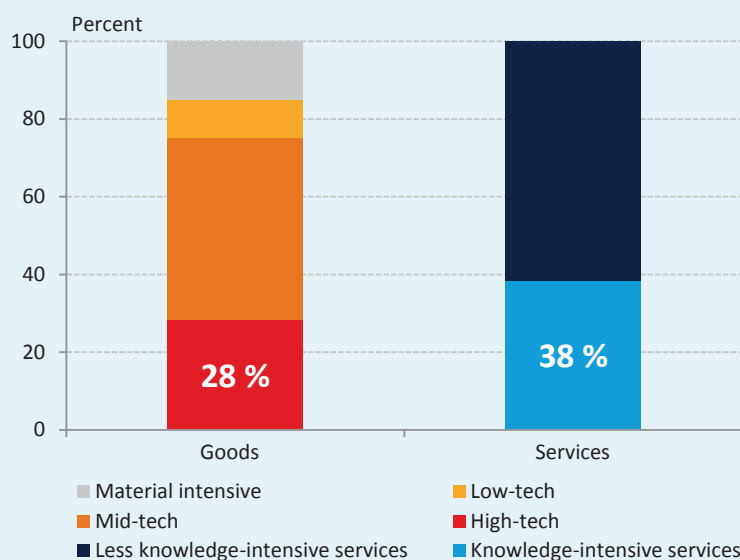
Source: Eurostat, external trade statistics.

5.5 Overview of the knowledge-intensity of the goods and services exports

The ratio of high-tech products and services compared to total exports is the highest in Hungary among the countries of the region (Chart 33). In 2017, in Hungary, the high-tech products and services – based on the Eurostat classification – accounted for roughly 15 percent of total exports, which is the sixth highest value in a European comparison. With this, Hungary precedes developed European countries, such as Germany or Austria. The index of the other countries of the region lags behind that of Hungary and the EU average to a smaller or larger degree. The Czech Republic comes immediately after Hungary with 15 percent, Slovakia is in the mid-range at nearly 10 percent, while Romania and Poland are in second half of the ranking, with figures slightly below 10 percent. The outlier of Ireland is mostly attributable to its pharmaceutical products and IT services.



Almost 30 percent of goods exports is of high technology intensity, while in the case of services exports, a larger part than that, at roughly 40 percent, can be deemed knowledge-intensive (Chart 34). We categorised the goods exported by the companies based on raw material and technological intensity, and the services based on knowledge intensity. Almost 15 percent of total goods exports is raw material intensive, while the rest of goods exports include products of various technology-intensity related to manufacturing. According to our classification, products of medium technology account for the largest part of goods exports (at 45 percent), while almost 30 percent of goods exports are of high technology intensity and 10 percent thereof is of low technology. Knowledge-intensive services account for 40 percent of services exports.

Chart 34: Exported goods and services based on technology- and knowledge intensity (2015)

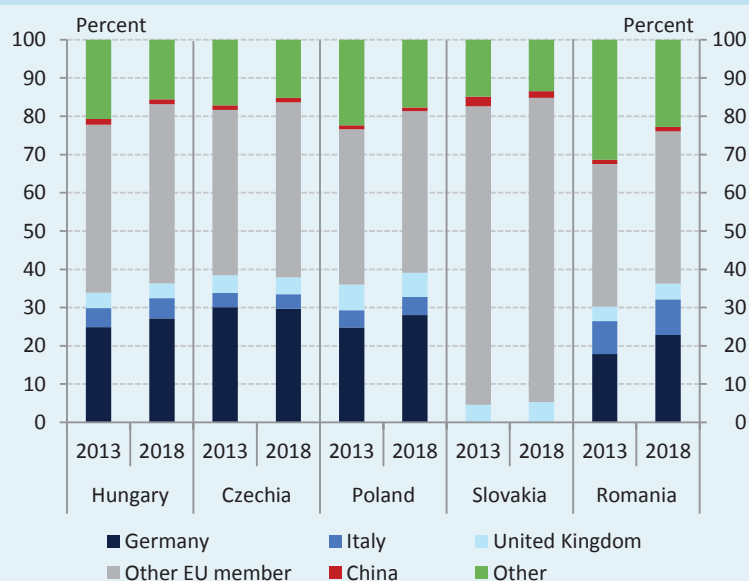
Note: The structure of the exported goods and services, based on technology and knowledge-intensity, has not changed substantially in recent years. Goods and services were categorised based on the NACE2 product codes and the EBOPS service groups, respectively.

Source: UN Comtrade.

5.6 Geographic orientation of exports

In the exports of the countries of the region, the weight of the EU – and particularly that of Germany – is outstanding, while that of the United Kingdom is relatively low, and in this sense the direct impact of Brexit on the economies of the region may be moderate (Chart 35). The countries of the European Union play a dominant – and gradually increasing role – in the export production of all countries of the region, without exception, since more than 70 percent of their exports are directed to the EU. Within the EU, the role of Germany is outstanding: in the majority of the countries of the region, roughly one third of exports are directed to the German economy. This also supports the fact that Germany's economic performance is of the utmost importance for the countries of the region. In recent years, several European countries have been affected by significant uncertainties. The key sources of uncertainty included domestic political and financial market tensions in Italy, and the terms of Brexit in England. At the same time, since the relative weight of these countries is around 10 percent everywhere, the vulnerability of the countries of the region, based on the direct indicators, cannot be deemed significant, particularly when compared to Germany. The geographic diversification of Hungarian exports gained new momentum in recent years with the rise in the intensity of external trade directed towards the Asian countries. This mostly appears in the fact that – although, compared to the total export performance of the countries, the exposure to China cannot be deemed significant yet – the role of the Asian country rose substantially in the external balances of the countries of the region (the level thereof exceeds the pre-crisis level by several times). In addition, the indirect exposure of the countries of the region to China may be higher due to Germany's exports to China, a large part of which takes the form of luxury car exports. Hence, the potential deceleration of the Chinese economy may impact Hungarian external trade indirectly through this channel.

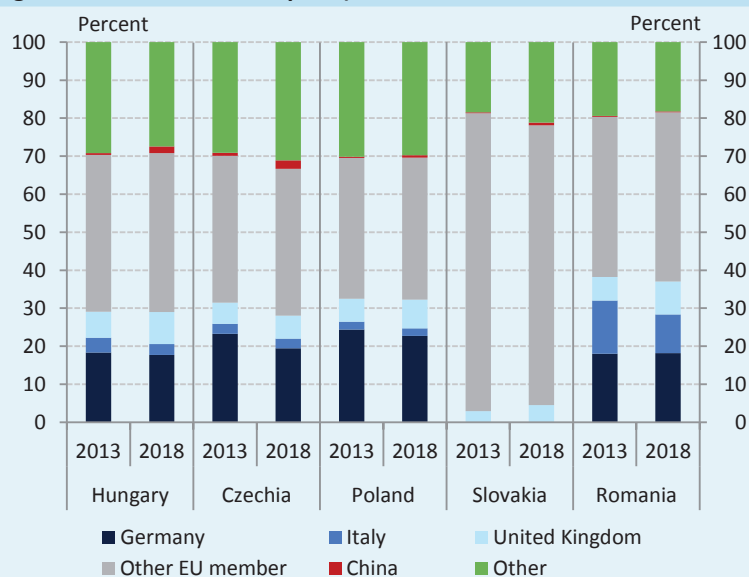
Chart 35: Goods exports of the countries of the region by a few key countries (as a percentage of total goods exports)



Source: Eurostat, balance of payments statistics, MNB calculations In the case of Slovakia there are no data for the exports to Germany and Italy, and thus they are included in the "Other EU" data point.

As follows from their nature, services can usually be moved with lower transaction costs over larger distances, and thus the countries of the region export them to a slightly higher degree – compared to goods – to non-EU countries (Chart 36). While in the case of goods exports, the value of exports to the EU exceeded 80 percent in several cases, this value for services is often below 70 percent. This may be mostly attributable to the fact that a large part of the services (e.g. bookkeeping or infocommunication services) may be moved over larger distances at lower costs, while in the case of other services (e.g. tourism, healthcare services) it is the user of the service who travels to the service provider and thus the turnover of these as well may show a different distribution compared to trade in goods. As a result of this, within the services rendered abroad by the countries of the region, the weight of both the EU and Germany is lower. Nevertheless, the weight of the non-EU countries still may be deemed moderate, since they account for only roughly 70 percent of total services exports. Similarly to goods exports, the share of China also cannot be deemed significant in services exports, and in this case the indirect exposure may be also more moderate.

Chart 36: Services exports of the countries of the region by key countries (as a percentage of the total services exports)



Source: Eurostat, balance of payments statistics, MNB calculations In the case of Slovakia there are no data for the exports to Germany and Italy, and thus these countries are included in the "Other EU" data point.

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Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

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