



REPORT ON THE BALANCE OF PAYMENTS



2020
APRIL

*'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 under the general guidance of Barnabás Virág, Executive Director for Monetary Policy and Economic Analysis. Contributors: Anna Boldizsár, Zsuzsa Nagy-Kékesi, Balázs Kóczyán, Péter Koroknai, Balázs Sisak, Daniella Tóth, Márton Varga and Noémi Végh. The Report was approved for publication by Márton Nagy, Deputy Governor.

This Report is based on information pertaining to the period ending 23 March 2020.

Summary

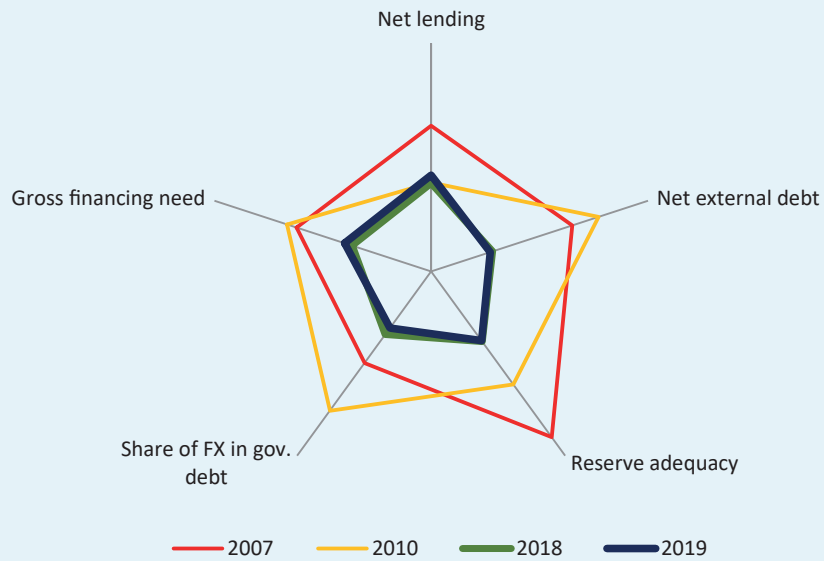
In 2019, the four-quarter current account balance-to-GDP ratio and the net lending of the economy stabilised. This was attributable to a slower decline in the trade surplus, while the absorption of EU funds increased. As a result of continued significant FDI inflows and the extremely strong economic growth, external debt ratios continue to fall. In 2019, Hungary was once again among the region's leaders in terms of net lending.

In 2019, the current account deficit corresponded to 0.8 percent of GDP, whereas the net lending calculated according to the real economy approach amounted to 1 percent. In 2019 as well, the trade balance was reduced by rising imports due to dynamic investment growth and the expansion in consumption, which was partly offset by the absorption of inventories and an improvement in the terms of trade. In addition, the current account balance was also improved by a slight decline in the income account deficit. Following a temporary drop, the absorption of EU transfers rose again at the end of the year, amounting to nearly EUR 4 billion in 2019 as a whole. Accordingly, on the whole, several items retarded the decline in the current account balance and net lending.

The economy's modest net borrowing in 2019 was a result of the fact that FDI inflows exceeded the decline in net external debt. The sustained, high net FDI inflows in excess of EUR 2.3 billion significantly contributed to the dynamic expansion in investment in 2019 as well. The ratio of reinvested earnings in Hungary once again played a major role in FDI inflows. The net external debt ratio declined further in 2019, falling to below 8 percent of GDP and thus reaching a new historical low. In addition to the net debt outflow, the impact of GDP growth was also reflected in the decline in the indicator, with revaluation effects having an opposite impact. The decline in net external debt was related to the general government, i.e. to EU transfer inflows and a decline in non-residents' government securities holdings. The banking sector had net external assets at end-2019 as well, i.e. banks' assets vis-à-vis the rest of the world slightly exceeded the value of their external debt, although the size of the latter declined. The gross external debt of the economy decreased more than the net indicator, falling to nearly 53 percent of GDP. Short-term external debt, which is of crucial importance in terms of the external vulnerability of the country, fell to EUR 17.7 billion at end-2019, while FX reserves exceeded EUR 28 billion. Accordingly, reserves remain much higher than the level expected and deemed safe by investors.

According to the savings position of the sectors, households' net savings in 2019 did not cover the net borrowing of the general government and corporations, which evolved in view of the dynamic investment activity. Households' government securities purchases gathered new momentum in 2019 H2, when the new MÁP+ long-term government securities scheme was introduced. As a result, households' direct financing of the government debt surged to 26 percent by end-2019, while also taking into account the government securities held through financial intermediaries (e.g. investment funds), financing by households rose to nearly 35 percent. As in the previous years, the general government deficit was moderate in 2019 as well, with a major contribution from a further decline in interest expenditures.

Net lending developments in Hungary were favourable in 2019 as well (Chart 1): According to the most important indicators, Hungary's external balance position was similar to that in 2018, i.e. much better than in the year preceding the crisis or in 2010 (the values closer to the centre – practically the shrinking of the 'net' – indicate lower vulnerability according to the given indicator). Hungary's net lending declined slightly, but it is important to emphasise that it was primarily related to the dynamic growth in investment that supported the subsequent higher potential growth. The net position still shows a stable surplus, while both the net and gross external debt-to-GDP ratios declined further. In parallel with a slight increase in gross financing need, reserve adequacy continues to be significant. In line with steadily high household savings, households' government securities holdings increased considerably, contributing to the continued decline in the share of foreign exchange within government debt.

Chart 1: Stylised depiction of Hungary's external balance position

Note: The chart presents the deviation of individual indicators from the long-term average scaled by dispersion; smaller values indicate the strengthening of the fundamentals (e.g. lower borrowing requirement).

In the special topic presented in this Report, we compare the changes in Hungary's external balance indicators to developments in the countries of the region. Hungary's net lending still exceeds the regional average, while Hungary's economic growth was remarkably high even in a EU comparison. The external positions of the countries in the region varied, mainly due to the trade balance: only Poland's net lending was able to improve, while the rate of deterioration decelerated in Hungary and the Czech Republic. The current account balance was around zero in most of the countries in the region, including Hungary, although this indicator was negative in Slovakia and Romania, where there were major declines in savings. The absorption of EU funds made a positive contribution to the balance position in Hungary as well as in Poland and Romania. Foreign direct investment inflows in Hungary were around the regional average as a share of GDP. Along with a further decline in debt indicators, Hungary's net external debt is already below the indicators for Poland and Slovakia.

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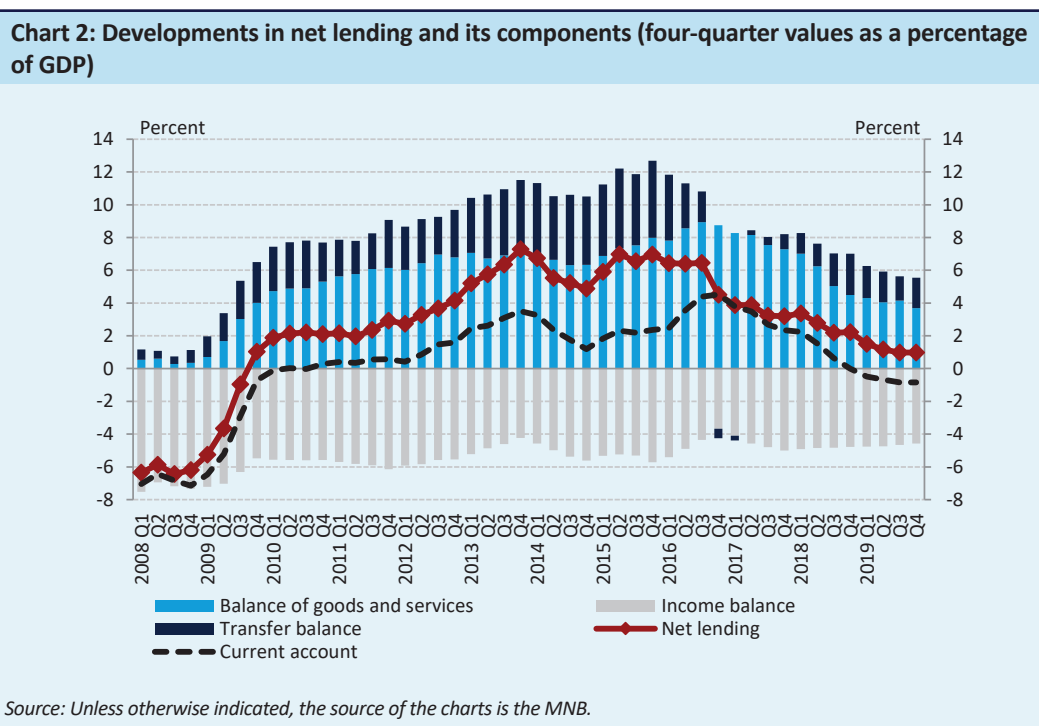
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1. Real economy approach

In 2019, both the current account balance and net lending stabilised. The current account deficit-to-GDP ratio was 0.8 percent in 2019, whereas net lending according to the real economy approach amounted to 1 percent. In 2019 as well, the trade balance was reduced by rising imports as a result of dynamic investment growth and expansion in consumption, which was partly offset by the impact of the absorption of inventories and favourable changes in the terms of trade. At the same time, the current account balance was improved by the slightly smaller income account deficit, which was primarily attributable to a further decrease in the net value of interest paid abroad. Following a temporary decline, the absorption of EU transfers expanded again at end-2019, amounting to nearly EUR 4 billion in 2019. Accordingly, on the whole, several items retarded the decline in the current account balance and net lending.

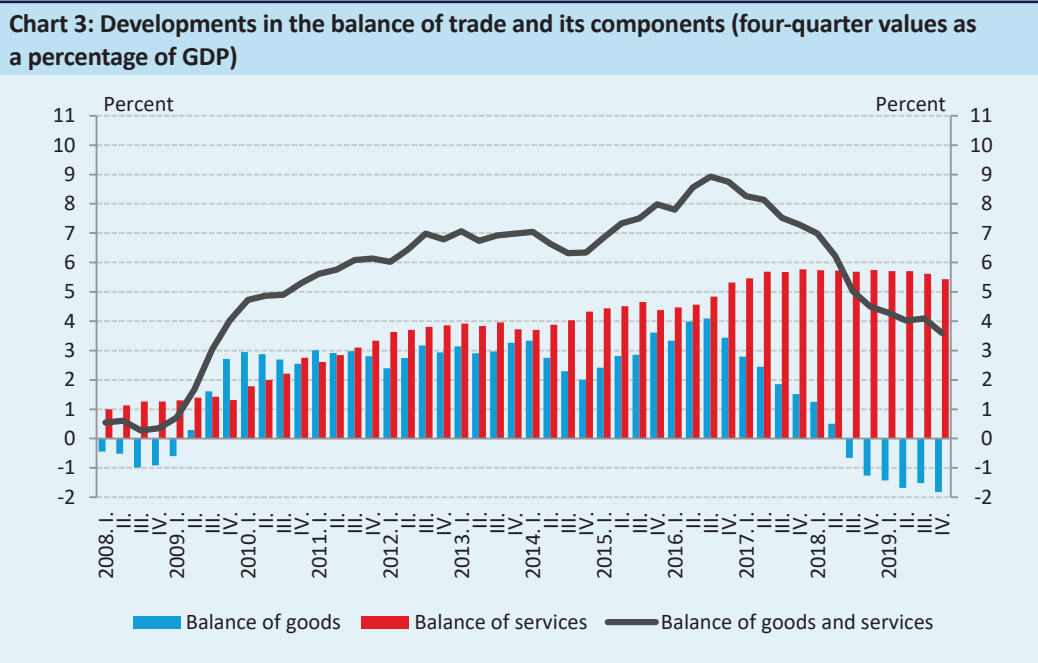
According to the real economy approach, the decline in the net lending of the economy decelerated in 2019 and stopped by the end of the year, and thus it corresponded to 1 percent of GDP in 2019 (Chart 2). According to seasonally unadjusted figures, net lending in Q4 amounted to EUR 540 million, with a current account deficit of EUR 775 million and a surplus of EUR 1,315 million on the capital account. Four-quarter data show that net lending was stable at 1 percent of GDP in H2. The balance of goods and services declined further as a result of a sustained dynamic expansion in domestic investment and an increase in household consumption, which was partly offset by the pick-up in export dynamics in annual terms against the background of a rise in export market share. The income balance improved slightly, while the transfer balance was up again at the end of the year, after a temporary decline. On the whole, the result of these developments was that the four-quarter current account balance-to-GDP ratio stopped declining in H2, and the deficit amounted to 0.8 percent of GDP at the end of the year.



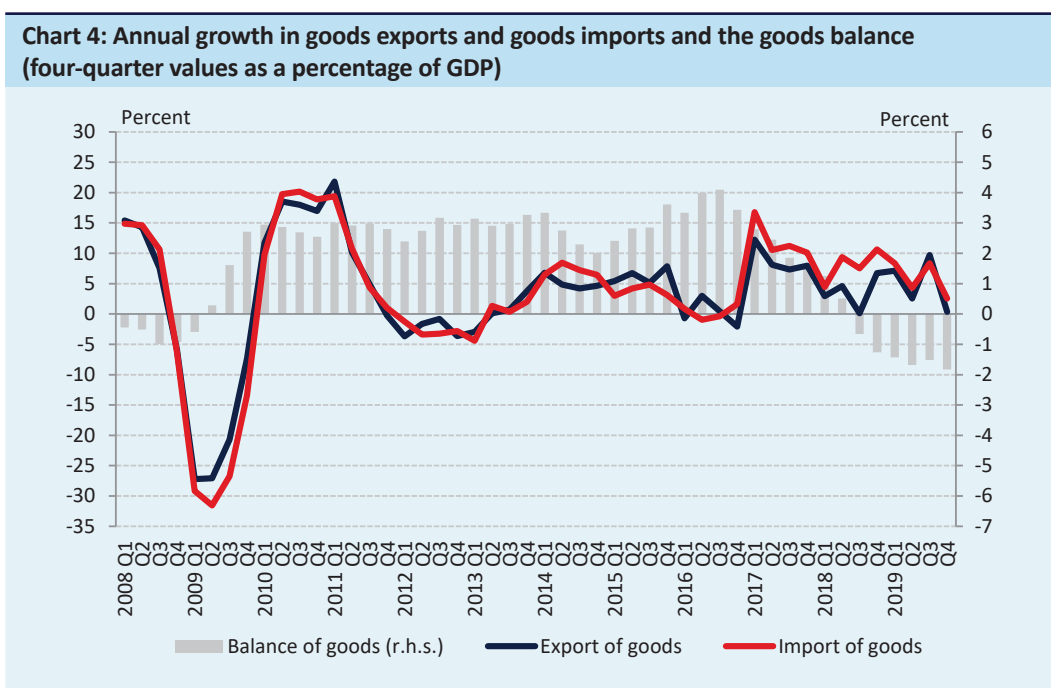
1.1. Trade balance

In 2019 Q4, the trade surplus corresponded to 3.7 percent of GDP, while the services surplus remained high (Chart 3). The gradual decline in the goods and services surplus since 2017, which is attributable to the dynamic expansion in investment, decelerated somewhat in the middle of the year, and was around 4 percent of GDP, decreasing slightly further in the final quarter. The developments in the trade balance seen in recent years were mainly related to the decline in the goods balance, but the change at end-2019 was determined by the developments in both the goods and services balances, as the services surplus fell slightly from its previously stable, high level to 5.4 percent of GDP by the last quarter. The

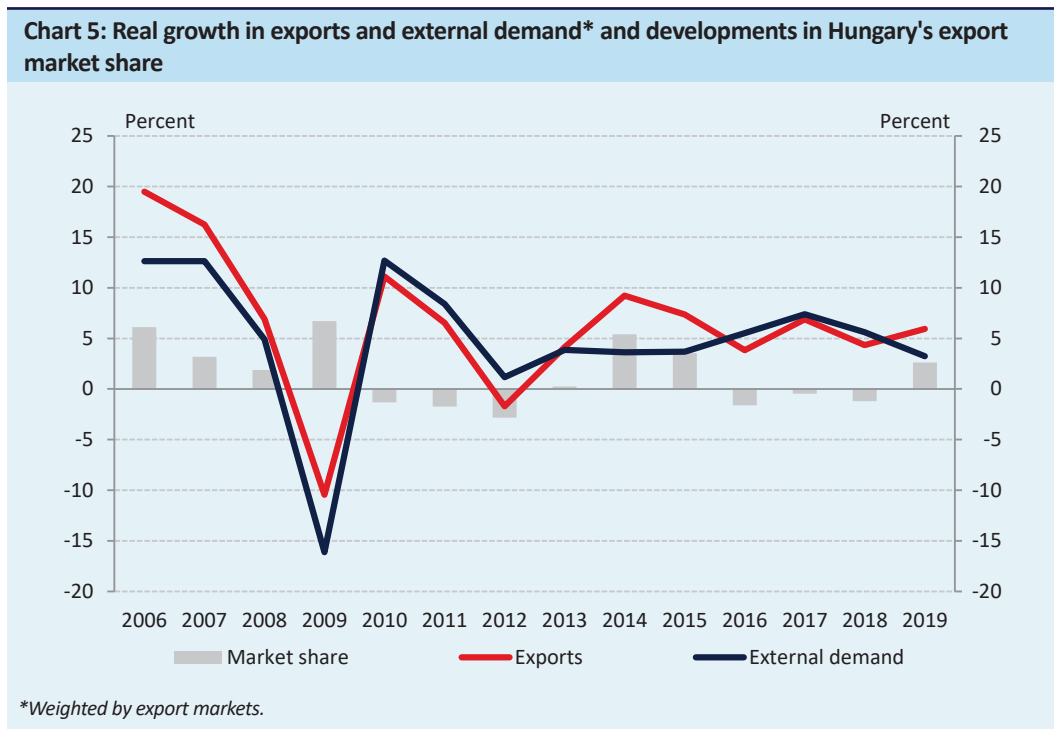
changes in the trade balance were attributable to various factors: firstly, compared to 2018, in line with the growth in euro area core countries, the growth rate of exports accelerated and, secondly, while still reaching a high level, imports resulting from the investment activity of the economy fell compared to the previous year (the drop in inventories in 2019 may have played a role in both). Compared to the previous year, the growth rate of household consumption continued to accelerate, and thus it may also have contributed to the decline in the goods surplus.



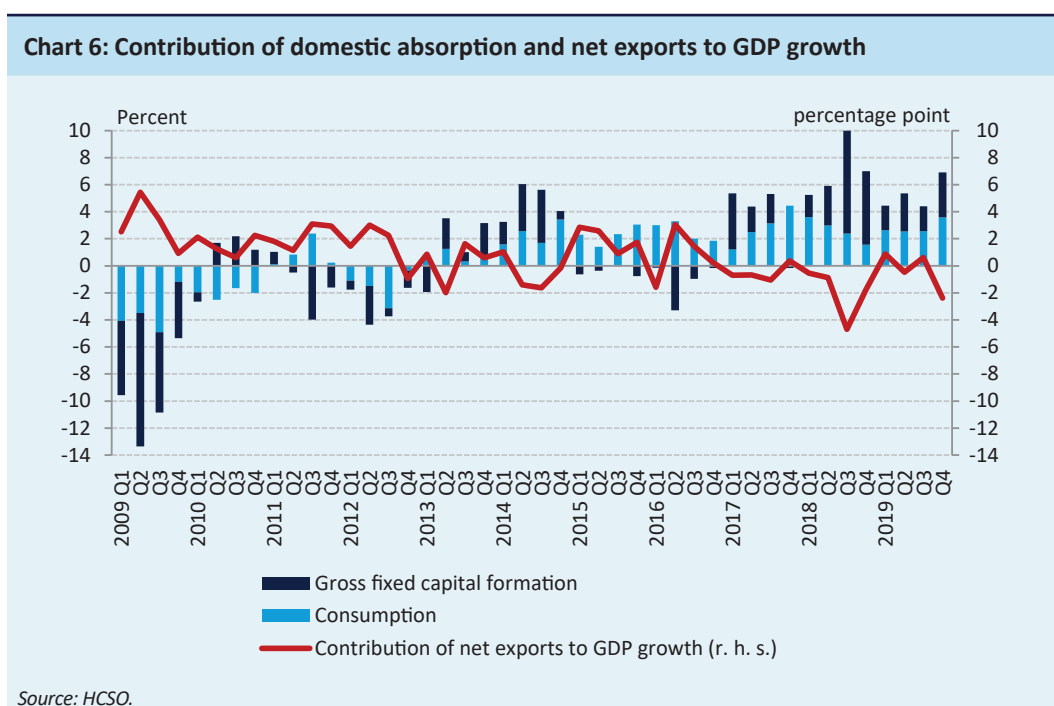
By the end of the year, growth in both exports and imports decelerated, but in 2019 – unlike in previous years – the growth rate of imports exceeded export dynamics only to a minimal degree (Chart 4). Starting from end-2016, mainly in line with a dynamic increase in investment, the increase in goods imports exceeded export dynamics, as a result of which the goods deficit corresponded to 1.8 percent of GDP by end-2019. At the same time, as opposed to previous years' larger differences, the gap between the growth rates of the two indicators narrowed significantly in 2019. Moreover, in 2019 Q3, growth in exports was more dynamic than in imports, with possible partial contributions from the changes in regulations in the automotive industry that reduced the 2018 base as well as in inventories, reducing the import demand of the economy.



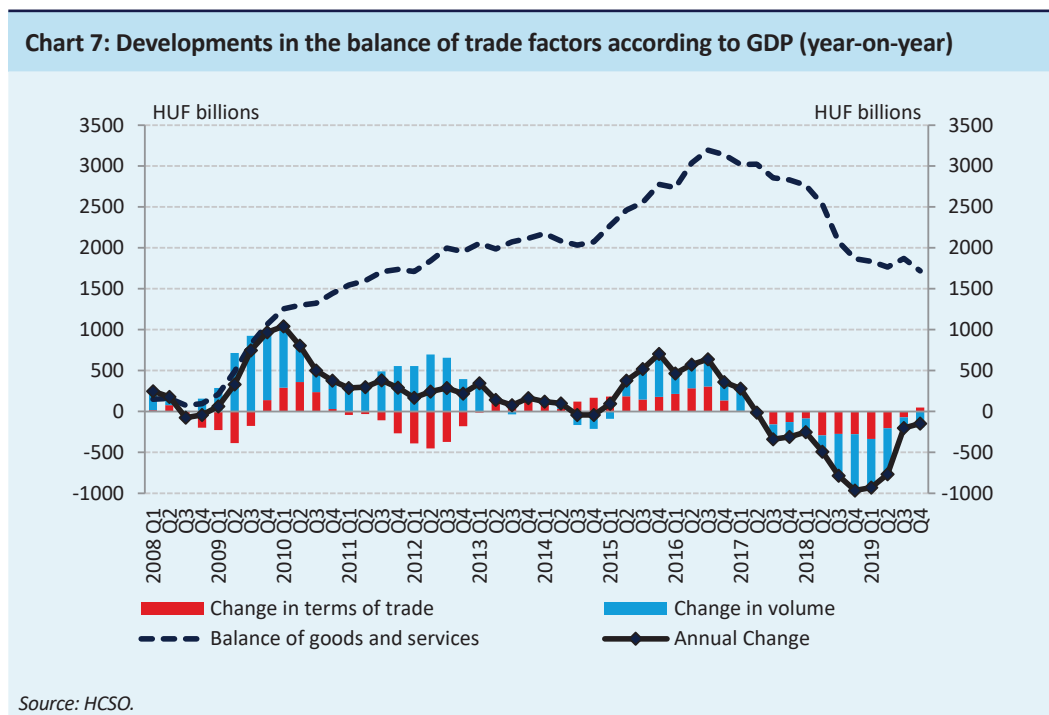
As opposed to previous years' decline, the export market share of the Hungarian economy expanded significantly again in 2019 (Chart 5). Despite lower expansion in external demand compared to the previous year, the growth rate of exports accelerated further. As a result, exports rose by nearly 6 percent again in annual terms, corresponding to a 2.6 percent expansion in Hungary's export market share.



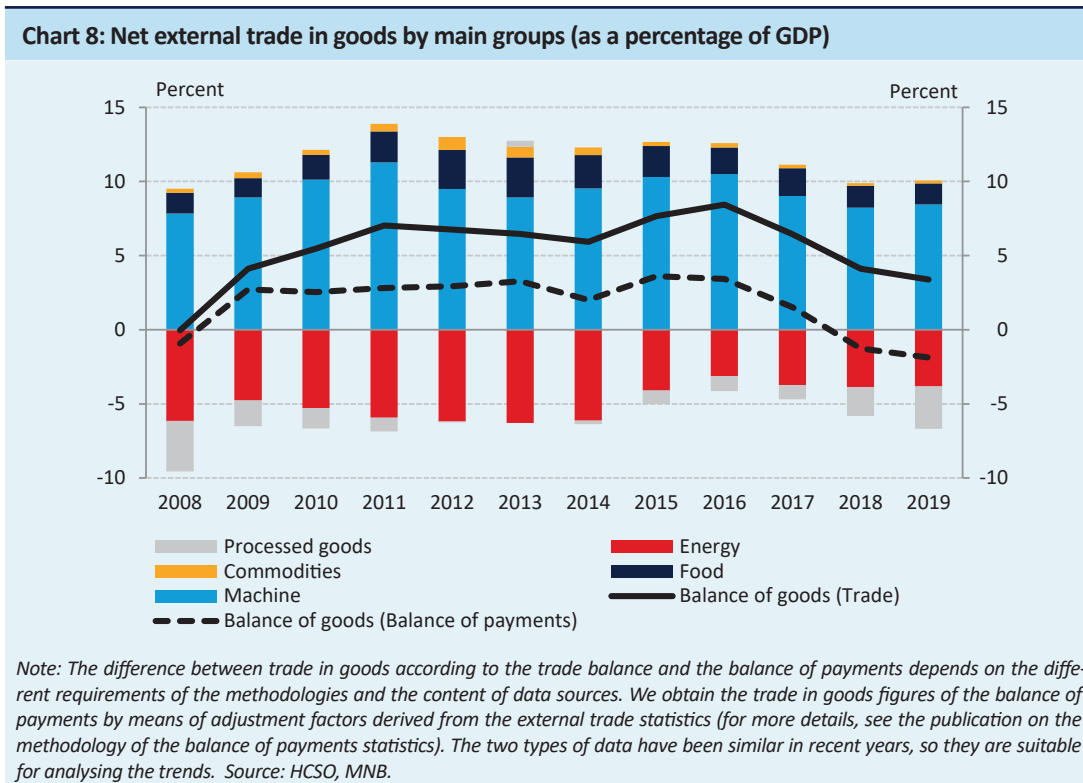
Domestic absorption items continued to grow rapidly in 2019, reducing the contribution of net exports to growth (Chart 6). Investment continued to expand in a still favourable domestic environment in 2019 as well. The increase in corporate investment was also supported by the rising absorption of EU transfers. The import content of the expansion in consumption also reduced the contribution of net exports to growth. In addition, the change in inventories also had an impact on the contribution of net exports to growth: inventories declined in the first three quarters and expanded in the last quarter of the year. Accordingly, while in the first three quarters of 2019 the growth in domestic absorption items was offset by export growth, as a result of the acceleration in investment and consumption at the end of the year, net exports already restrained economic growth.



The decline in the trade surplus slowed considerably in 2019, mostly reflecting a weaker balance-deteriorating impact of volume effects, whereas the terms of trade slightly increased the nominal level of the trade balance at the end of the year (Chart 7). In 2018, the slowdown in exports due to seasonal effects affecting Q3 and to the tightening of rules in the automotive industry as well as the increase in imports in relation to dynamically expanding investment partly contributed to the decline in net exports related to changes in volume. With these effects falling out of the base and a slowdown in the expansion in investment, changes in volume reduced the trade balance only to a minimal degree in 2019. In addition, by end-2019, changes in relative foreign trade prices already slightly improved the level of net exports, primarily as a result of the annual dynamics of oil prices.

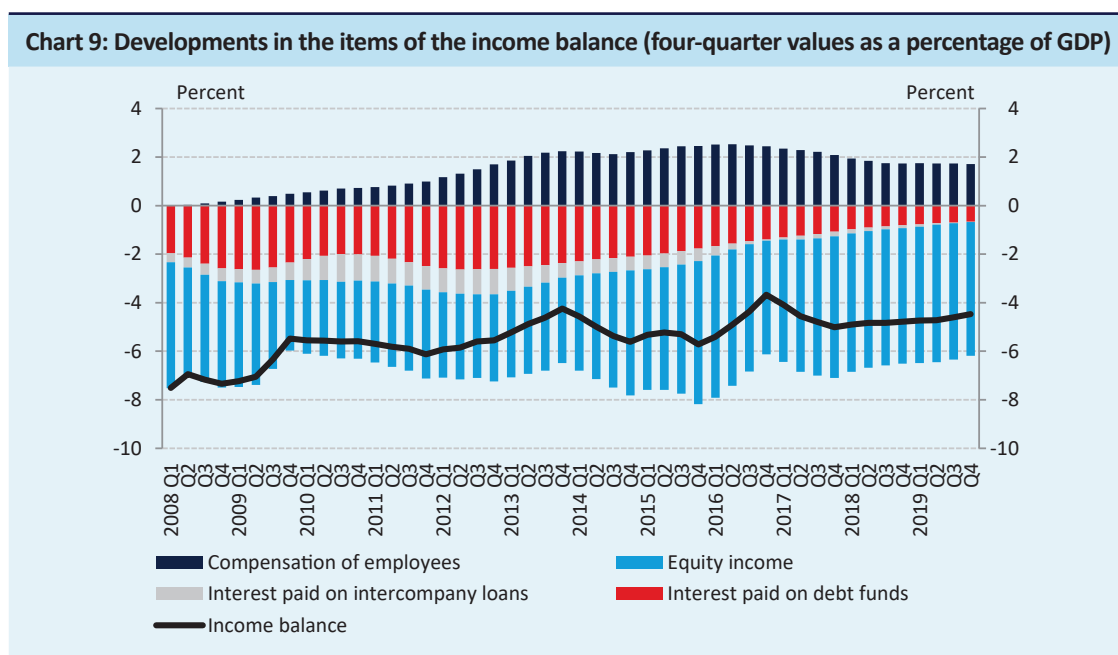


The decline in the goods balance in 2019 is primarily attributable to the decrease in the balance of processed products, while the net balance of machinery increased slightly (Chart 8). While in previous years the decline in the balance was primarily attributable to the decrease in the net balance of machinery, this changed in 2019, as machine imports linked to the slowing investment dynamics were already offset by the exports of Hungarian industrial production, and thus the balance of machinery did not decline further and actually increased to a small degree in 2019. Accordingly, the slight moderation in the goods balance is mainly attributable to the growth in imports entailed by an expansion in processed products. In terms of consumer goods, it is worth mentioning that this range of products also includes various imported items related to investment (e.g. the expanding imports of professional scientific control instruments were significant). The increase in net imports of energy stopped in 2019, in line with the annual price dynamics of energy.



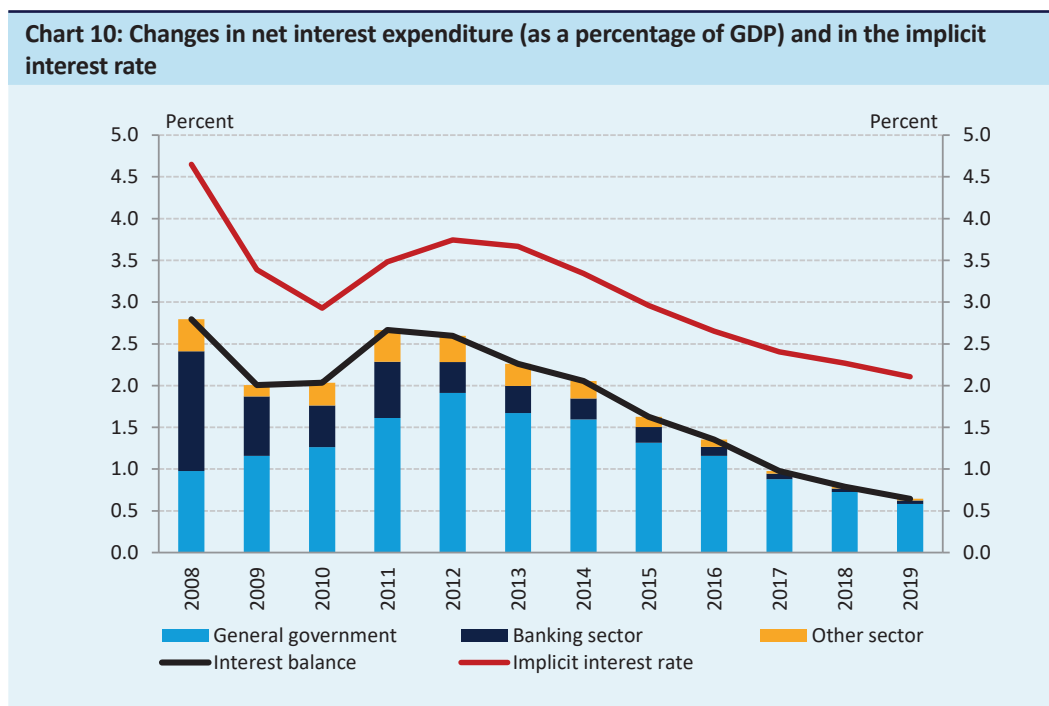
1.2. Income balance

The deficit on the income balance as a percentage of GDP declined further in 2019, reaching 4.5 percent at the end of the year (Chart 9). The profit of foreign-owned companies,¹ which fell to 5.5 percent of GDP by 2019 Q4, accounts for most of the income balance. Earned income of employees working temporarily abroad remained practically unchanged in 2019 and thus in the last quarter as well, at a level close to 1.7 percent of GDP. The interest balance of loans from abroad kept falling, owing to the low yield environment and the continued improvement in external debt indicators.



¹ We only have limited quarterly data concerning the profits of foreign-owned companies net of the factors outside current operating performance. Therefore, the information on profit outflows is based on estimates (for more details, see the publication 'Methodological notes to the balance of payments and international investment position').

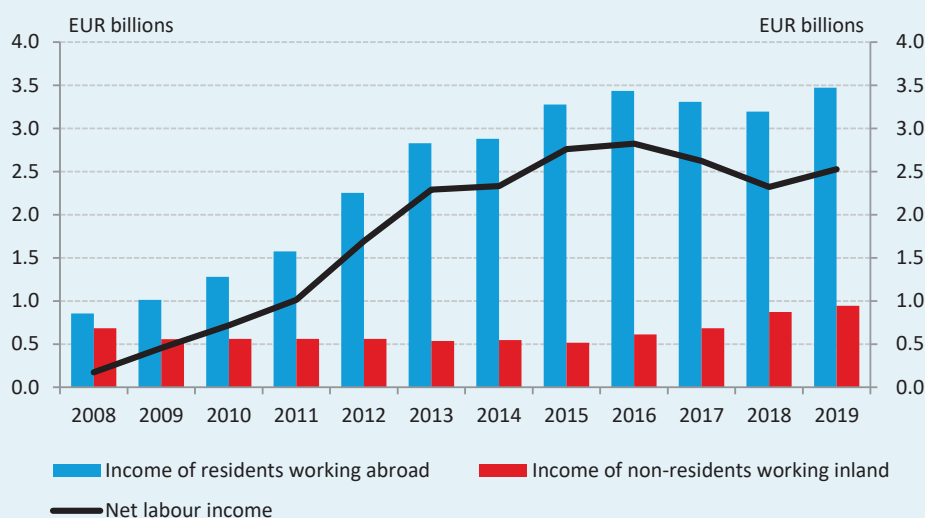
The downward trend in the net interest balance observed since 2012 continued in 2019, and thus its value dropped to 0.6 percent of GDP by the end of the year, representing a slight decrease compared to end-2018 (Chart 10). The decline in interest paid on external debt observed since 2012 also continued in 2019, supported by the drop in outstanding external debt and the low yield environment (the implicit interest rate on external debt was 2.1 percent at the end of the year²). In a sectoral breakdown, it is seen that the value of banks' and other sectors' (mostly non-financial corporations') net interest balance as a percentage of GDP was around zero, i.e. the net interest expenditure and its decline are almost entirely related to the interest balance of the general government, which corresponds to 0.6 percent of GDP.



In 2019, the decline in the balance of the income of those employed abroad observed in the past years came to a stop, and the nominal balance rose slightly (Chart 11). After the crisis, the earned income of resident economic agents working abroad temporarily rose dynamically, which helped improve the income balance deficit. This trend reversed in 2015, and the balance started to decline, which is attributable to a decrease in the earned incomes of Hungarian residents working abroad temporarily as well as to the rise in the earned incomes of foreigners working in Hungary for less than a year. These developments may be explained by the decline in taking jobs abroad due to the double-digit rise in domestic wages since 2017 as well as by the moving abroad for an extended period of time of those who work abroad temporarily (statistically, those who work abroad for more than a year belong to another category). The income of those employees who work abroad for less than one year started to increase again in 2019, even exceeding the level measured in 2016, which was only partly offset by the slight increase in foreign employees' income in Hungary. As a result, the balance of employee incomes was slightly up in nominal terms compared to the previous year, which meant that the balance remained at the same level as a percentage of GDP.

² Developments in the implicit interest rate (i.e. average interest paid on debt) do not necessarily reflect the changes in the current interest rate levels, because at present interest must also be paid on debt originating from earlier periods at the applicable rates (for example, fixed-rate debt); in other words, the repricing of the total debt volume to the new interest rates may prove to be a lengthy process in view of the multi-year average maturity.

Chart 11: Compensation of employees working abroad temporarily



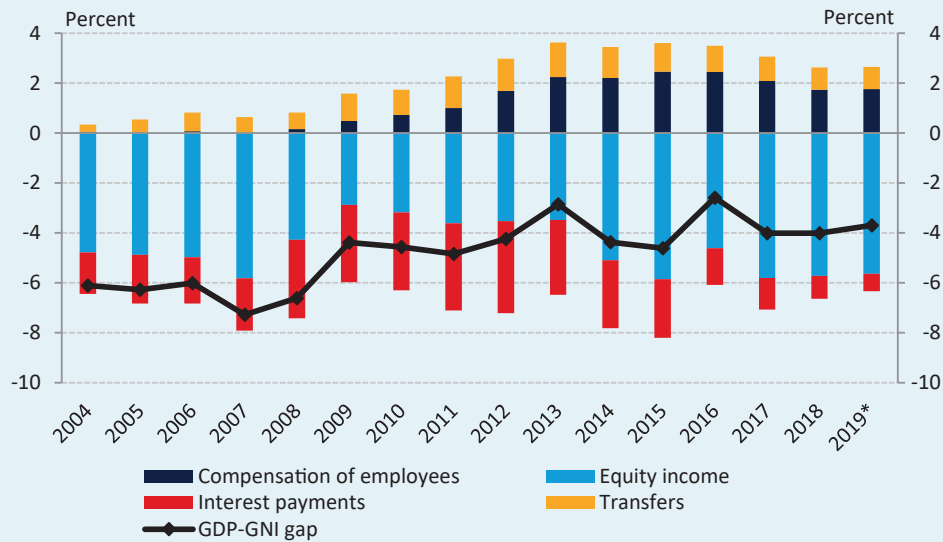
Source: HCSO, MNB.

Box 1: Difference between GDP and GNI

The difference between gross domestic product and gross national income shows the balance of income movements vis-à-vis the rest of the world, based on which conclusions can be drawn regarding domestic actors' actually disposable income. In economics, the most often used indicator to measure economic development is gross domestic product (GDP). However, there are a number of other indicators suitable for measuring the economic development of a country. One of them is gross national income (GNI), which – in contrast to GDP – is closer to the resident sector's disposable income. While the gross domestic product measures the size of the income produced by resident economic agents on the territory of a country, the GNI also takes into account whether the owners of the income produced are resident or non-resident economic agents. The difference between the two indicators appears in the balance of payments within the primary incomes. They include the wage income of those working temporarily abroad, the capital and interest incomes on investments as well as some of the current transfers, which in the case of Hungary mainly mean the agricultural subsidies received from the EU. During the economic convergence of a country it is a natural process that the value of GNI falls short of GDP, in view of the profitability of the foreign capital flowing in in the period of catching up. At the same time, above a certain level it may indicate dependency on foreign funds, and may even decelerate the convergence process.

In Hungary, the gap between GDP and GNI narrowed slightly in 2019, but still remained between 2–4 percent, which was typical in recent years (Chart 12). The large drop in the indicator in 2008 and 2009 was primarily attributable to the fall in profitability of foreign-owned companies, as a result of which the difference, which had previously exceeded 6 percent of GDP, fell to 4 percent of GDP. The indicator has been around for 4 percent of GDP since then, or slightly below it in recent years. This is primarily attributable to the fact that while prior to the crisis the interest incomes originating from the significant external debt widened the gap between the two indicators considerably, as a result of a major decline in net external debt the interest balance of the economy decreased significantly, with interest expenditures falling below 0.7 percent of GDP. Developments in corporate incomes continue to play a determining role in both the level and dynamics of the difference between the two indicators: in the past two years, the changes in the profitability of foreign-owned companies also contributed significantly to the slight narrowing in the GDP–GNI gap.

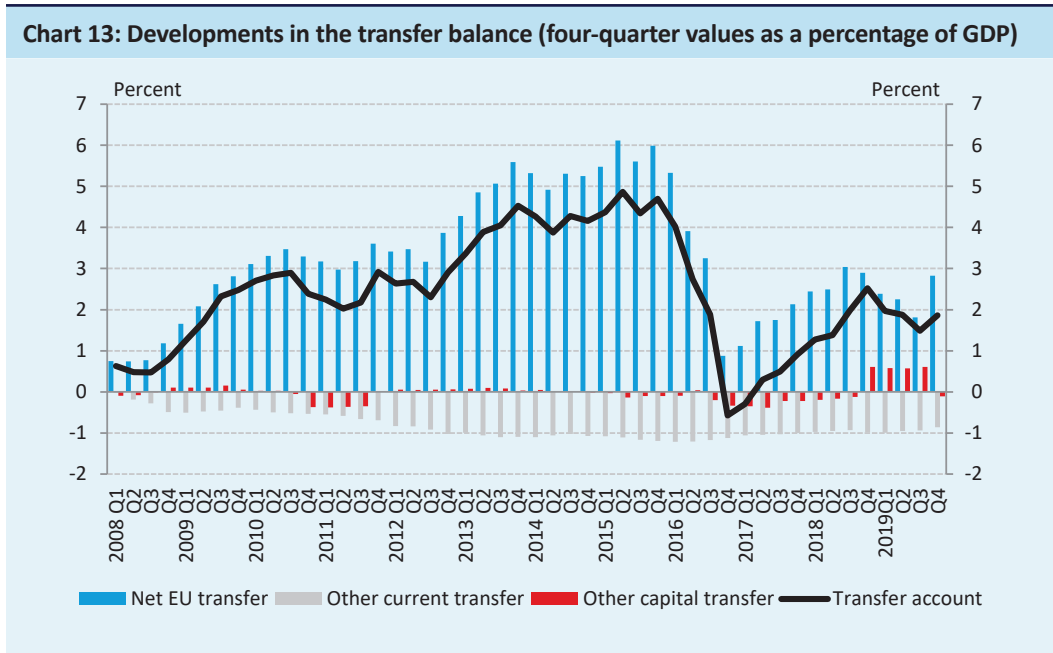
Chart 12: GDP–GNI gap in Hungary (as a percentage of GDP)



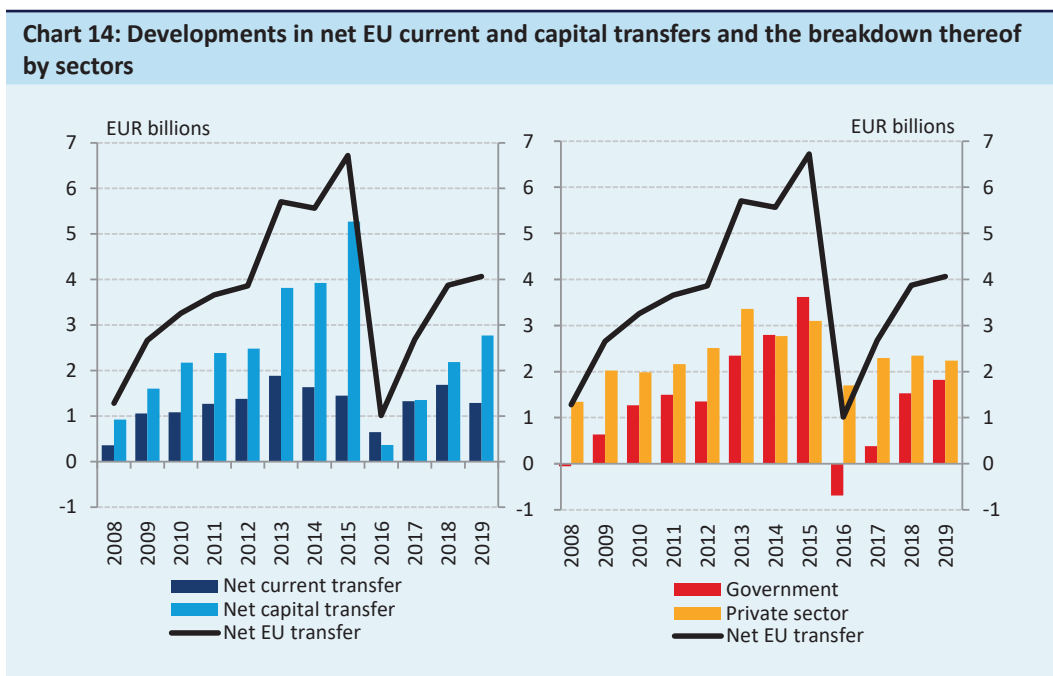
Note: At present, no official GNI data for 2019 (published by the HCSO) are available. The data for 2019 are based on the primary income of the balance of payments data release (excluding SPEs, containing an estimate for the profit of foreign-owned companies for the time being).

1.3. Transfer balance

In 2019, the transfer balance surplus amounted to 1.9 percent of GDP, resulting from the fact that the effect of the dynamically expanding balance of EU transfers at the end of the year was mitigated by the fall in other capital transfers that took place at the end of the year (Chart 13). Since end-2018, a temporary downturn had been observed in the four-quarter absorption of EU funds, the effect of which was offset by a one-off capital transfer received by the domestic corporate sector also at end-2018. This latter item dropped out of the four-quarter indicator in 2019 Q4, and thus it would have entailed a decline in the annual surplus of the transfer balance. This was offset by the increased absorption of EU transfers at the end of the year, which was significantly related to the surge in the November transfer balance. This may have been attributable to the fact that during 2019 the disbursements of several EU funds were temporarily suspended. When the temporary suspension ended, the absorption of transfers may have partly made up for the lag of the previous months, and thus the absorption of EU transfers in 2019 was similar to that in the previous year.



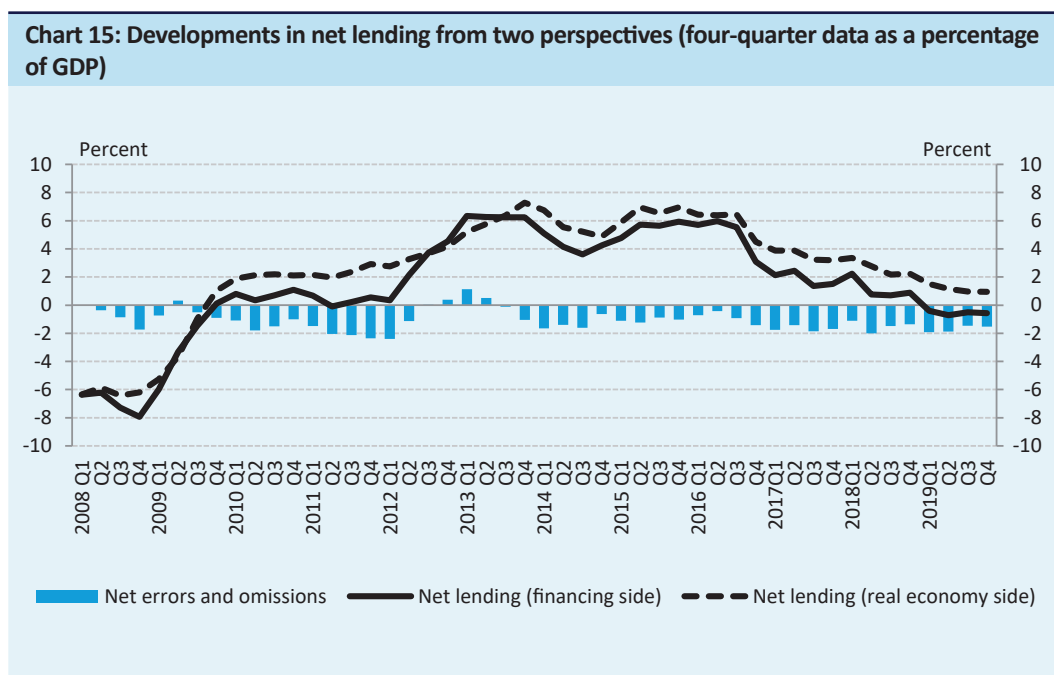
In 2019, the absorption of EU funds increased to above EUR 4 billion, which was related to an expansion in the capital transfers of the state (Chart 14). As a result of the EU programming period and the related rules on drawing down funds, the absorption of EU transfers reached its low in 2016. Since then, the annual absorption of funds has been increasing year by year, partly supported by advance payments as well. In line with that, the absorption of EU transfers was up in 2019 as well and amounted to nearly EUR 4.1 billion. The rise was a result of a decline in current transfers and a higher absorption of capital transfers. In a sectoral breakdown, the higher absorption was related to the state, while a slight decline took place in the case of companies.



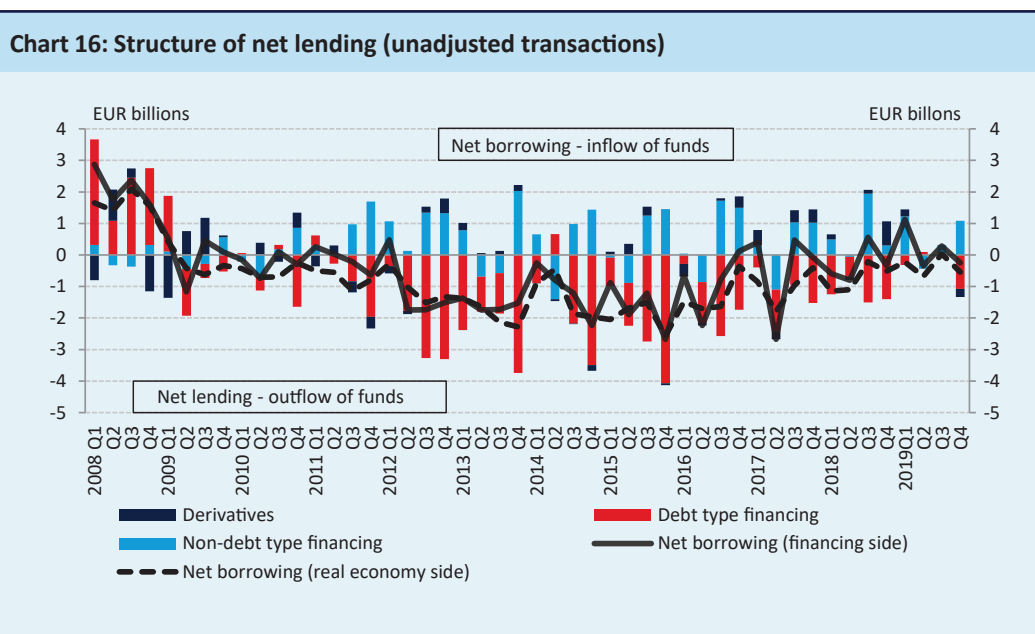
2. Financing approach

In the final quarter of 2019, the four-quarter net borrowing calculated on the basis of the financing items was around 0.6 percent of GDP. The inflow of funds was related to net FDI inflows, which had been high for years, while the net external debt of the economy declined further. In Q4, FDI inflows were offset by the net outflows of debt liabilities. The decrease in net external debt was related to the consolidated general government, whereas the indicator for the private sector increased. In 2019 as a whole, based on the financing items, the net position vis-à-vis non-residents turned into net borrowing: borrowing by the private sector exceeded the declining net external liabilities of the general government. The net borrowing of the corporate sector took place against the background of sustained high FDI inflows amounting to EUR 2.3 billion, which also play a role in the dynamic expansion in investment. As in previous years, reinvestment of incomes generated by foreign-owned companies played an important role in the increase in corporate liabilities. There was a major slowdown in the decline in net external debt in 2019: the general government and companies reduced their external indebtedness further, while the net external debt of the banking sector rose. The decrease in the net external debt of the state was partly attributable to EU transfer inflows and partly to non-residents' declining government securities holdings. The rise in the net external debt of banks was mainly explained by the increase in liabilities, but foreign assets also declined considerably.

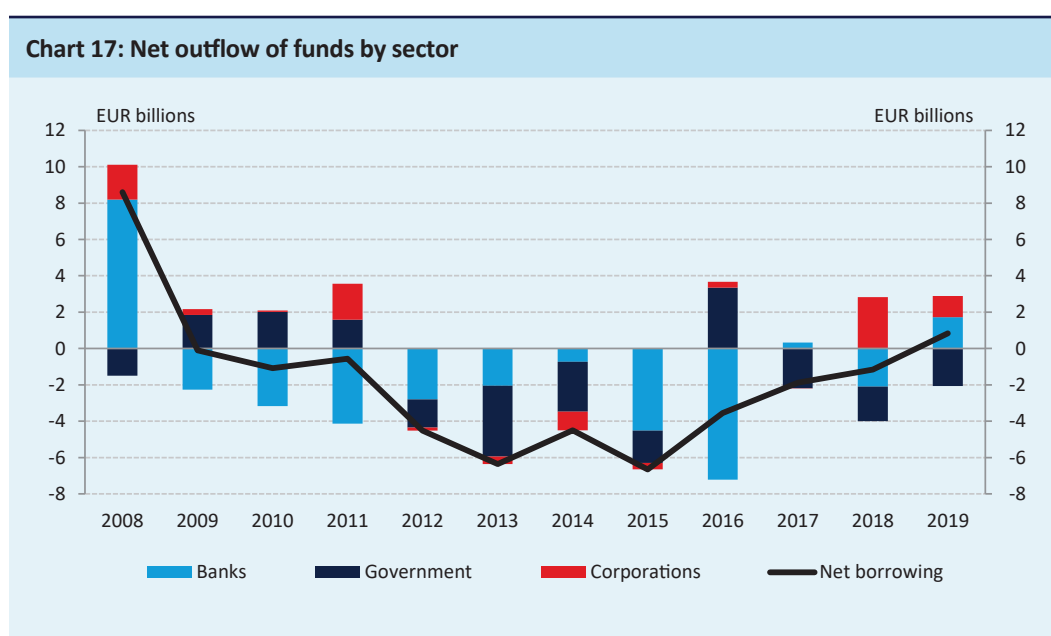
In 2019 Q4, the four-quarter net borrowing requirement of the economy according to the financing approach was around 0.6 percent of GDP. The four-quarter net lending calculated on the basis of real economy data corresponded to 1 percent of GDP, whereas the balance position calculated from the financing side showed a borrowing requirement (Chart 15). This means that – in spite of the net lending, which is significant according to the real economy indicator – financing data pointed to a rise in external debt. The difference between the two indicators, i.e. the balance of net errors and omissions, was around 1.5 percent of GDP, which corresponds to the average of the previous years and to the level prevailing in the countries of the region (for more details, see Section 5).



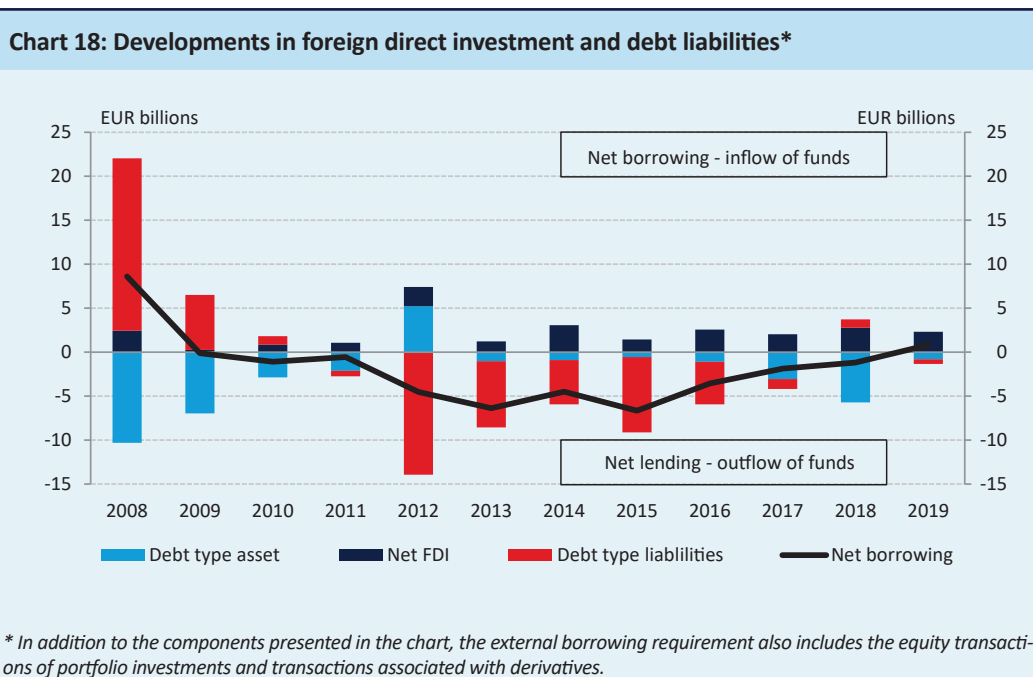
The quarterly net borrowing requirement of the economy edged slightly higher in 2019 Q4, as a result of a decline in debt-type liabilities and a similar degree of inflow of non-debt liabilities (Chart 16). Debt-type liabilities decreased by nearly EUR 1.1 billion in Q4, which was entirely related to the state, while the net external debt of the private sector rose. By contrast, the external non-debt liabilities of the economy advanced by more than EUR 1.1 billion in Q4, mainly due to foreign direct investment. On the whole, the net borrowing of the economy was around EUR 0.25 billion in Q4.



In 2019, on the whole, net borrowing evolved in the Hungarian economy vis-à-vis the rest of the world, which was attributable to borrowing by the private sector, while the external debt of the general government continued to decline (Chart 17). In the previous years, in line with the real economy developments determined by the changes in the trade surplus, the decline in external liabilities gradually decelerated, and then in 2019 net borrowing evolved in the Hungarian economy vis-à-vis the rest of the world. This was partly attributable to the fact that, as a result of a dynamic expansion in corporate investment, the net borrowing of the sector increased gradually, which was mostly related to foreign direct investment. In addition, the net external debt of banks also increased, with contributions from a decrease in foreign assets as well as an expansion in foreign liabilities. In parallel with that, the general government reduced its external debt further, primarily owing to non-residents' declining government securities holdings and the absorption of EU transfers.

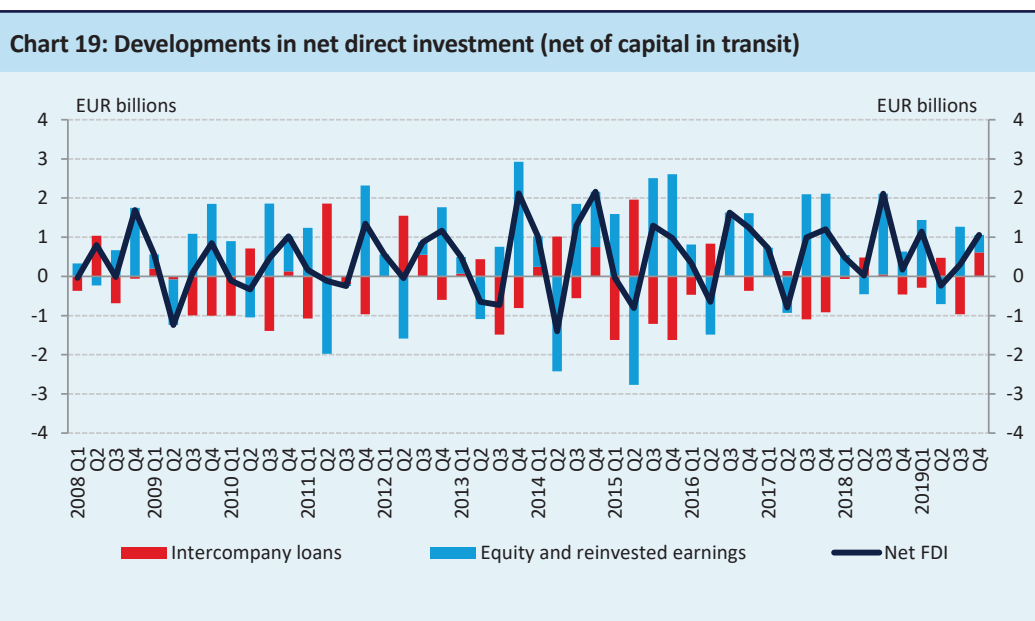


The country's external position shifted to net borrowing due to the fact that net FDI inflows exceeded the net outflows of debt-type liabilities (Chart 18). The debt liabilities of the economy declined by some EUR 1.3 billion, which is below previous years' figures. Expansion in foreign assets contributed to the decline in net external debt to a greater extent; following a moderate rise in the previous year, external debt liabilities decreased slightly. Net FDI inflows dropped to EUR 2.3 billion in 2019.

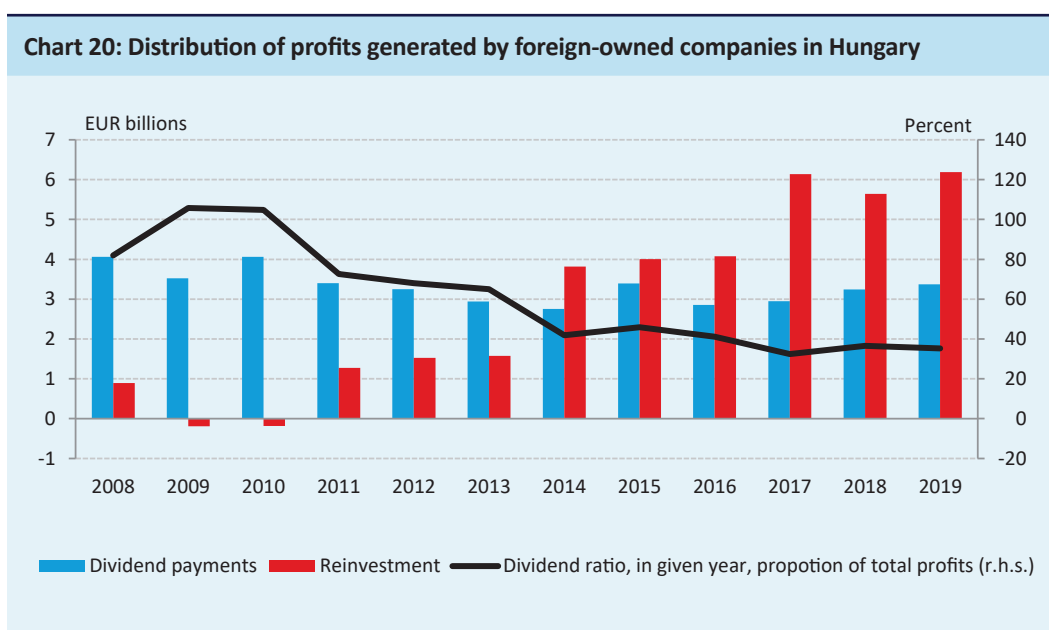


2.1. Non-debt liabilities

In past years, it was mainly the increase in reinvestments that contributed to the expansion in net foreign direct investments, and in parallel with that, intercompany loans typically declined (Chart 19). After significant inflows in Q1, net FDI fell in Q2 as a result of dividend payments, but then accelerated again in H2. Following the crisis, in terms of the structure of foreign direct investment, the changes in equities and intercompany loans often offset one another, which was reflected in the significant slowdown in net FDI inflows. In the past few years, the inflow of funds related to reinvested earnings accelerated again, while intercompany loans declined further. The decline in equities is partly explained by the reducing effect of acquisitions by the state (e.g. MOL, E-On, Főgáz, Budapest Bank), while the decrease in intercompany loans may have been related to the balance sheet adjustment of the corporate sector (entailing the repayment of domestic and foreign loans). Intercompany loans outstanding declined slightly further in 2019. The major expansion in reinvested earnings continued in Q4, while loans within groups of companies (i.e. intercompany loans) were also up slightly. The considerable increase in domestic companies' investment abroad contributed to the decline in net FDI. Non-debt financing other than FDI, i.e. net portfolio equity investment, remained at a low level in 2019.



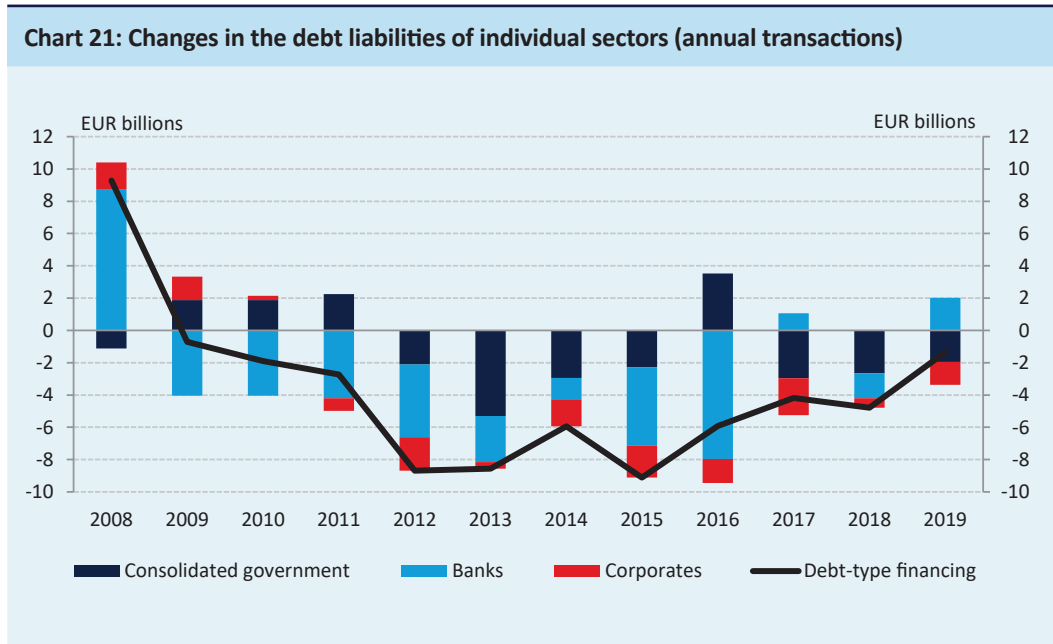
While foreign-owned companies remained highly profitable, reinvested earnings still exceeded EUR 6 billion, contributing significantly to the expansion in foreign direct investments. Amounting to EUR 9.6 billion, the profitability of foreign-owned companies was around the previous year's high level in 2019 as well.³ As the dividend disbursement to profit ratio remained around 35 percent, i.e. at a level that is low in a regional comparison as well (for more details see the October 2019 Report on the Balance of Payments), reinvestment of the incomes shown in the balance of payments statistics contributed significantly to FDI inflows again (Chart 20).



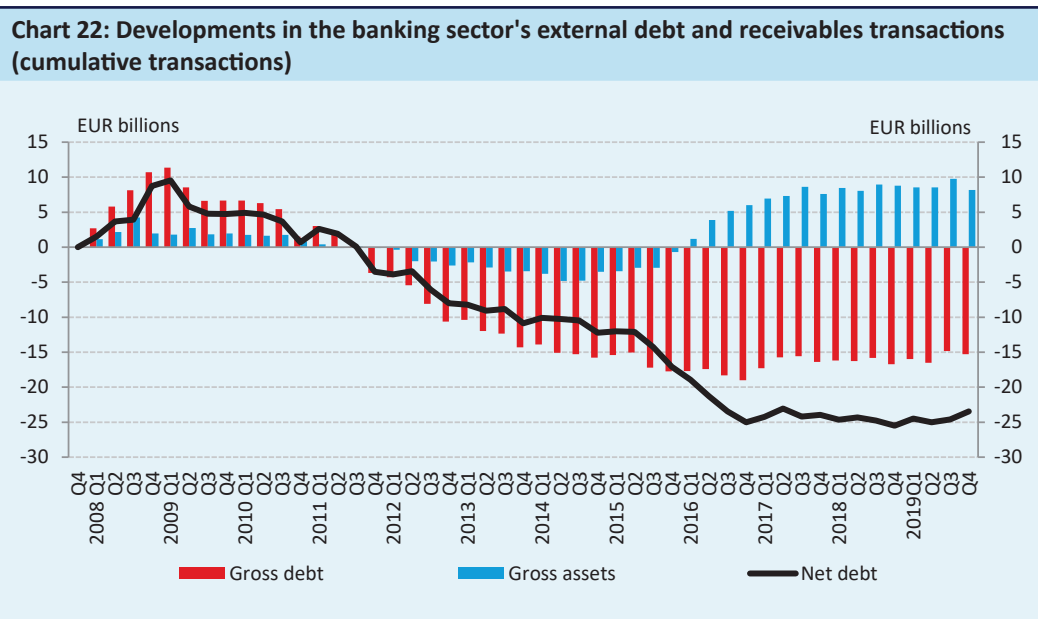
³ Profit of foreign-owned companies, as well as the reinvested income shown in the income balance are based on an estimate for 2019, which will be replaced by actual figures based on corporate surveys together with the publication in September 2020.

2.2. Debt liabilities

Based on transactions, the net external debt of the economy declined by EUR 1.1 billion and EUR 1.3 billion in Q4 and for the year as a whole, respectively, with the general government as the main contributor, while the net external debt of the banking sector increased (Chart 21). The adjustment of the economy concerning net external debt decelerated in 2019: net outflows of debt-type liabilities fell from EUR 4.8 billion in 2018 to EUR 1.3 billion in 2019. The net external debt of the banking sector expanded by EUR 2 billion, while the net external debt of the consolidated general government declined by EUR 1.9 billion. Both the rise in foreign assets and the fall in liabilities contributed to the decrease in the net external debt of corporations. In the last quarter, as a result of higher EU transfer inflows, the net external debt of the general government declined considerably, while the indicator for the private sector rose to a lesser extent than that.

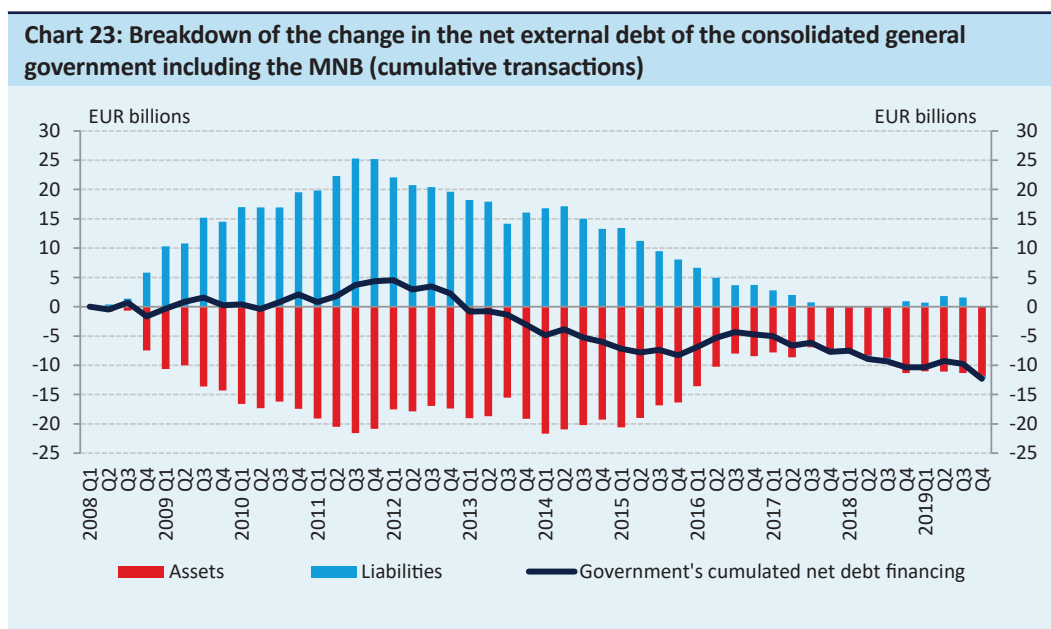


The net external debt of the banking sector rose slightly in 2019, which was primarily due to an expansion in foreign liabilities, but foreign assets also dropped (Chart 22). In the first three quarters of the year, the FX deposits of non-financial corporations held with credit institutions declined considerably as a result of transactions, which was also reflected in a decrease in banks' foreign assets. As an adjustment of the significant increase in the previous quarter, banks' debt-type assets fell considerably, dropping by some EUR 1.6 billion in Q4, which resulted in higher net external debt. In parallel with that, the gross external debt of the banking sector fell by EUR 400 million, entirely affecting long-term liabilities. Looking at the year as a whole, the banking sector's gross external debt expanded by EUR 1.4 billion, while external assets declined by EUR 0.6 billion. As a result, banks' net external debt rose by some EUR 2 billion.



The net external debt of the general government including the MNB declined considerably in Q4, which was primarily explained by the decrease in gross liabilities (Chart 23). The government's external debt was influenced by the following key items.

- The absorption of EU transfers significantly reduced net external debt for the year as a whole and particularly in Q4. In addition to the absorption, the EU also transferred significant amounts of funds at the end of the year, resulting in an increase in FX reserves.
- Following a decline in Q1, non-residents' government securities holdings rose in 2019 Q2, but started to fall again in H2. Looking at the year as a whole, non-residents' government securities holdings declined by nearly EUR 1.6 billion.



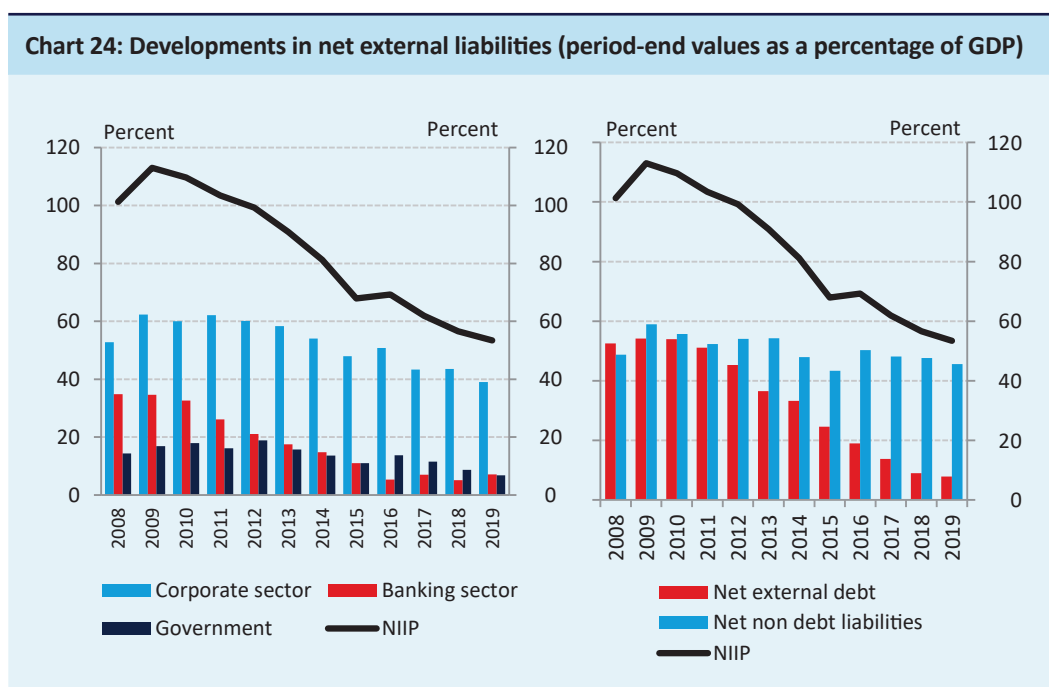
The net external debt of non-financial corporations increased slightly in 2019 Q4, which was attributable to a decline in commercial credit claims vis-à-vis the rest of the world. At an annual level, there was a major decline in the net external debt of companies, with an expansion in foreign assets as the driving factor, while foreign liabilities declined to a lesser degree. Since 2016, liabilities increased by a mere EUR 0.5 billion, while external assets rose by more than EUR 6 billion. In 2019, the net external debt of the corporate sector fell by a total of almost EUR 1.5 billion.

3. Developments in debt ratios

In 2019, in view of the dynamic expansion of GDP, external debt indicators continued to improve, and thus the external vulnerability of the Hungarian economy declined further. The decline in both non-debt liabilities and net external debt as a proportion of GDP contributed to the decrease in net external liabilities. The net external debt-to-GDP ratio and gross external debt fell to below 8 percent and to around 53 percent, respectively, which was attributable to fund outflows as well as an increase in nominal GDP, although its effect was partly offset by the revaluation of the stock. The 2019 decline in net external debt was primarily related to the general government, with contributions from both a decrease in its external debt and an increase in FX reserves. The net external debt of the private sector rose slightly in 2019, as the degree of the decline in the corporate sector's net external debt was exceeded by the rise in the indicator for the banking sector. A rise in external liabilities and a drop in the sector's foreign assets also contributed to the higher net external debt of banks. As a result of the debt reduction of the general government and corporations, the decline in gross external debt exceeded that of the net debt ratio in 2019. Short-term external debt, which is crucial in terms of the external vulnerability of the country, fell to EUR 17.7 billion at end-2019. By contrast, FX reserves increased further during 2019 as a result of EU transfers and an expansion in the central bank's forint liquidity providing swap instruments, and thus reserves continue to significantly exceed the level expected by investors.

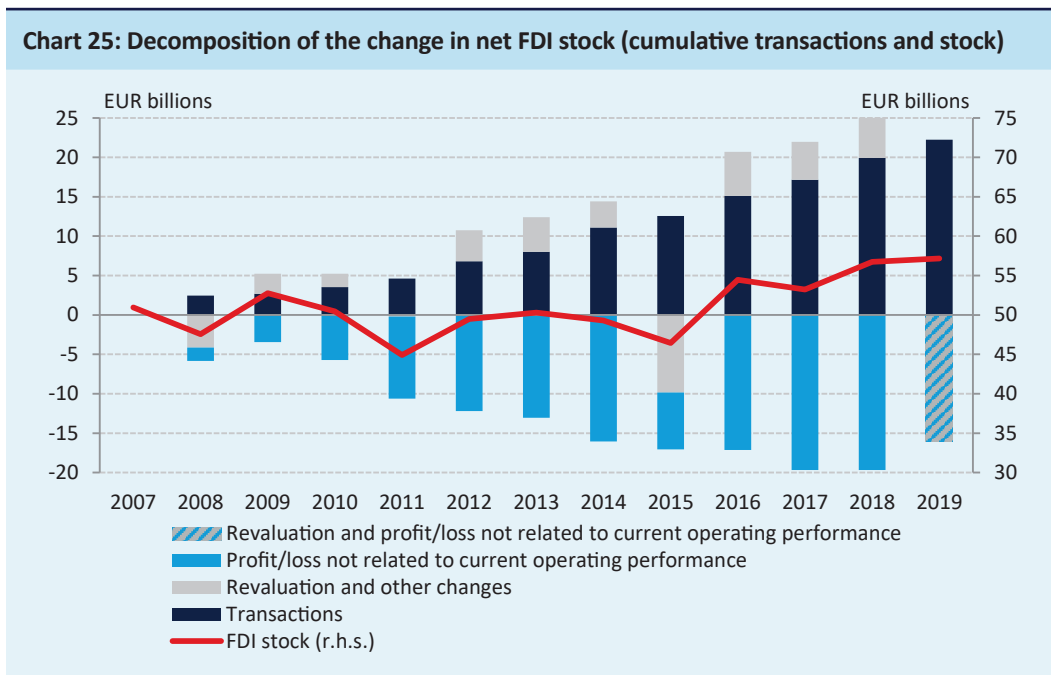
3.1. Net external liabilities

Hungary's net external debt continued to decline in 2019, supported by the decrease in both debt-type and non-debt liabilities as a percentage of GDP (Chart 24). By end-2019, net external liabilities, which contain external debt as well as non-debt liabilities (FDI, portfolio equities and derivative liabilities), fell to around 53 percent of GDP. Following a temporary interruption in 2016 (which took place as a result of a sharp temporary rise in the stock of FDI), the decline in the net external liabilities of the country, which had been lasting since the crisis, continued in 2017–2019. Both debt liabilities and non-debt liabilities declined in 2019, resulting in a reduction of 3.2 percentage points of GDP in net liabilities. This decrease took place against the background of a decline in the net external liabilities of the government and the corporate sector, which was partly offset by the rise seen in the case of the banking sector.



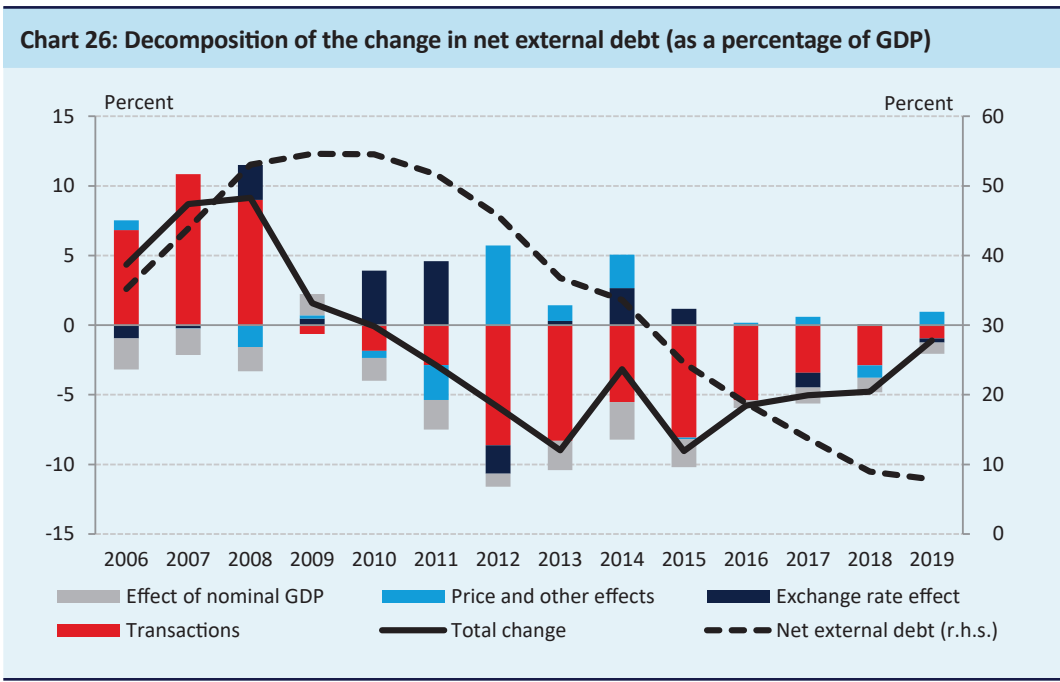
In 2019, the rise in the net FDI stock continued at a slower pace compared to the previous year: the effect of FDI inflows was mostly offset by the revaluation of stocks (information on corporate profit/loss not related to current operating performance will only be available in September). Resulting from transactions, foreign direct investments have increased gradually in past years. At the same time, the rise in non-residents' net FDI stock fell short of that rate (Chart 25). This was

mainly attributable to losses not related to the normal course of business, the impact of which was typically partly offset by the effect of the revaluation of the stock. Between 2008 and 2019, these two items reduced the FDI stock by nearly EUR 16 billion in total (for more details on profit/loss of non-recurring items see the October 2019 Report).



3.2. Net external debt

In 2019, the net external debt-to-GDP ratio declined as a result of the outflows of debt-type liabilities and an expansion of GDP, which, however, was partly offset by the revaluation of the stock (Chart 26). The sharp decline in the debt indicator seen since the crisis is primarily attributable to the outflows of debt-type liabilities. After the outbreak of the crisis, the adjustment of net external debt was curbed by the decline in nominal GDP in 2009, and later by the depreciation of the forint. Accordingly, the reduction of the excessive debt accumulated in the pre-crisis years accelerated from 2011: from then on, in connection with the outflows of debt-type liabilities, net external debt declined by nearly 47 percentage points, and in addition, the growth in nominal GDP also contributed to the improvement in the indicator to a smaller extent. Hungary's net external debt fell by 1.1 percentage point in 2019: the outflow of debt-type liabilities and the impact of GDP growth contributed to the improvement in the indicator to larger and smaller degrees, respectively, which was offset by the impact of the revaluation of the debt stock, due to a reduction in FX yields.



The net external debt-to-GDP ratio declined by 1.1 percentage point in 2019, coming in at below 8 percent of GDP at the end of the year. The improvement in the debt indicator was primarily related to the general government, while the private sector's net external debt rose slightly (Chart 27). The 1.4-percentage point decline in the government's net external debt-to-GDP ratio was attributable to the fact that the decrease in the government's external liabilities took place in parallel with an increase in FX reserves. The reserve-reducing effect of the FX assets required for the repayment of the government's maturing FX bonds was offset by the FX asset inflows related to EU transfers and the increase in forint liquidity providing swaps. In addition, a decline in non-residents' government securities holdings also contributed to the debt outflow of the state. The rise of 0.4 percentage point in the debt indicator of the private sector was related to the increase in the net external debt of the banking sector, which was partly offset by a smaller decline in the corporate indicator. Expansion in the sector's external liabilities as well as a decrease in its foreign assets also supported a rise in the net external debt of banks. In spite of the net debt inflow, banks' receivables from the rest of the world continued to moderately exceed their external liabilities, and the net external debt of the private sector including companies was also around zero (Chart 28).

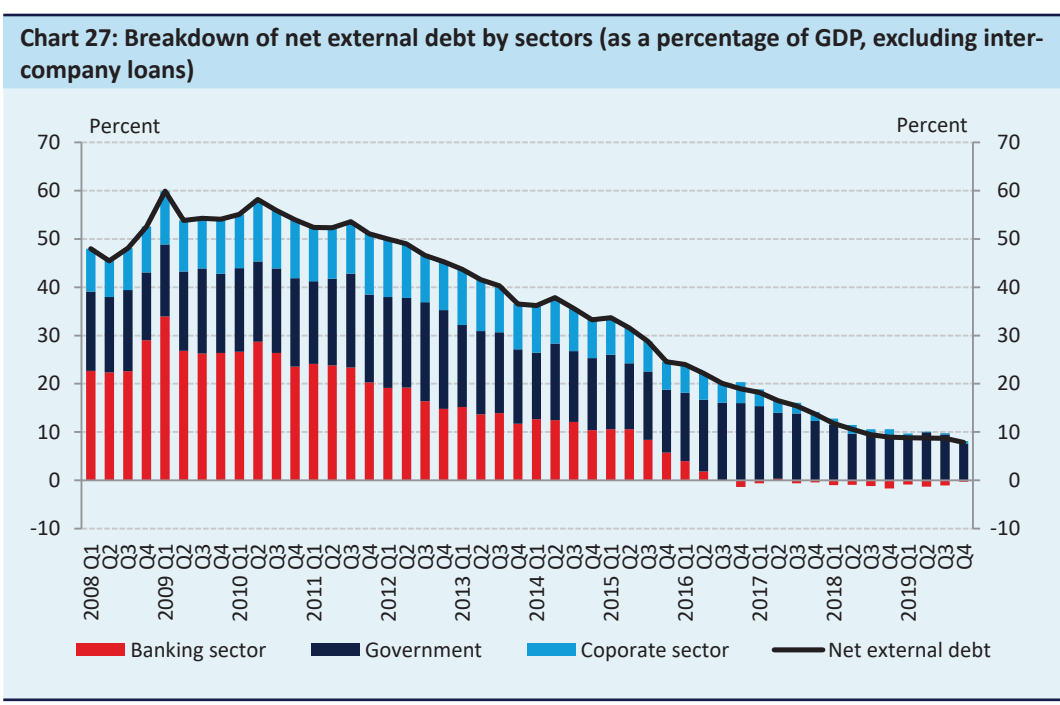
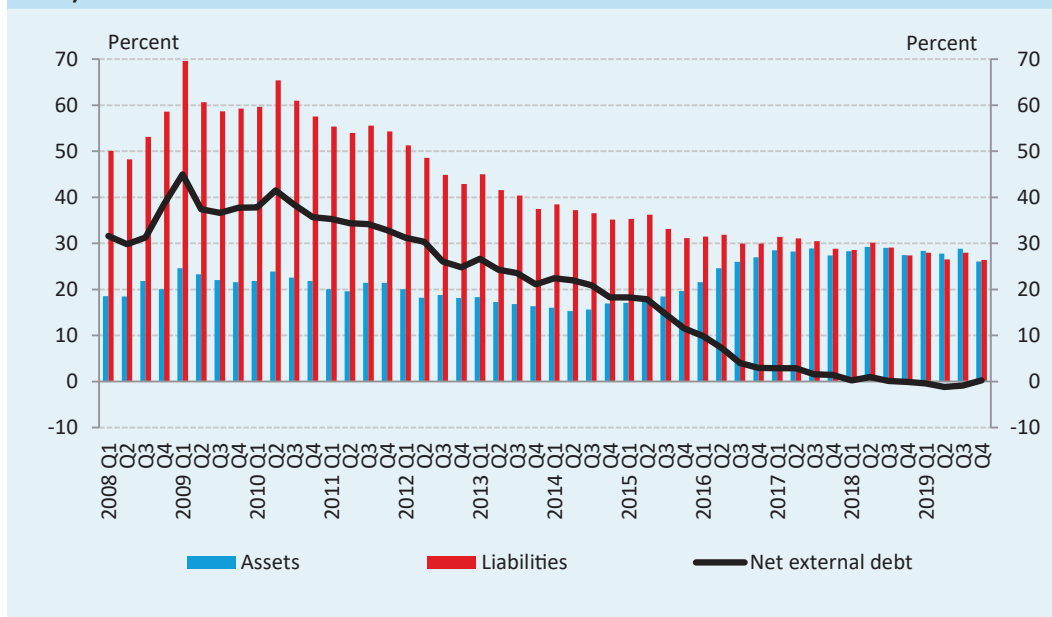
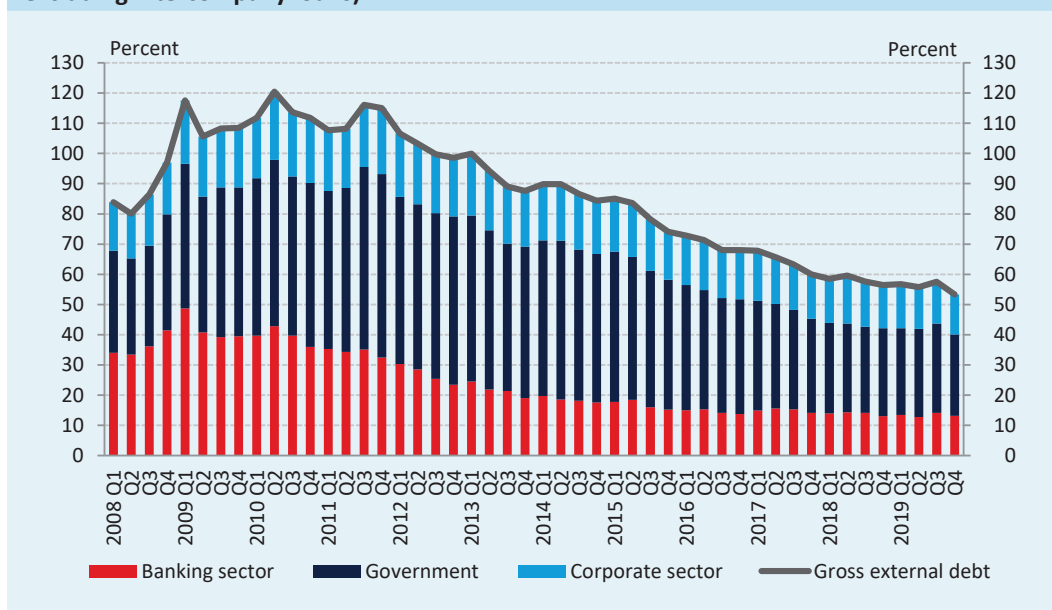


Chart 28: Developments in the private sector's external assets and debt (as a percentage of GDP)

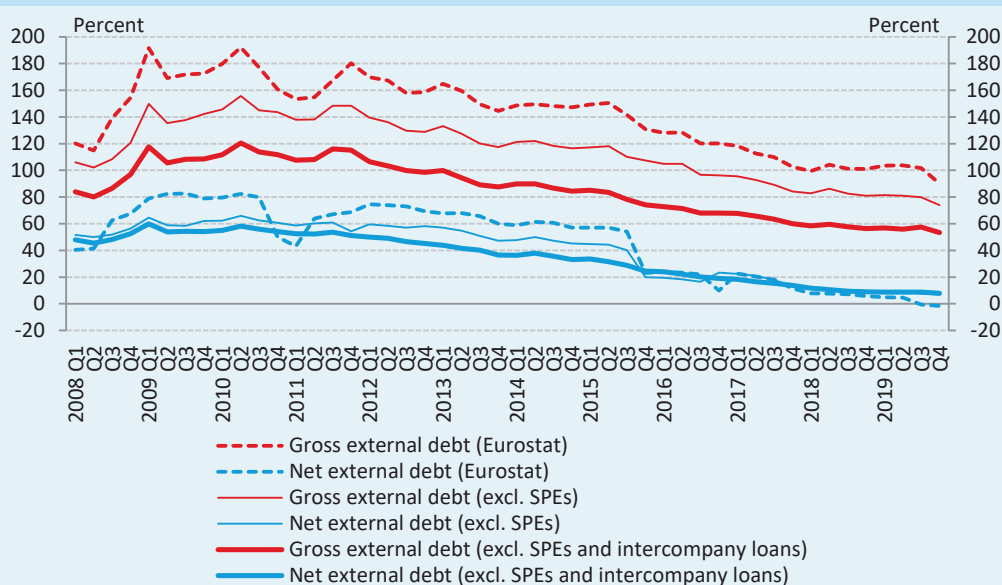
3.3. Gross external debt

As a result of a fall in the debt of the general government and companies, Hungary's gross external debt dropped to around 53 percent of GDP by end-2019 (Chart 29). The annual 3-percentage point decline in the gross external debt ratio was primarily attributable to the decrease in the government's liabilities as a proportion of GDP, but the external debt of companies also fell to a smaller extent. The gross external debt-to-GDP ratio of the banking sector remained practically unchanged in 2019: the rise seen in the first three quarters of the year was followed by an adjustment of the indicator in Q4. On the whole, the effect of the annual debt inflow was offset by the expansion of GDP. In 2019, the decline in gross external debt exceeded that of the net external debt: while the improvement in the net indicator was restrained by a decline in the foreign assets of the banking sector, but this impact did not prevail in the gross indicator.

Chart 29: Breakdown of gross external debt by sector (market value as a percentage of GDP, excluding intercompany loans)

Box 2: Changes in external debt from various points of view

Irrespective of SPEs and intercompany loans, net external debt reached a historical low, but in the case of gross external debt, the indicators comprising SPEs and intercompany loans as well continue to exceed the debt ratio according to underlying trends. Based on economic considerations, the MNB's analyses and publications analyse the debt indicators excluding SPEs (special purpose entities) and intercompany loans. However, in the Eurostat database only indicators calculated together with these factors are available at the international level. SPEs do not perform genuine real economy activity in the given country and typically have less than five employees. Their activity typically does not have an impact on the net external liabilities of the country, as in parallel with their liabilities they have external assets of the same value as well, and thus they only significantly influence the gross debt indicators. In view of their fundamentals, intercompany loans can be considered more as non-debt liabilities rather than debt-type ones (for more details see the April 2014 Report on the Balance of Payments). In line with that, the balance of payments statistics show intercompany loans among foreign direct investments. In accordance with the net external debt according to underlying trends, net external debt including SPEs and intercompany loans also declined to a low level in the past years. The net external debt calculated by Eurostat declined to -1.6 percent from the previous year's level of 5.6 percent (i.e. according to this indicator, foreign assets exceed foreign liabilities), while the net debt indicator excluding SPEs and intercompany loans also declined further, to 7.9 percent of GDP, although at a slower pace than in 2018. The levels of gross indicators vary significantly according to various methodologies, whereas in terms of their dynamics they typically indicate changes in a similar direction (Chart 30). In 2019, the gross external debt calculated by Eurostat and without SPEs declined considerably, similarly to the indicator according to underlying trends (excluding SPEs and intercompany loans). The difference between the gross indicators narrowed gradually in the past years, as the gap nearly halved between 2015 and 2019.

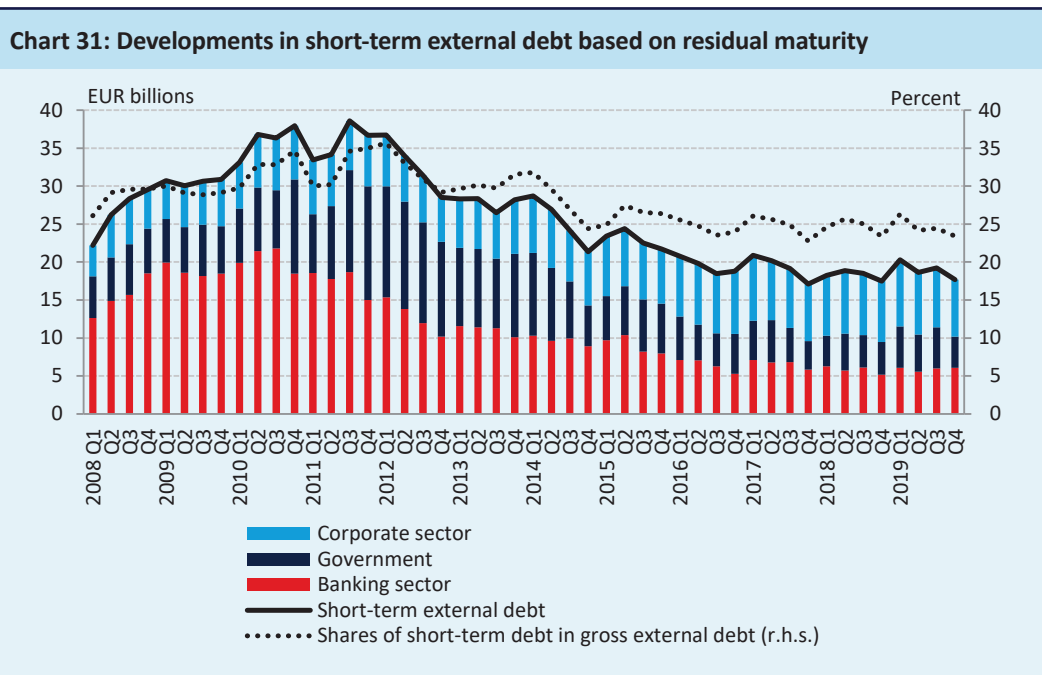
Chart 30: Developments in net and gross external debt (as a percentage of GDP)

Source: Eurostat, MNB.

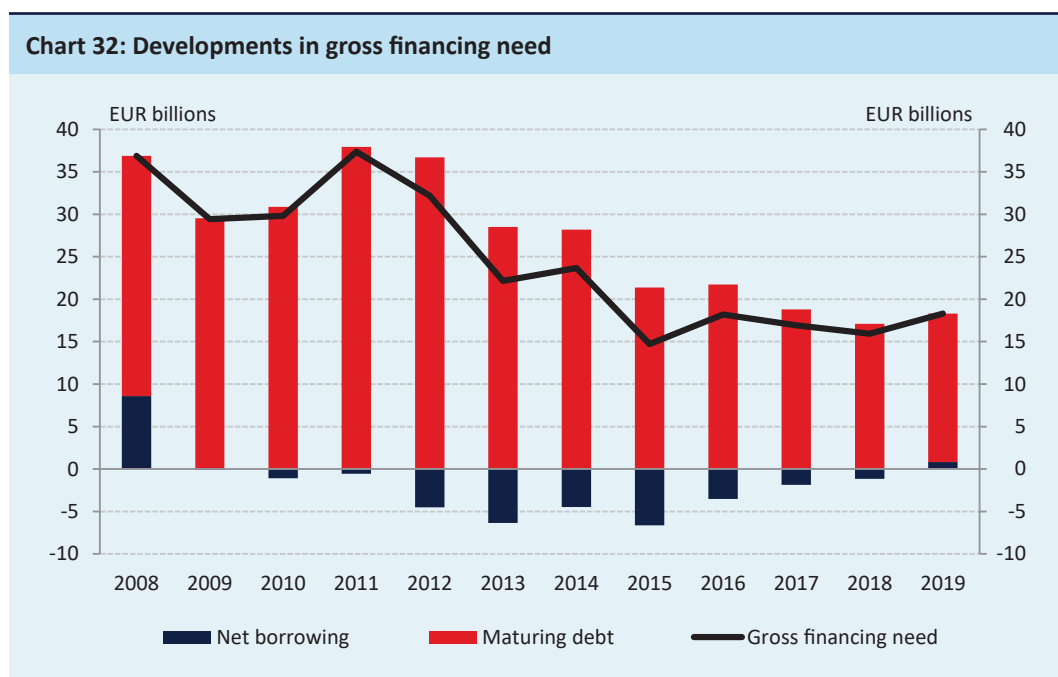
3.4. Short-term external debt and gross financing need

Following a temporary increase observed during the year, Hungary's short-term external debt fell to EUR 17.7 billion by end-2019 (Chart 31). From its low point at end-2018, the indicator temporarily rose in early 2019, but by the end of the year, it had dropped again to a level close to its historical low, i.e. to EUR 17.7 billion. Following a surge early in the year, short-term external debt of the banking sector was persistently close to EUR 6 billion, whereas the indicator for the corporate sector was down to EUR 7.5 billion by end-2019. After a temporary increase in early 2019, which was primarily

related to the shortening of the maturities of the stock, the short-term external debt of the general government fell significantly, amounting to EUR 4.1 billion at the end of the year. On the whole, the persistently low level of short-term external debt, which is more than EUR 10 billion lower than the FX reserves, is favourable in terms of the investors' assessment of the economy and the external vulnerability of the latter.



In 2019, Hungary's gross external borrowing requirement rose to EUR 18.3 billion. At end-December 2018, short-term external debt amounted to EUR 17.5 billion, i.e. the external debt maturing in 2019 exceeded the previous year's level slightly, by EUR 0.4 billion (Chart 32). The external borrowing requirement calculated from the items in the financial account, which shows the external funding requirement of the country, amounted to EUR 0.8 billion. Accordingly, the gross external borrowing requirement, which shows the value of the external liabilities of the Hungarian economy to be renewed in a given year amounted to EUR 18.3 billion.



3.5. Reserve adequacy

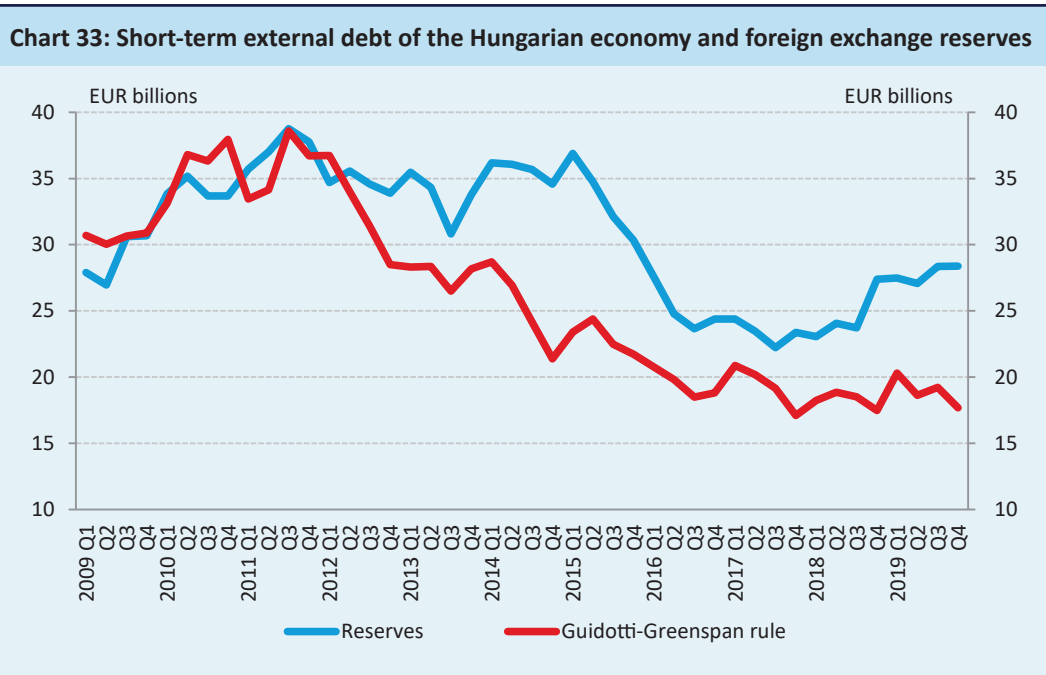
Compared to September, the level of FX reserves remained practically unchanged in 2019 Q4, amounting to EUR 28.4 billion at the end of the year. The changes in reserves were affected by various factors, the most important of which were the following:

- The reserve-increasing effect of EU funds was some EUR 1.4 billion, resulting primarily from the payment by the European Commission of the performance-based invoices of the 2014–2020 EU programming period and to a lesser degree from agricultural subsidy programmes.
- The change in the stock of the forint liquidity providing FX swap instrument raised the reserve level by nearly EUR 0.7 billion, and thus it amounted to nearly EUR 6.9 billion at end-December 2019.
- The reserves were reduced by EUR 280 million by the revaluation of other currencies resulting from their strengthening against the euro and of gold expressed in euro, and by nearly EUR 0.6 billion in total by net financial flows linked to the MNB's derivative transactions as well as by changes in foreign currency deposits placed by Hungarian credit institutions.
- The net FX financing of the Government Debt Management Agency (ÁKK) reduced the reserves by EUR 0.5 billion, most of which is attributable to the maturing of the residency bonds issued in 2014.
- The FX transactions of the Hungarian State Treasury (MÁK) and other foreign currency expenditures of the ÁKK reduced the reserves by nearly EUR 0.7 billion.

In 2019 as a whole, the international reserves of the MNB rose by EUR 1 billion. The reserve-boosting effect of EU transfers and the liquidity providing foreign exchange swap instrument were only partly offset by other factors. FX reserves grew from EUR 27.4 billion in December 2018 to EUR 28.4 billion by end-2019, with the following items as main contributors:

- Foreign exchange reserves were boosted by the net annual *transfers from the European Commission*, which amounted to about EUR 4 billion.
- The reserve-increasing effect of the *forint liquidity providing FX swap instrument* added EUR 0.7 billion to the reserves.
- *Net financial flows linked to the MNB's derivative transactions and the foreign currency deposits of Hungarian credit institutions placed with the MNB* raised the level of international reserves by around EUR 0.3 billion, and the *revaluation* of currencies other than the euro and of the EUR-denominated price of gold added EUR 0.7 billion to the MNB's international reserve holdings.
- *Items related to the repayment of public debt*, especially the public sector's net foreign currency interest expenditures and the *ÁKK's net foreign currency financing* reduced the reserves by around EUR 2.7 billion in total. The latter includes the USD, Chinese renminbi and euro bond maturities in H1 as well as FX bond repurchases.
- Other FX transactions of the MÁK and the ÁKK (e.g. FX interest payments and the change in the margin deposit holdings related to the hedging swap transactions of the ÁKK) reduced the reserves by EUR 2.1 billion during the year.

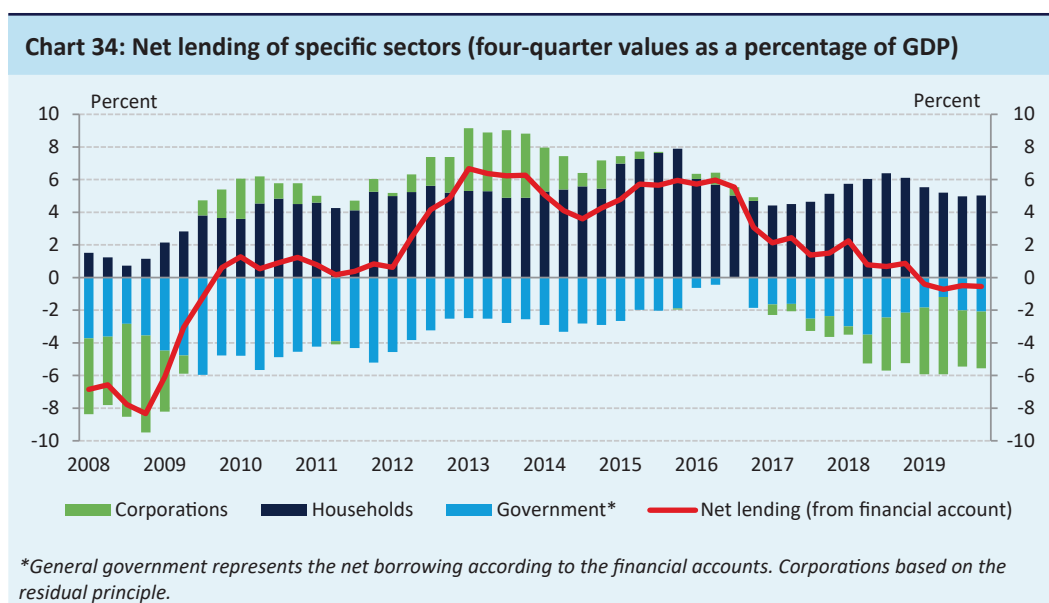
At end-2019, the MNB's international reserves exceeded the level of short-term external debt, which is closely followed by investors, by more than EUR 10 billion. At end-December 2019, international reserves and short-term external debt amounted to EUR 28.4 billion and EUR 17.7 billion, respectively. Accordingly, the reserve adequacy compared to short-term external debt improved by EUR 1.6 billion in 2019 Q4, while the leeway above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, exceeded EUR 10 billion at the end of the year (Chart 33).



4. Sectors' savings approach

In 2019, households' net financial savings fell slightly short of the aggregate net borrowing of companies and the government, and thus Hungary's net external position turned into a borrowing requirement. The net position of the sectors remained practically unchanged in Q4: against the background of households' consistently high net lending, only some external borrowing was needed. Dynamic corporate investment activity kept the sector's net borrowing at a steadily high level. The low net borrowing of the general government evolved as a result of tax revenues and expenditure that considerably exceeded the appropriations.

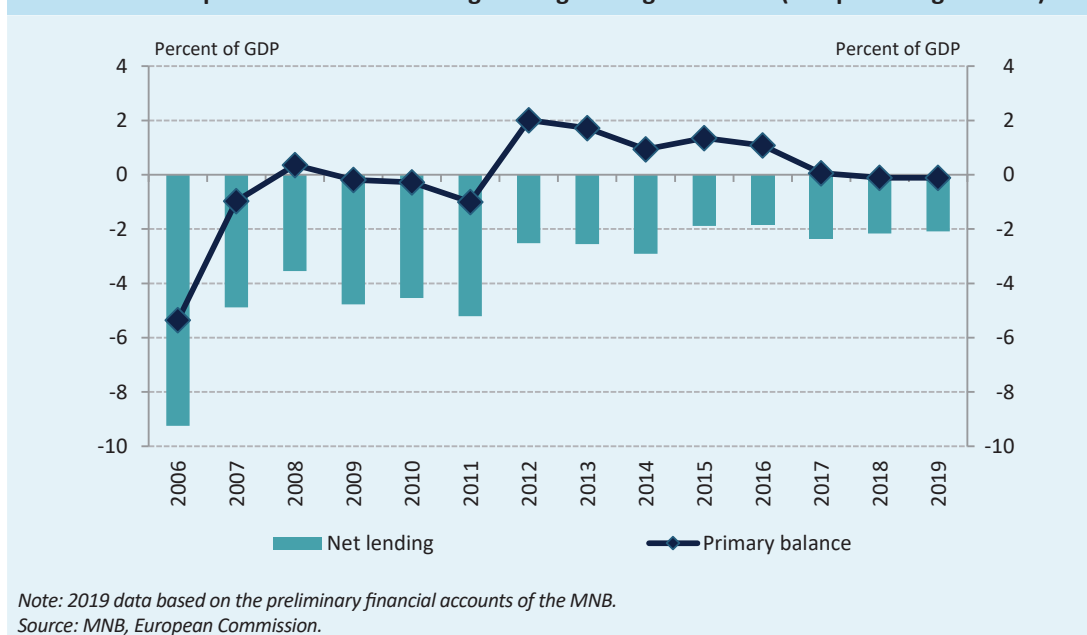
At end-2019, the low four-quarter external borrowing requirement was attributable to the corporate net borrowing evolving against the background of consistently high net savings of households and a small general government deficit (Chart 34). The change in the financial savings of the individual sectors is ultimately reflected in external funding, and thus changes in the external balance can also be captured as the sum of the sectors' savings – which corresponds in turn to financing-side processes. Based on preliminary data, the annual net borrowing of the consolidated general government remained moderate and was close to the level seen last year. In 2019 as well, the low budget deficit was explained by the expansion in tax revenues resulting from higher employment and consumption and also by a further decline in interest expenditures. In parallel with an upswing in lending, households' gross financial savings also increased, while the net financial savings of the sector expanded only slightly. The net borrowing of the corporate sector stabilised at a high level, which is still attributable to the dynamic investment activity.



4.1. General government

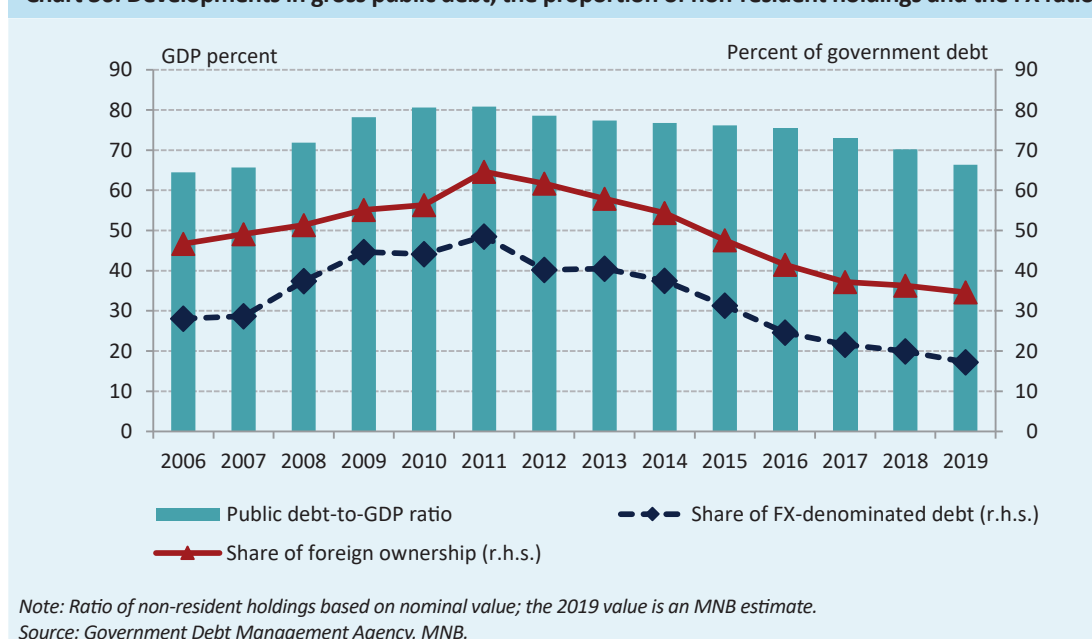
The general government's net borrowing remained moderate in 2019 again (Chart 35). Based on the preliminary data from the financial accounts, in 2019 the net borrowing of the general government amounted to 2.1 percent of the gross domestic product, i.e. the budget deficit is around the average of the past seven years.⁴ This figure exceeded the 1.8-percent deficit target and at the same time reflected a decline compared to 2018. The budget deficit, which exceeded the appropriation, is primarily the result of higher expenditures of the central budget at the end of the year, which was partly offset by rapidly rising tax revenues as well as a higher-than-expected balance of local governments and companies classified into the government sector. On the expenditure side, due to the persistently low interest rate environment and the gradual repricing of debt, interest expenses declined further and the GDP-proportionate value of financial transfers also decreased.

⁴ Data regarding the ESA balance of the budget is not yet available for 2019, but in general, there is only a minor difference between preliminary net lending data calculated according to the financial accounts and the ESA balance.

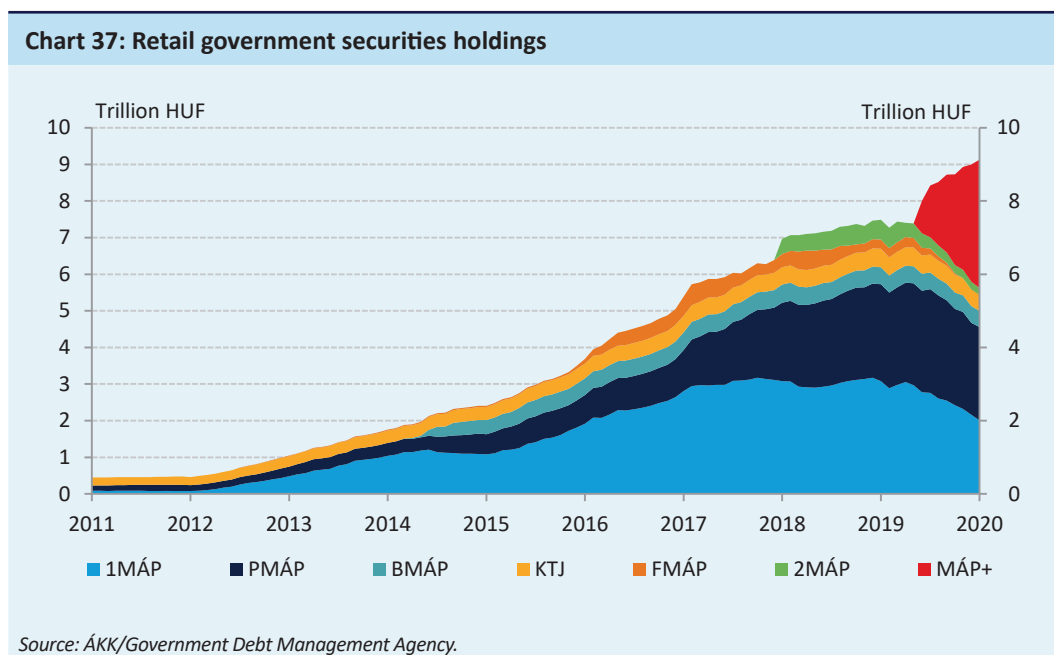
Chart 35: Developments in the net lending of the general government (as a percentage of GDP)

The trend decline observed since 2011 in gross public debt as a percentage of GDP continued in 2019 (Chart 36). By end-2019, the government debt-to-GDP ratio had fallen to 66.4 percent, representing an exceptionally significant, 3.8-percentage point decrease compared to end-2018. In addition to dynamic economic growth, the low level of net borrowing by the government also contributed to the decline. The significant debt reduction against the background of the low deficit was supported by low net issuance and the adjustment of the Single Treasury Account as well.

The drop in the foreign currency ratio and the contraction in non-resident holdings within public debt supported the reduction of external vulnerability. One of the key objectives of the government debt management strategy is to strengthen domestic financing, which was supported by the central bank's self-financing programme as well as the strengthening of households' government securities holdings. As a result of these measures, the share of non-residents' holdings within government debt dropped sharply, from roughly 65 percent at end-2011 to below 35 percent by end-2019. Meanwhile, the foreign currency ratio within general government debt fell from its peak of above 50 percent at end-2011 to close to 17 percent. The trend decline in non-resident holdings and the foreign currency ratio make a considerable contribution to the continuous reduction of external vulnerability and the upgrading of Hungary's credit rating.

Chart 36: Developments in gross public debt, the proportion of non-resident holdings and the FX ratio

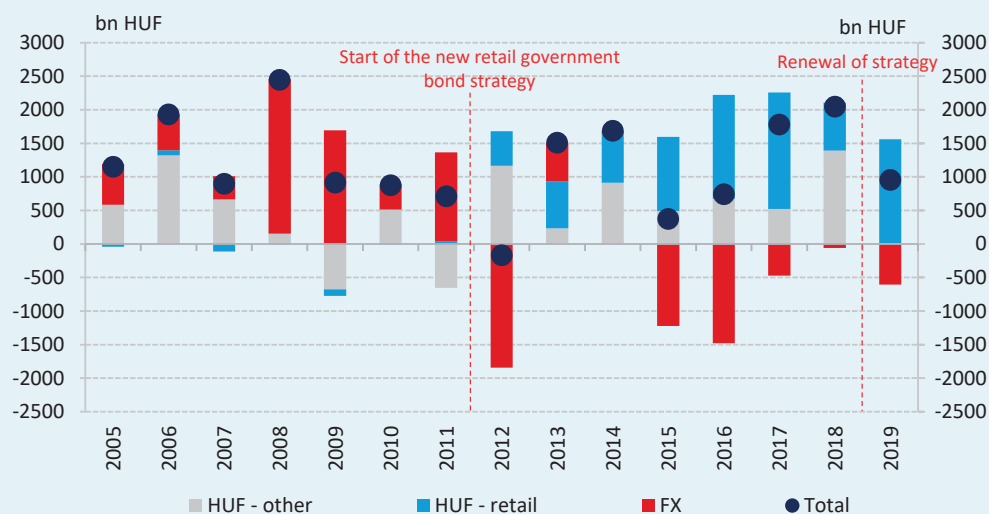
Households' government securities holdings have surged. The renewal of the range of government securities offered to households as well as the Hungarian Government Security Plus (MÁP+) introduced in June 2019 and the tax exemption of households' investments in government securities contributed to a favourable transformation in the debt structure. There has been very keen demand since the introduction of the new retail government security, with the outstanding stock increasing to roughly HUF 3,200 billion by end-2019 (Chart 37). The attractive conditions of the MÁP+ (such as the gradually rising yield, automatic reinvestment of interest and free-of-charge redemption) contribute to sustaining households' high savings rate and directing newly generated savings into government securities. In addition, the new government security facilitates the refinancing of FX maturities from forints, i.e. the holding of an increasing portion of the debt by residents (for more details see the box). In 2019, households' government securities holdings rose by nearly 40 percent, i.e. by more than HUF 2,250 billion, to about HUF 8,000 billion by the end of the year. As a result, households directly hold 26.5 percent of the securities issued by the government (i.e. nearly 35 percent taking into account the government securities holdings through mutual funds, insurers and pension funds), which can be deemed high by EU standards.



Box 3: Impact of the renewal of the government securities strategy on the denomination of government debt

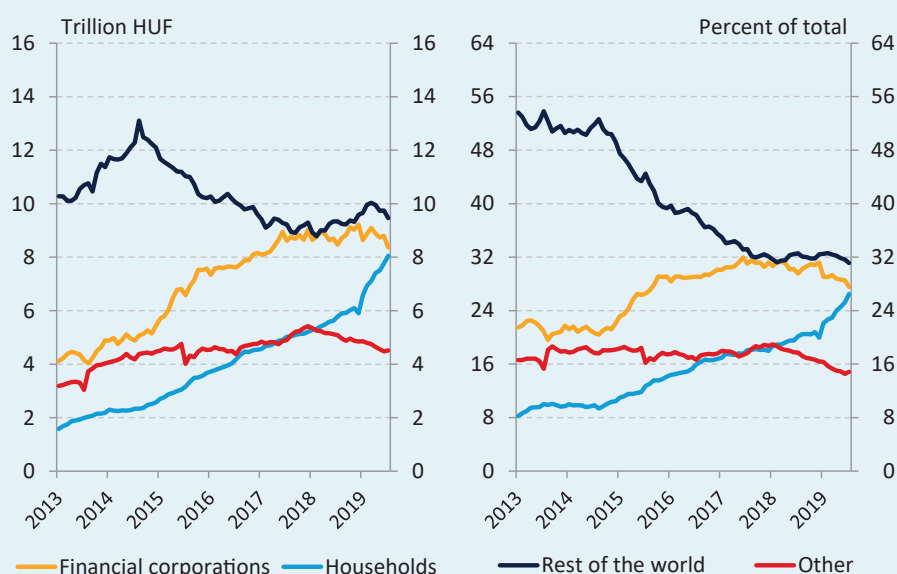
The launch of the retail government securities strategy in 2012 and the introduction of the MÁP+ in mid-2019 led to major changes in the financing structure of public debt. In the period prior to the launch of the retail government securities strategy, government debt was financed through the “traditional” forint and foreign currency debt components (wholesale government securities, loans), while the role of retail government securities was marginal. During this period, the weight of FX debt components and non-resident investors' holdings increased significantly. Within this framework, the reduction of FX-denominated debt, which was necessary in order to improve the vulnerability profile, could only have been implemented through HUF bond issues (and, to a lesser degree, through borrowing). Nevertheless, significantly increased HUF bond issuance would have resulted in the remaining of the high foreign share (as well as of the related vulnerability) in the financing of public debt, and, by burdening the wholesale forint market, it would have had an unfavourable impact on the yield environment as well.

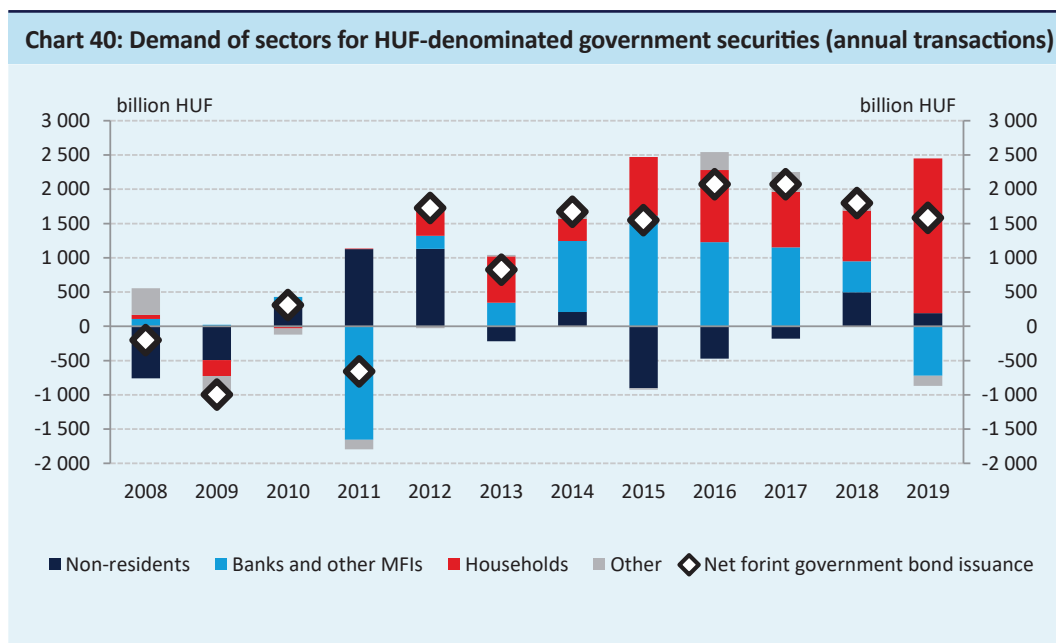
By contrast, by strengthening the issuance of retail government securities from 2012, a financing channel opened towards resources that had previously been unavailable for the state, which allowed for the gradual replacement of FX liabilities and thus improved Hungary's risk assessment (Chart 38). In line with that, starting from 2012, the additional funds borrowed directly from households increasingly facilitated the reduction and replacement of FX financing. Responding to the deceleration in the household financing channel in 2018, the MÁP+ was introduced in June 2019. This gave new impetus to borrowing from households, allowing for further replacement of FX debt components using forint sources, primarily in the form of FX bond repurchases and the refinancing of maturing papers.

Chart 38: Annual net changes in debt components financing government debt

Source: ÁKK/Government Debt Management Agency.

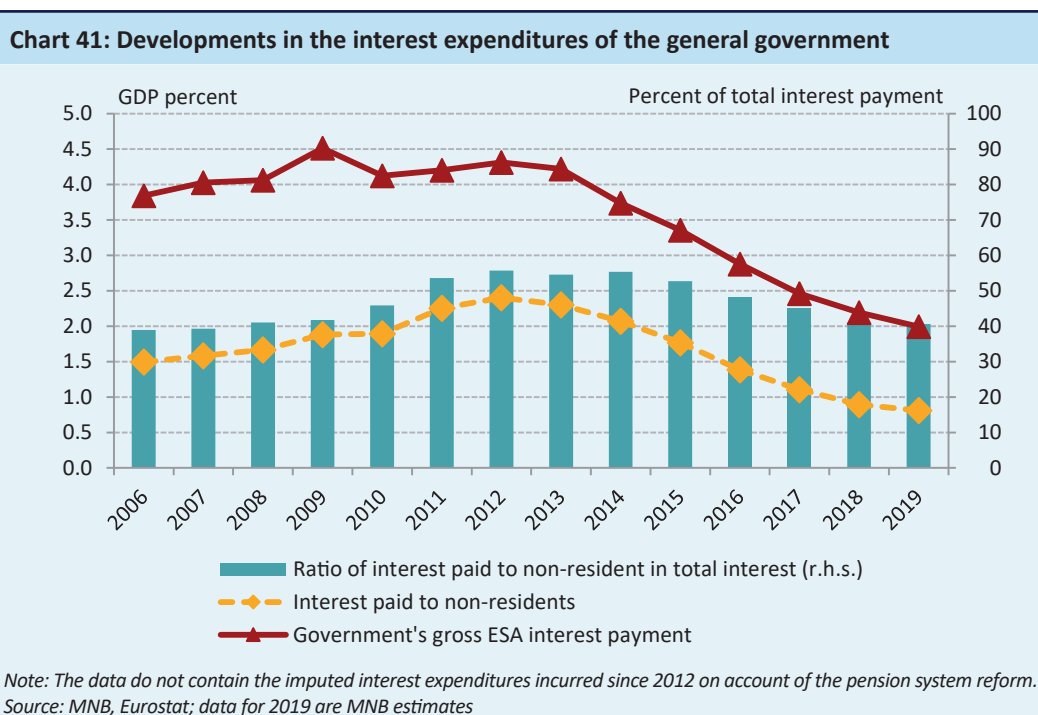
While households' role increased markedly, non-residents' government securities holdings rose slightly in 2019. Non-residents' (FX- and HUF-denominated) Hungarian government securities holdings increased moderately in 2019 (Chart 39). At the same time, due to the high ratio of domestic sectors, the share of non-residents within the total Hungarian government securities holdings fell slightly, and was close to 31 percent. Non-residents' long-term HUF-denominated government securities holdings expanded considerably, while compared to that, their short-term government securities holdings and FX bonds decreased to a lesser degree. The household sector's considerable demand for government securities – which was attributable to the introduction of the new MÁP+ scheme – (Chart 40) contributed strongly to mitigating Hungary's external vulnerability, while non-residents' HUF-denominated government securities purchases also contributed to the fall in the FX portion of public debt.

Chart 39: Government securities holdings of households, banks and non-residents



As a result of the decline in yields, the government's interest expenditure has declined further and now only amounts to 2 percent of GDP, marking a fall of roughly 2.2 percentage points compared to the figure of 4.2 percent recorded in 2013 (Chart 41). In 2019, average yields declined at all maturities in the government securities market, as a result of which the general government's gross interest expenditure-to-GDP ratio decreased further. In view of the repricing of the public debt, the decline in expenditure will continue in the coming years as well, because the ratio of low-yield liabilities within debt is growing year by year in the low interest rate environment. One factor contributing to repricing was that in 2019 a decline of approximately 1 percentage point took place in the longer segment of the yield curve. Accordingly, by end-2019, the 3-, 5-, 10- and 15-year yields were some 0.3 percent, about 1.2 percent, 2 percent and 2.8 percent, respectively. The stable macroeconomic situation in Hungary, the central bank's programmes (rate cut cycles, self-financing programme, transformation of monetary policy instruments), the upgrades and the supportive international environment all contributed to the evolution of the extremely low yields.

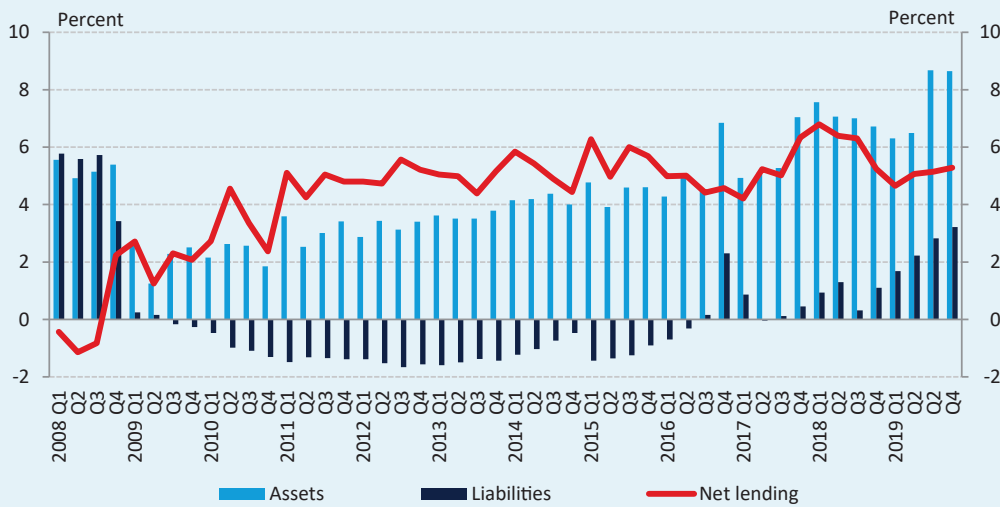
In 2019, public interest paid to non-residents dropped to 0.8 percent of GDP, corresponding to a ratio of 40 percent, i.e. to the pre-crisis level, within total interest expenditure. As a result of the fall in non-residents' ownership share within government debt and the decline in yields in Hungary, interest expenditure paid to non-residents has been on a downward path since 2012, also improving the current account balance. Based on the debt management strategy, in the coming years the decline in non-residents' debt holdings, and within that mainly in FX debt, may continue, and thus the interest paid to non-residents may also keep decreasing.



4.2. Household sector

According to the underlying trends, households' net saving was at a high level of around 5.3 percent of GDP in 2019 Q4 again (Chart 42). Following a major decline observed in 2018, households' seasonally adjusted net savings increased slightly during 2019, reaching 5.3 percent of GDP at the end of the year. The net position rose in spite of the fact that net borrowing accelerated steadily during the whole year; the explanation for this is that households spent a considerable portion of the loans borrowed on expanding their gross financial assets. The extremely high gross financial asset accumulation is attributable to various factors (rising real wages in view of the increasing employment and tightening labour market, loans borrowed to buy pre-owned homes as well as the upturn in lending primarily related to the prenatal loans). Against the background of the debt cap rules and the rise in the ratio of loans with interest rates fixed for a longer period, the increase in real estate loans took place in a prudent manner, and thus does not jeopardise the functioning of banks and through that the external balance of the economy.

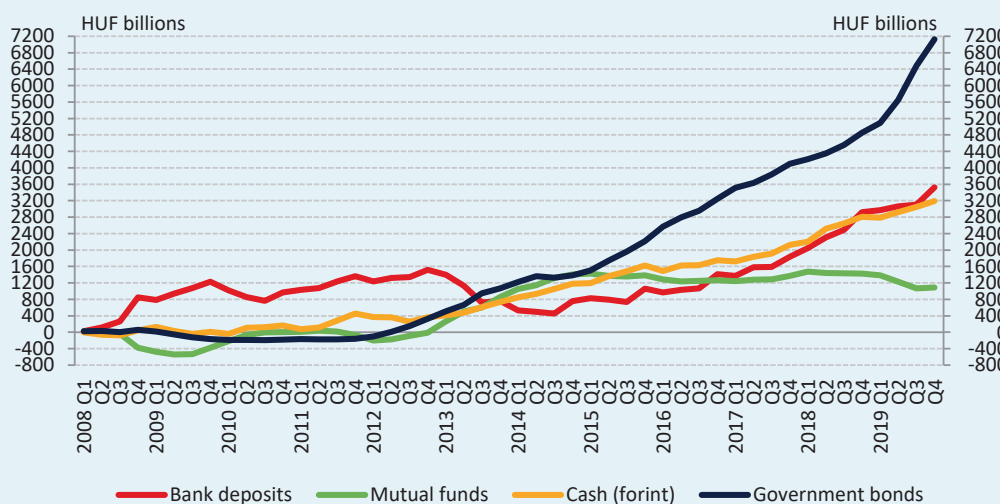
Chart 42: Net lending of households (seasonally-adjusted, revised* values, as a percentage of GDP)



*Figures showing underlying trends, adjusted for pension fund savings, the early repayment scheme, the real yield payment, the indemnification related to the liquidated mutual savings banks as well as the conversion into forints and settlement.

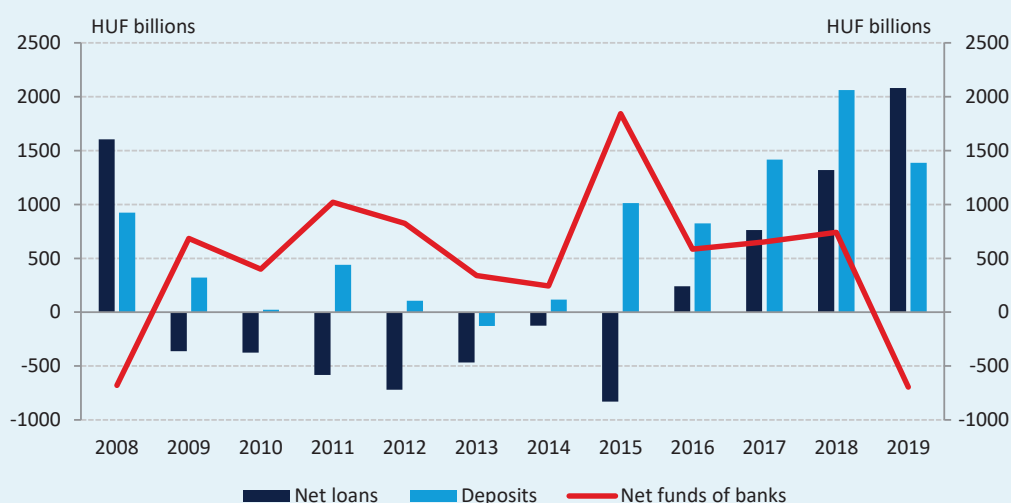
The demand for retail government securities accelerated in 2019, which contributes to the decline in external vulnerability through financing the state from domestic funds (Chart 43). The steady expansion in retail government securities holdings since 2012 accelerated significantly in mid-2019, which was primarily attributable to the Hungarian Government Security Plus (MÁP+), which provides a considerable yield advantage and high liquidity in the low interest rate environment. By end-2019, households' government securities holdings increased to more than HUF 8,200 billion, of which the holdings of the MÁP+ accounted for nearly HUF 3,200 billion in half a year. Accordingly, households invested most of their new savings into government securities, but savings held in bank deposits also increased considerably. At the same time, the dynamics of cash savings decelerated significantly in 2019, although the growth was still deemed considerable. Of mutual fund shares, only the holdings of bond funds and mixed funds increased slightly, while the holdings of money market funds decreased further, and contrary to previous years, the holdings of property funds also fell. In H2, significant restructuring was observed in the government securities market from short-term papers towards long-term ones, which primarily concerned the MÁP+ holdings. Households' strong demand for government securities increased the internal financing ratio of the general government, which is favourable with respect to Hungary's external vulnerability.

Chart 43: Developments in households' key financial assets (cumulative transactions)



Box 4: Developments in the private sector's bank loans and deposits

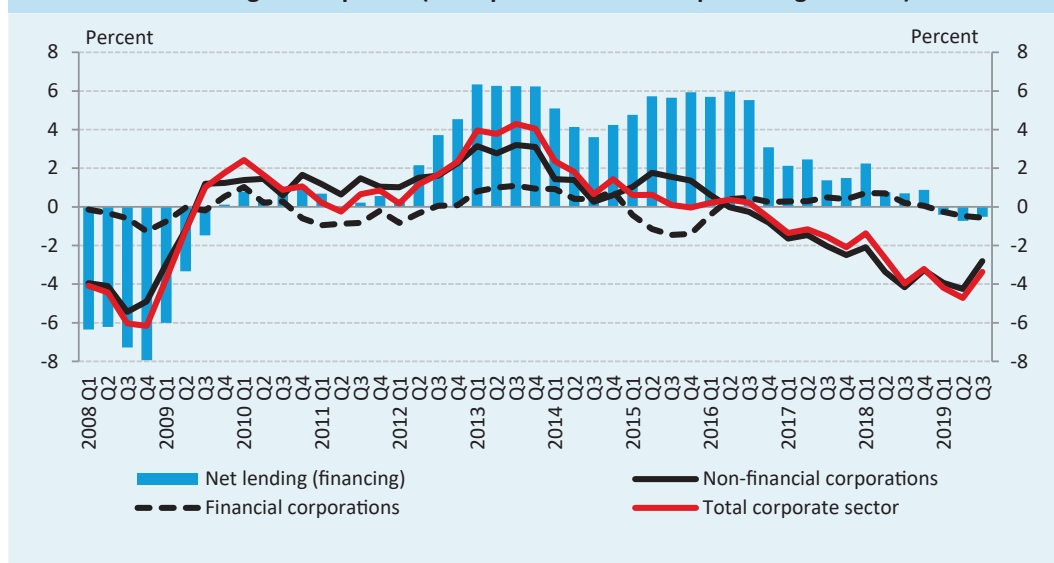
The private sector's borrowing accelerated further in 2019, while the placement of deposits declined, resulting in net lending by banks. The bank loans of households and companies contracted continuously in the post-crisis years, but there was a turnaround on the credit side in 2016. The private sector's net borrowing continued to increase in 2019 as well, at a pace similar to that observed in the previous years (Chart 44). In parallel with all that, until 2018 the private sector's deposits were also increasing, but last year the amount of new deposits was down, which may also have been attributable to the portfolio restructuring into the MÁP+. Accordingly, net bank liabilities declined, i.e. for the first time since the outbreak of the 2009 crisis the private sector's deposits did not finance banks' lending, which may have contributed to the rise that took place in banks' external debt.

Chart 44: Developments in the private sector's bank loans and deposits**4.3. Corporate sector**

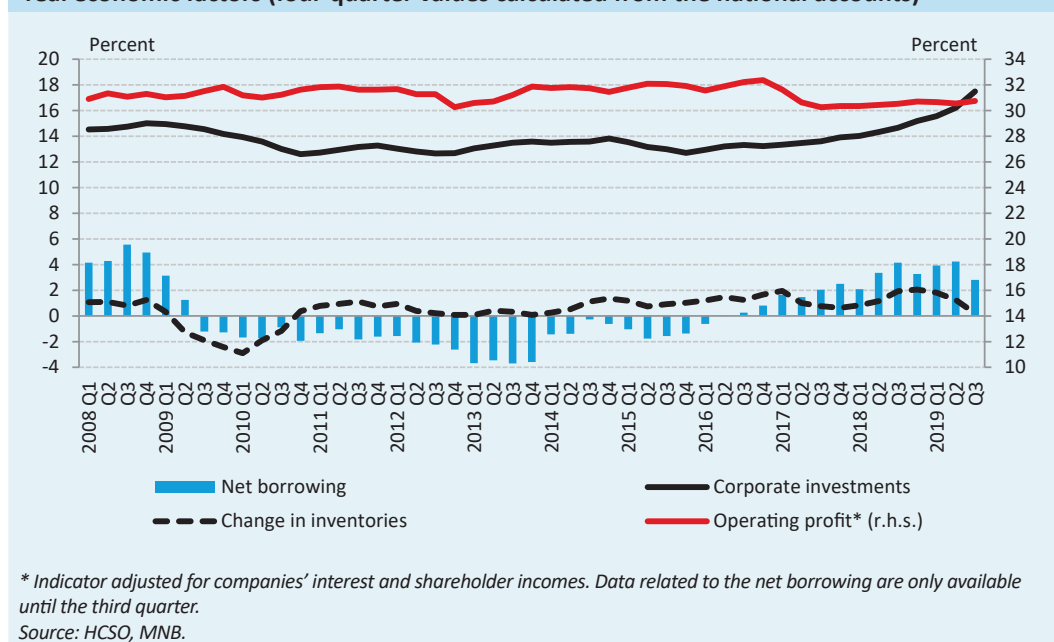
The borrowing requirement of the corporate sector fell slightly, and in parallel with that the decline in net lending also stopped. According to four-quarter data, following an expansion in H1, the borrowing requirement of the corporate sector as a whole moderated considerably in 2019 Q3.⁵ In parallel with that, the net lending of financial corporations turned into a low net borrowing (Chart 45).⁶ Considering that as well, the overall contribution of the corporate sector as a whole to the balance position of the economy was negative.

⁵ Financial accounts for 2019 Q4 will only be published after the editorial deadline for this report.

⁶ The net lending of financial corporations is mainly influenced by the profits or losses of the sector and by the change in their non-financial assets (e.g. real estate). However, besides the above, the position of the sector was also strongly influenced by the crisis and later by the losses incurred during the early repayment scheme and the foreign currency settlements: the difference between the market rate and the fixed exchange rate and the foreign currency settlements as a capital transfer provided to the household sector reduced banks' net lending while simultaneously raising households' net financial savings.

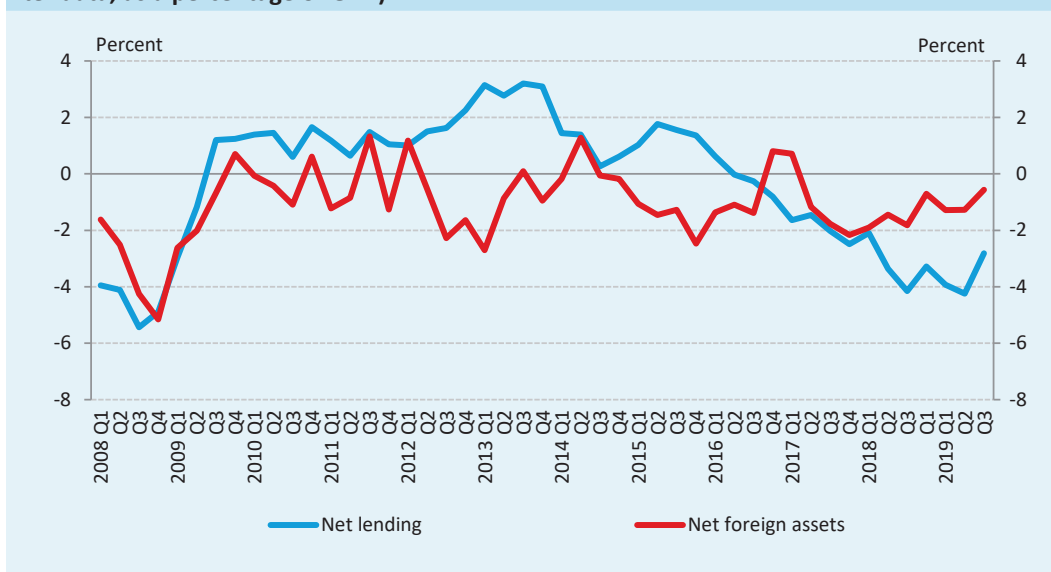
Chart 45: Net lending of companies (four-quarter values as a percentage of GDP)

The net borrowing of non-financial corporations fell to 2.8 percent of GDP, primarily due to the absorption of inventories. The operating profit of non-financial corporations remained roughly unchanged in 2019, while companies absorbed their inventories continuously. In parallel with that, corporate investment activity accelerated steadily, resulting in a rise in the borrowing requirement. As a result of these effects, the corporate borrowing requirement rose in H1, before falling sharply in Q3 in view of the absorption of inventories (Chart 46).

Chart 46: Non-financial corporations' net borrowing relative to GDP and the main underlying real economic factors (four-quarter values calculated from the national accounts)

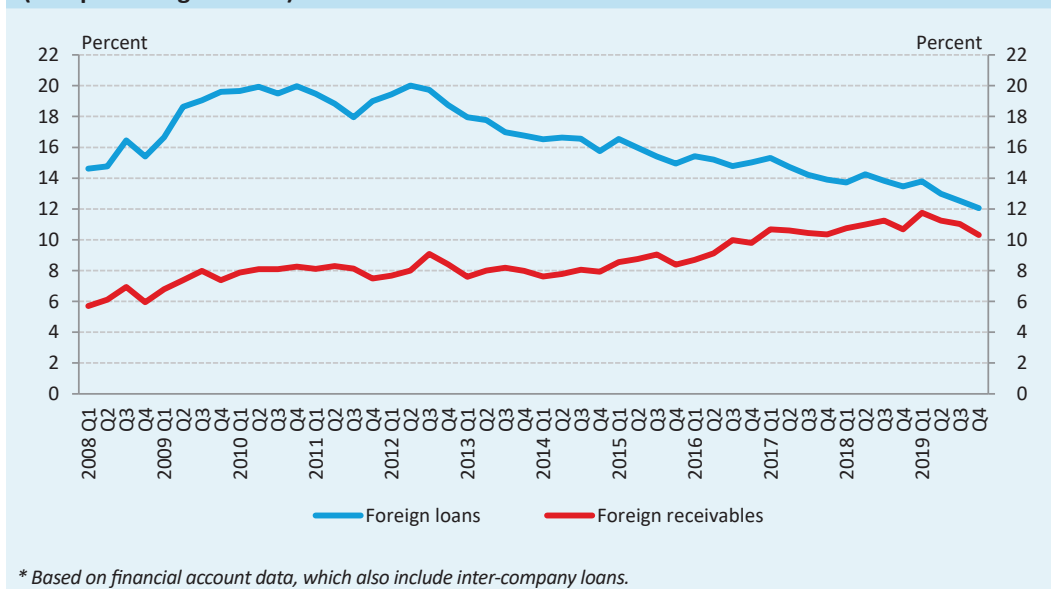
In parallel with non-financial corporations' declining net borrowing, their borrowing from abroad was also slightly down (Chart 47). The rise in bank loans and the increase in equity stemming from reinvested earnings were the main contributors to the expansion in corporate liabilities; companies' foreign loans declined in the first three quarters. A steady rise was observed in domestic loans, resulting in a decrease in net financial savings of companies. The growth in companies' financial assets decelerated considerably in 2019, primarily affecting bank deposits. As regard financial assets, the sector mostly increased domestic bank deposits and non-resident participations in 2019.

Chart 47: Net lending and net external transactions of non-financial corporations (four-quarter data, as a percentage of GDP)



In 2019, external liabilities also declined in parallel with the decrease in foreign loan debt. By 2019 Q4, corporations' external loans outstanding fell to below 12 percent of GDP, also supported by the adjustment process that had started after the crisis and affected the external liabilities of companies, as well as by strong GDP growth. The holdings of companies' foreign assets reached their peak in 2019 Q1 and since then they have been steadily declining in parallel with the liabilities (Chart 48).

Chart 48: Foreign loan liabilities and receivables of non-financial corporations (as a percentage of GDP)*



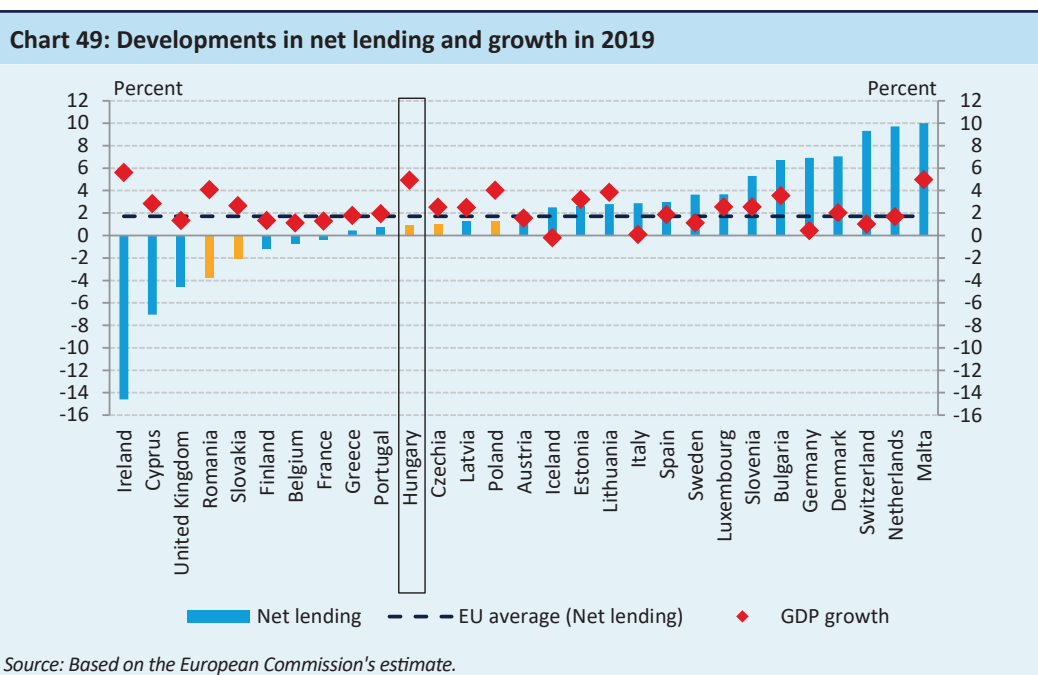
5. Regional comparison

In 2019, Hungary's net lending once again exceeded the regional average, while economic growth in Hungary was among the highest in the EU. The decline in net lending in the Hungarian economy as a share of GDP slowed down in 2019 as a whole, and came to an end from the second half of the year, and thus Hungary remains one of the region's leaders in the external balance position. The somewhat diverse external balance developments in the regional countries were mainly caused by changes in trade balances. In Poland, net lending increased, supported by improvements in the trade balance, income balance and transfer balance. In line with developments in net exports, the decline in net lending decelerated in the Czech Republic from the second half of the year, similarly to the situation in Hungary, while the external balance position deteriorated in Romania to a lesser extent, and in Slovakia to a more significant extent. Weak performance by the German automotive industry and the slowdown in economic growth among foreign trade partners, which both suggest a slowdown in export dynamics, played an important role in the region's foreign trade tendencies. All of this may have been partly offset by an improvement in the terms of trade related to the fall in energy prices. Besides the external environment, regional developments also reflect the effects of internal factors: In the Czech Republic and Poland, the improvement in the goods balance was accompanied by a slowdown in investment dynamics, while in Slovakia and Romania, the decline in net exports was accompanied by a pick-up in investments. According to financing data, the value of foreign direct investments in terms of GDP in Hungary reached a level similar to the average of the regional countries in 2019. In Hungary, net lending was supported by high household savings (even at the regional level), which was offset by the impact of mounting corporate financing needs in the context of the steady government deficit and internationally high investment activity. The decline in net external debt indicators typically continued in the region in 2019, and Hungary's net external debt and government debt are in line with levels observed in other countries in a regional comparison.

In the section entitled “Regional comparison”, we present the developments in Hungary's external balance in comparison to the countries in the region. In terms of balance of payments figures, Hungary should be compared primarily to countries which are at a similar level of development and face similar challenges. Accordingly, our regional outlook is mainly based on these aspects. For this purpose, the most ideal group of countries comprises the countries in the region which joined to the European Union at the same time, plus Romania, which joined the EU later and does not always show the same trends as those observed in the Visegrad countries.

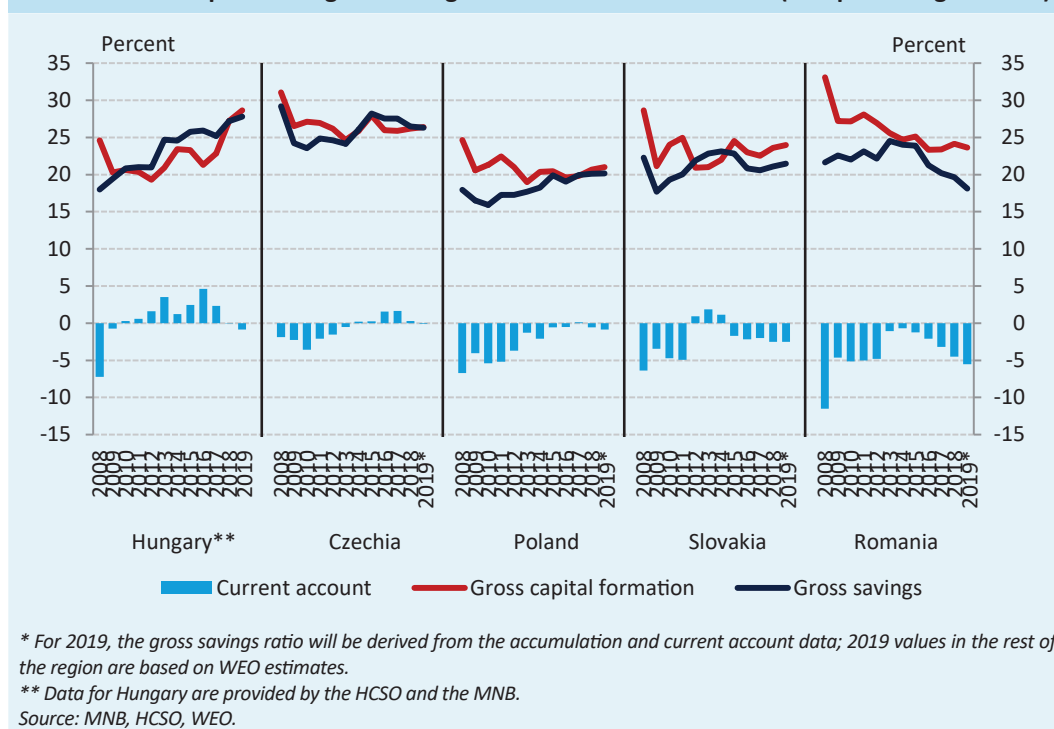
5.1. Net lending

Hungary's net lending still exceeds the regional average, while Hungary's economic growth was remarkably high even in a EU comparison (Chart 49). Hungary's net lending amounted to 1 percent of GDP in 2019, which – based on the European Commission's estimate – was close to that of the Czech Republic and Poland, and was significantly higher than the level expected in the rest of the region. In most EU countries, net lending as a percentage of GDP continued to fall in 2019, and in line with that the EU-28 average also declined. The highest net lending in the European Union is still observed primarily in export-oriented countries, but in these developed countries the favourable external balance position is usually accompanied by lower GDP growth. In 2019, economic growth in Hungary was the highest among the countries in the region, at 4.9 percent, making the country one of the EU leaders in terms of growth, well above the average of the EU 28.



Hungary's favourable external balance position at the regional level is due to high and rising gross savings, despite significant investment activity, which is driven by rising consumption in line with income growth (Chart 50). An economy's current account balance is given by the difference between gross saving (which is the difference between income and consumption) and the accumulation-type expenditures of the national economy (investment and inventories). Following the outbreak of the financial crisis, the current account balance improved in all CEE countries due to declining investment rates and gradually increasing gross savings, as a result of balance sheet adjustments. Similarly to Hungary, this trend has reversed in several countries in the region, with the current account balance declining in the last 2-3 years. In Hungary, the background of this development is primarily the dynamically growing investment activity, which is also reflected in the accumulation rate exceeding the regional level, including changes in inventories. However, the downward impact of the dynamic expansion of the Hungarian investment rate on the external balance position is offset by the fact that the savings dynamics have also increased, almost at the same rate in recent years. Gross accumulation also increased at a more moderate pace in the Czech Republic, Poland and Slovakia. In these countries, similarly to gross accumulation, savings showed more subdued dynamics. In the Czech Republic and Poland, with these two indicators at similar levels, the current account balance was forecast by the IMF to be close to 0 in 2019, while in Slovakia the lower current account balance turned negative with a lower savings rate. In Romania, the current account balance has been deteriorating since 2014, which is explained by the fact that gross savings have declined significantly due to the stagnating accumulation rate, which indicates a rise in consumption in excess of income growth.

Chart 50: Developments in gross savings and total investment ratios (as a percentage of GDP)



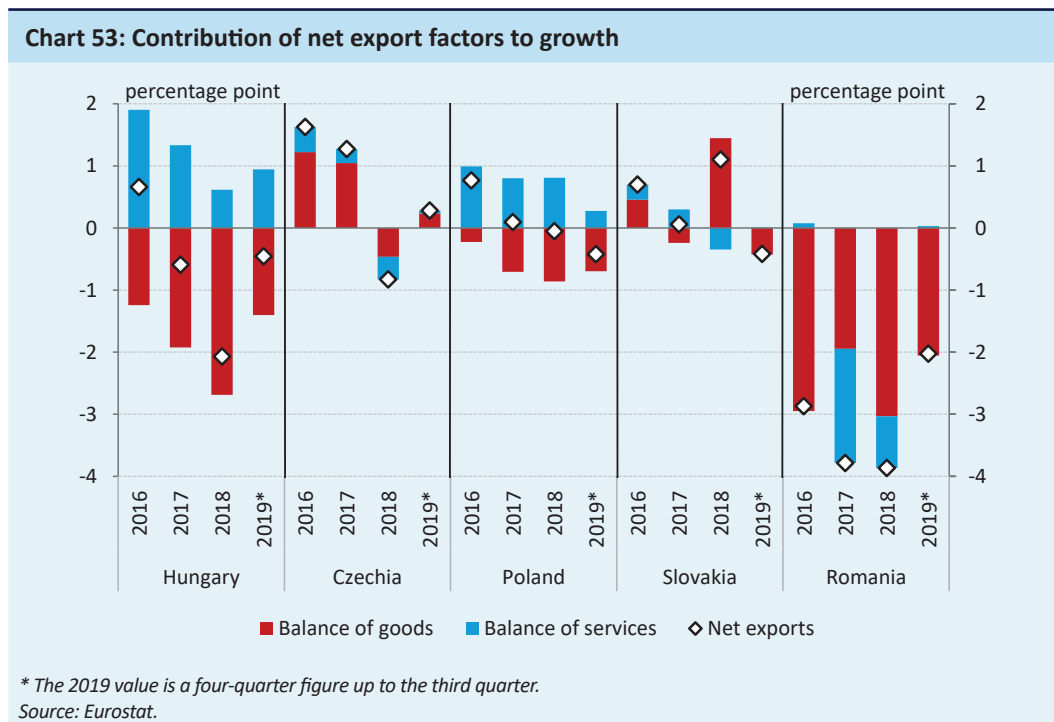
5.2. Net lending and its real economic factors

The favourable domestic net lending typical for the region is mainly due to the significant balance surpluses for foreign trade and transfers (Chart 51). Based on real economy data, Hungary's four-quarter net lending was close to the Czech and Polish levels and was above the average in the region. The decline in the external balance position slowed down for 2019 as a whole: the declining net lending has been stagnating since the second half of the year. Partly different processes took place in the region: In Poland, after stagnating in 2018, net lending increased, while in the Czech Republic, similarly to Hungary, the deterioration of the external balance position slowed down, whereas in Romania and Slovakia the indicator declined.

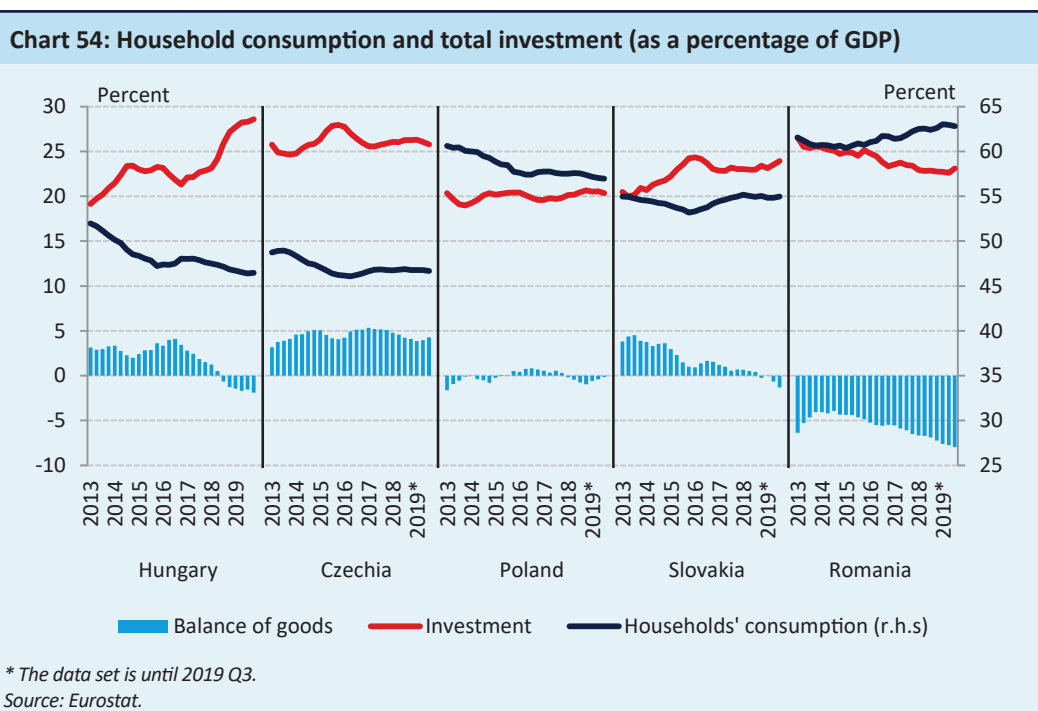
The divergence in the development of external balance indicators results from the combined effect of several factors:

- The four-quarter surplus of the **balance of goods and services** as a share of GDP increased in the Czech Republic and Poland, and stabilised in Hungary after declining in the previous years, while in Slovakia and Romania the trade balance continued to deteriorate. Net exports are primarily driven by changes in the goods balance; the region is characterised by a relatively stable surplus on the services balance. Within the region, the surplus of the services balance as a percentage of GDP is the highest in Hungary (Chart 52).
- The level of the deficit of the **income balance** is one of the highest in Hungary, but the balance shows a deficit in all of the neighbouring countries. In 2019, the income balance continued to improve in Hungary and Poland, with slight adjustments in Romania, while in the other countries in the region the deficit did not change significantly.
- The **transfer balance** typically supports the economy's external balance position in the countries of the region. The absorption of EU transfers was the highest in Hungary and Poland among the regional countries in 2019. In the Czech Republic and Slovakia, the transfer balance had a nearly neutral impact on the external balance position, while in Romania, remittances from long-term workers abroad also improved the transfer balance, in addition to the absorption of EU transfers.

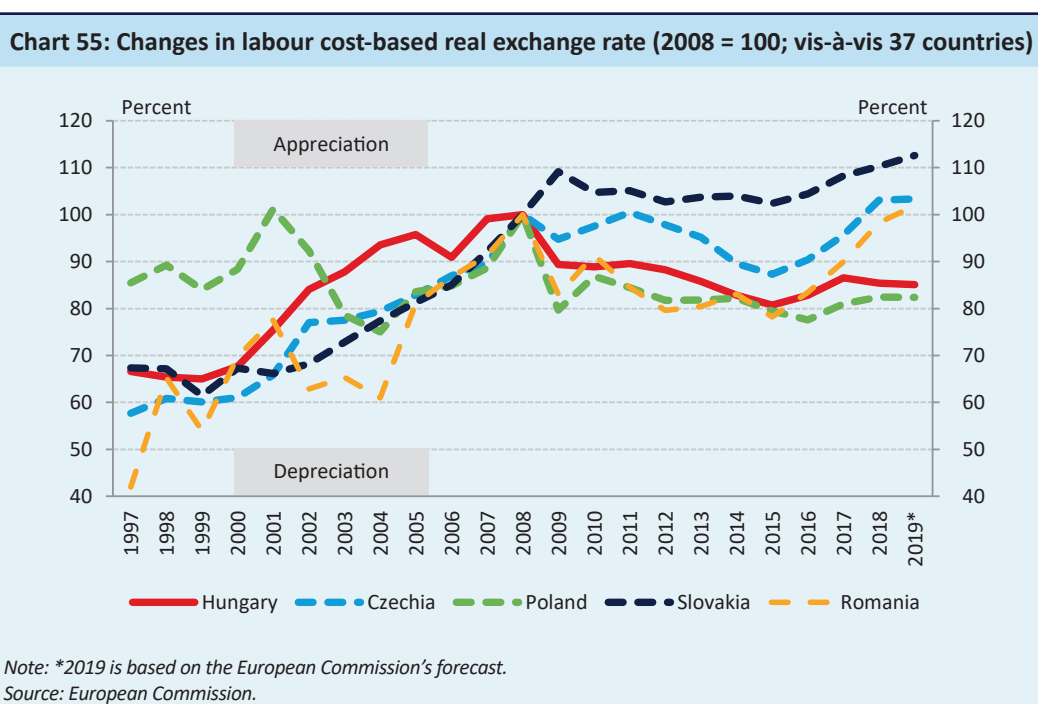
The contribution of net exports to growth in the countries of the region has been subdued in recent years and negative in several countries: the typically negative contribution of the goods balance in some countries has been partly offset by the growth contribution of the services balance. Net exports contributed the most negatively to economic growth in Romania, which was mainly related to the goods balance, but between 2017 and 2018 the services balance also contributed to this effect. In addition to the high level of investment, the goods balance contributed negatively to economic growth in Hungary as well. However, unlike in Romania, net services exports resulted in a substantial growth increase in Hungary, partly offsetting the negative impact of the goods balance, and thus net exports retarded GDP growth only to a slight degree. In the other countries of the region, a gradual decline in the contribution to growth of the services balance was observed, and this even turned into negative in the Czech Republic and Slovakia. Overall, the contribution of the balance of goods and services to growth was subdued in all three countries.



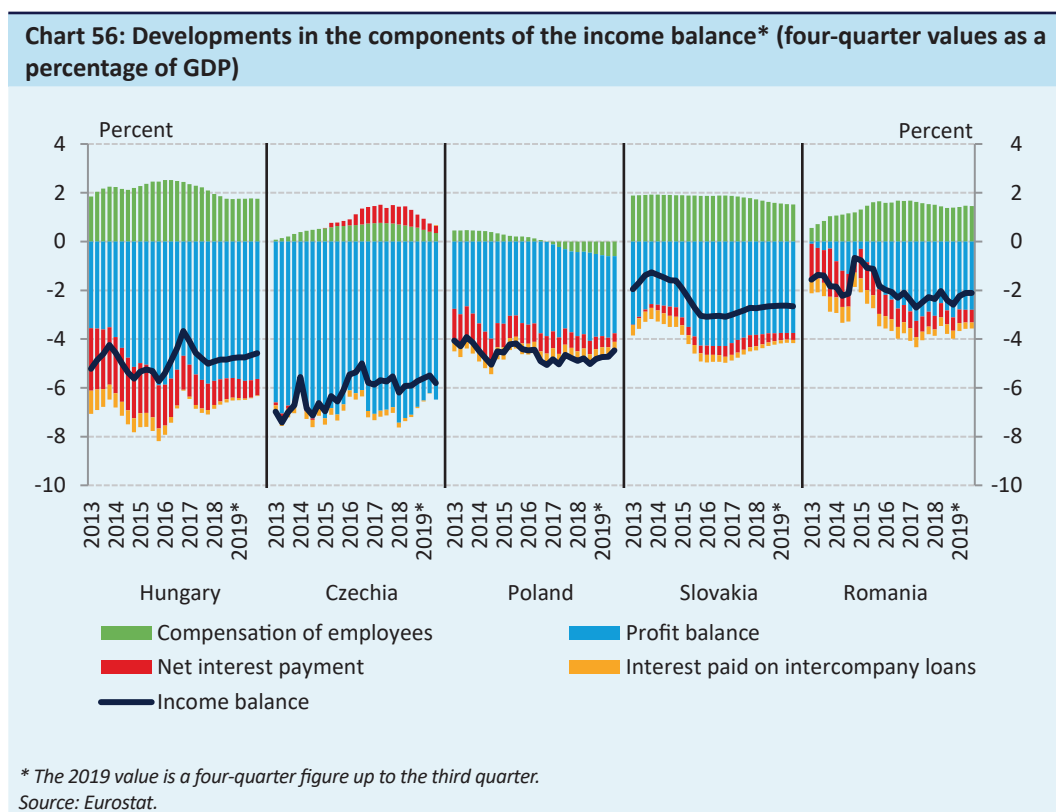
Although investment-driven accumulation expenditures slowed in the second half of the year in Hungary, they still increased in the fastest pace among the countries of the region and reached the highest level of GDP here as well (Chart 54). In most of the region, the development of the goods balance reflected the dynamics of domestic accumulation. In Hungary, the ratio of domestic accumulation to GDP (in line with strong investment activity) advanced to an outstanding level, reaching almost 29 percent of GDP at the end of 2019. Similarly to Poland and the Czech Republic, households' consumption expenditure as a share of GDP moderated slightly in Hungary, thus reaching the lowest level in the region together with the Czech figure. All of this is positive for the country's external balance: a substantial part of the surplus income generated by the strong wage dynamics was used by households to accumulate financial assets, and thus a high level of household savings continues to provide significant internal funding for the economy.



The labour cost-based real exchange rate rose in Romania and Slovakia, in line with slower wage growth in 2019, while it decreased moderately in Hungary (Chart 55). The slight decline in the domestic labour cost-based real exchange rate was the result of contrasting effects: the wage growth remained above 10 percent in 2019, but this was more than offset by the approximately 2-percent depreciation of the Hungarian forint against the euro, the decrease in employers' contributions and the increase in productivity. The indicator in Poland and the Czech Republic was stable, indicating that the exchange rate based competitiveness of the two countries remained unchanged from the previous year. In Romania, wage growth continued to outstrip productivity growth, which was partly offset by the depreciation of the Romanian leu against the euro, and therefore the appreciation of the labour cost-based real exchange rate continued to rise in 2019, albeit in a slower pace. The indicator also rose in Slovakia, which is related to inflation and higher wage growth in comparison to its trade partners.



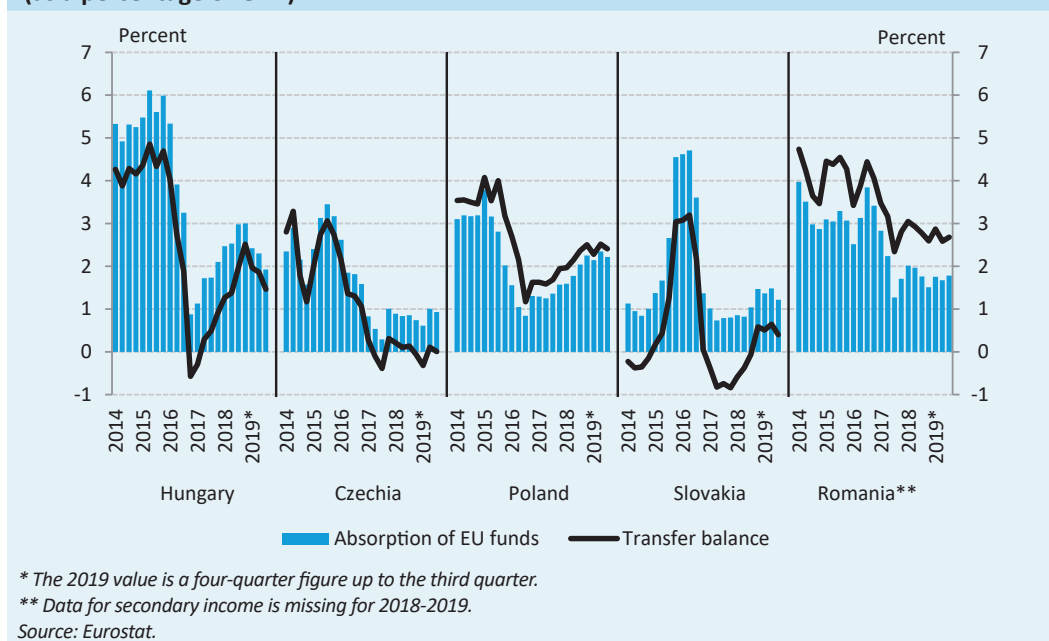
The income balance shows a deficit in all the countries of the region, most of which is made up of the profit balance of non-resident companies (Chart 56). Among the countries of the region, Hungary, Poland and Romania showed a slight improvement in the income balance, while in the Czech Republic and Slovakia the deficit did not change noticeably. In the countries which showed improvement, net interest expenditures paid to non-resident entities and the profit balance deficit declined. The non-resident companies, such as the automotive companies playing a role in the surplus of goods, have built up significant production capacities in all the countries of the region, and therefore the largest portion of the income balance deficit is from the profit balance of non-resident companies. Moreover, in line with the value of net external debt, the income balance is also reduced by the interest paid abroad in most of the regional countries. This is usually moderated by the incomes of employees temporarily working abroad. Some exceptions, however, should be noted in both cases. Uniquely in the region, the Czech Republic has net external debt that is negative, i.e. the value of receivables from abroad exceeds its external debt, and thus net interest income improves the income balance. The other exception for the income of employees temporary working abroad is Poland, which received a significant number of Ukrainian workers,⁷ and the value of their income earned in Poland is already higher than that of Polish workers temporarily working abroad, which, in a unique way in the region, increases the income balance deficit.



The inflow of EU transfers slowed down in 2019, but Hungary continues to be at the forefront in the use of funds among the countries in the region (Chart 57). The extent to which the transfer balance supports the economy's external balance position varies across the countries of the region and is largely determined by the inflow of funds under the EU's 2014-2020 programming period. Since 2017, Hungary and Poland have recorded the highest growth in this regard. As a proportion of GDP, the four-quarter absorption of EU transfers in Hungary has gradually declined from the high level of 2018 to 2 percent of GDP, while in Poland it has gradually increased to a similar level. The absorption of EU transfers accounted for 1 percent in the Czech Republic and nearly 1.5 percent in Slovakia. In Romania, four-quarter EU transfer inflows were stable at around 1.8 percent of GDP, and as in the previous year remittances of long-term workers abroad improved the Romanian transfer balance by approximately 1 percent of GDP.

⁷ https://www.nbp.pl/en/publikacje/raport_inflacja/iraport_november2019.pdf

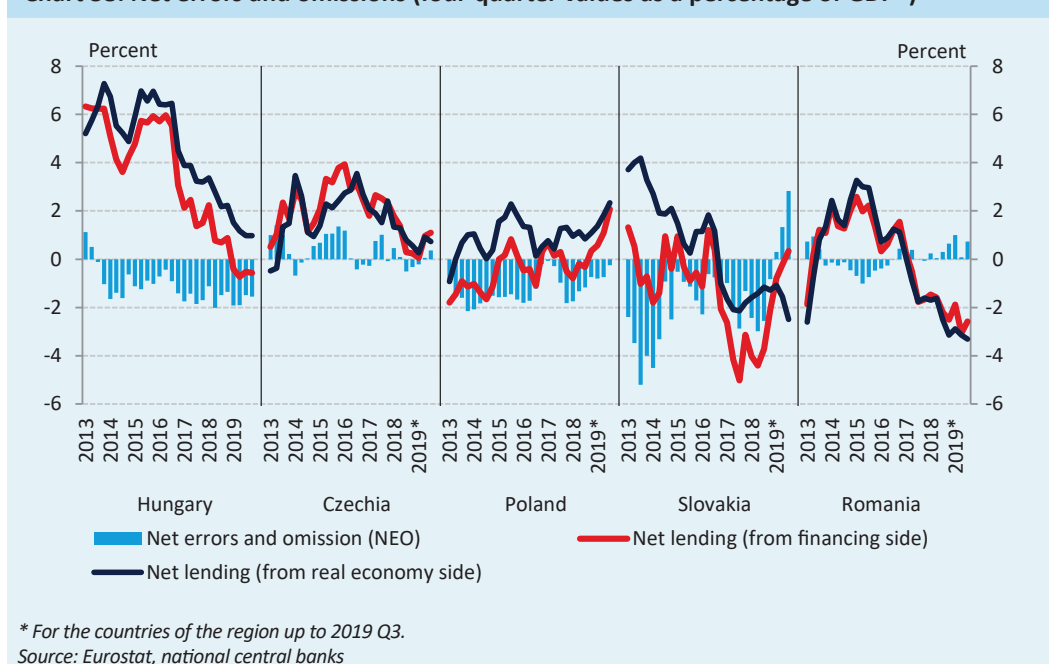
Chart 57: Transfer balance and the absorption of EU transfers in the countries in the region (as a percentage of GDP)



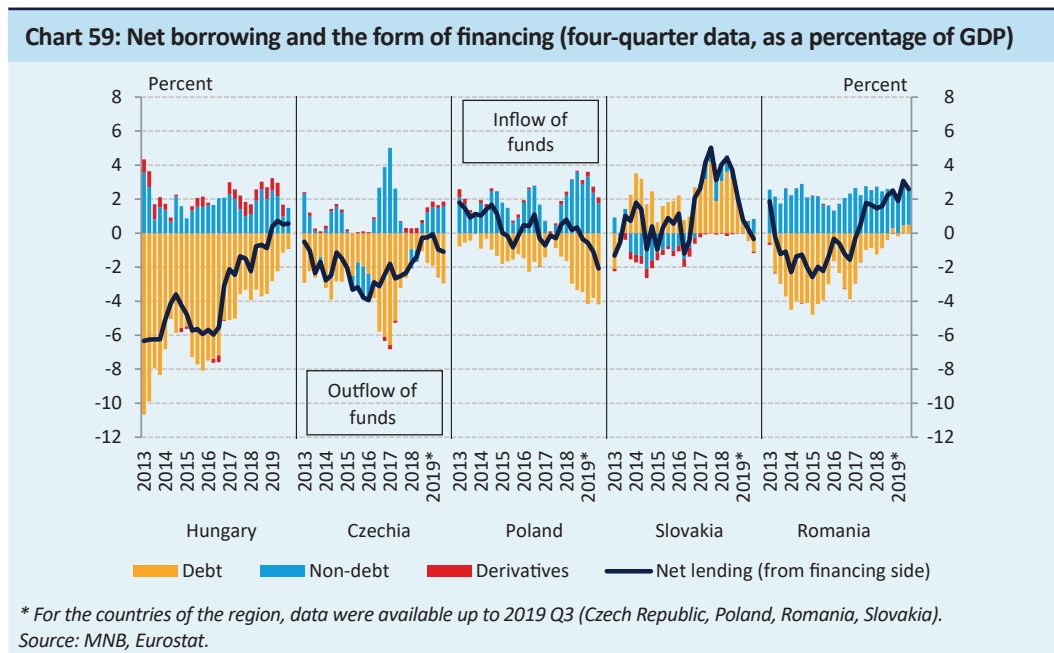
5.3. Financing side developments

The difference between net lending calculated on the basis of the financial balance and the real economy approach is slightly larger in Hungary than in the countries of the region (Chart 58). The item “Net errors and omissions” (NEO) shows the discrepancy between net lending calculated from the financing side and from the real economy side. At the end of 2019, the balance of net errors and omissions was around 2 percent of GDP in Hungary and Slovakia, but its direction was opposite: while in Hungary the indicator calculated from the real economy side was consistently above the computed value based on financing items, in Slovakia the difference turned around last year. By contrast, in Czechia, Poland and Romania, net lending calculated from the financing side is nearly the same as net lending calculated from the real economy side.

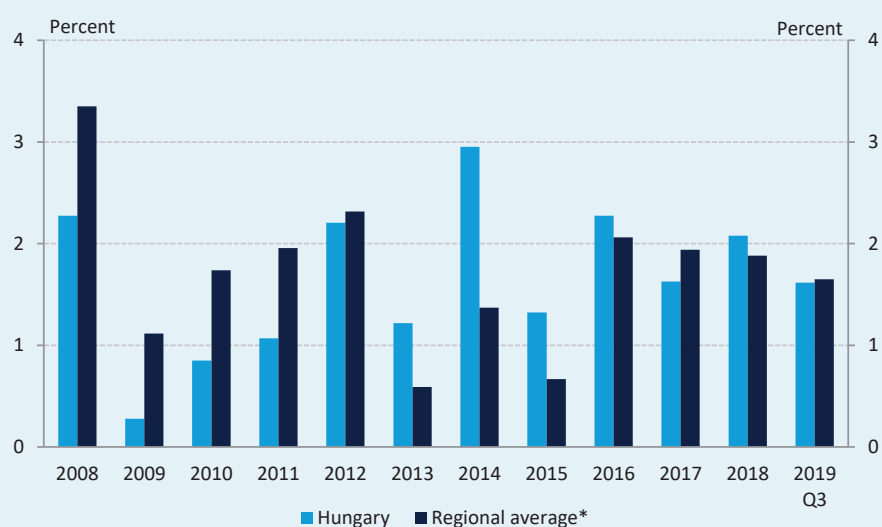
Chart 58: Net errors and omissions (four-quarter values as a percentage of GDP*)



Net lending, calculated on the basis of the financial account, declined to close to zero in most countries in the region (Chart 59). Calculated on the basis of financing items, net lending typically improved or stagnated in the countries of the region, but deteriorated substantially compared to the previous year in Romania, where the level of financing needs was 2.5 percent of GDP. In Poland, the economy's net lending gradually increased over the past year, reaching more than 2 percent of GDP at the end of 2019. With respect to the structure of net borrowing, the inflow of non-debt liabilities permitted the Czech Republic and Poland to further reduce their net external debt. Debt outflow continued in Hungary as well, but its pace gradually slowed. Net external debt stopped increasing in Slovakia, while in Romania the economy's external net borrowing was financed by non-debt liabilities.



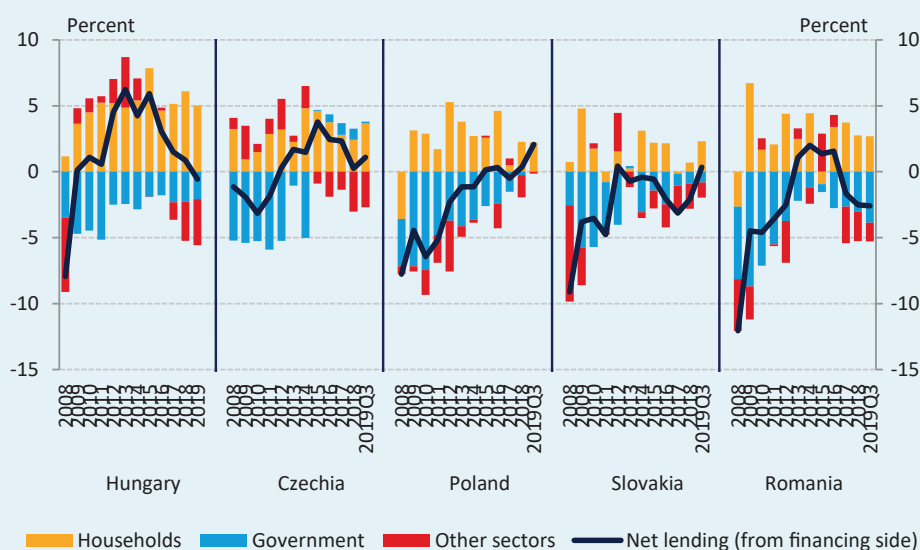
In Hungary, the ratio of foreign direct investment to GDP in 2019 was close to the average of the countries in the region (Chart 60). In the past ten years, net FDI inflows were fairly similar in the countries in the region. After a downturn following the crisis, FDI inflows shifted upwards from 2010 and following a temporary decline in 2013, they then began to rise again. Since 2016, FDI inflows in Hungary have fluctuated around 2 percent of GDP, similar to the other countries in the region. In 2019, FDI inflows in Hungary amounted to 1.6 percent of GDP, which corresponds to the regional average. The correlation between the net foreign direct investment inflows of the regional economies indicates that, in line with global economic trends, non-residents essentially judge these countries similar for investment purposes.

Chart 60: Net FDI inflows in the Visegrad countries (as a percentage of GDP)

* For the countries in the region, four-quarter data were available up to 2019 Q3. (The regional average does not include Hungary.)
Source: Eurostat.

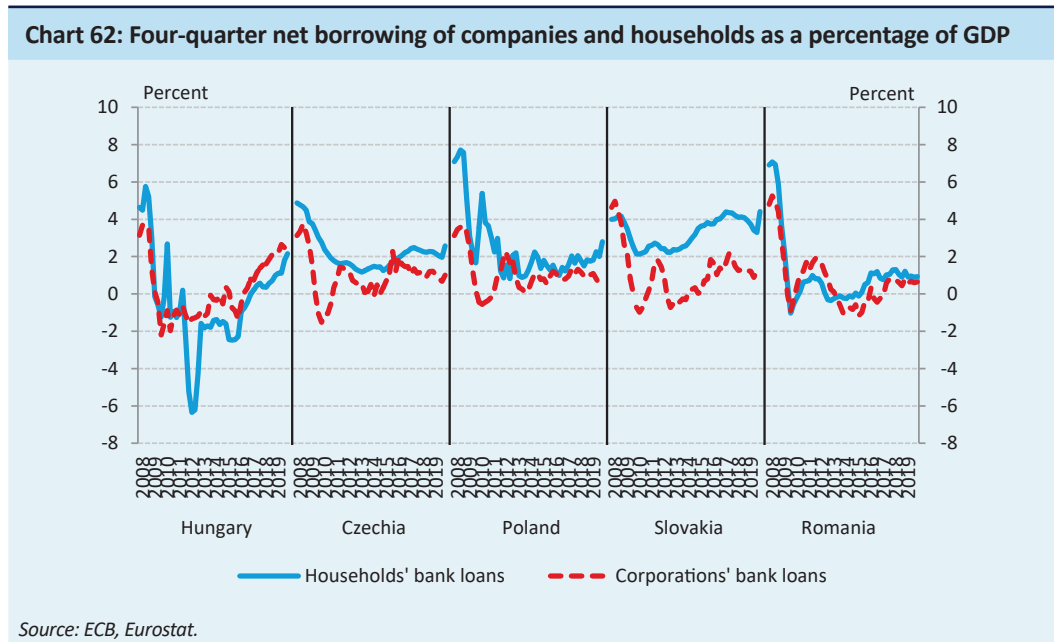
5.4. Savings side developments

Compared to the countries in the region, Hungary has relatively high financial savings for households, but (in line with the strong investment dynamics) the financing needs of companies are also above the regional average (Chart 61). Net lending of the countries of the region increased noticeably in the last year, partly due to the expanding net savings of the households, and partly due to the decreasing demand for corporate financing. In parallel with this, budget deficits remained low: the Czech Republic has registered a surplus for years, while in Poland and Slovakia the states' financing requirement was below 1 percent of GDP in the third quarter of 2019. Net lending of households was the highest in Hungary, but the stable government deficit and the increasing corporate financing demand in line with the substantial investment activity, even at the regional level, meant that in 2019 amongst the regional countries the external net savings position deteriorated not only in Romania but also in Hungary.

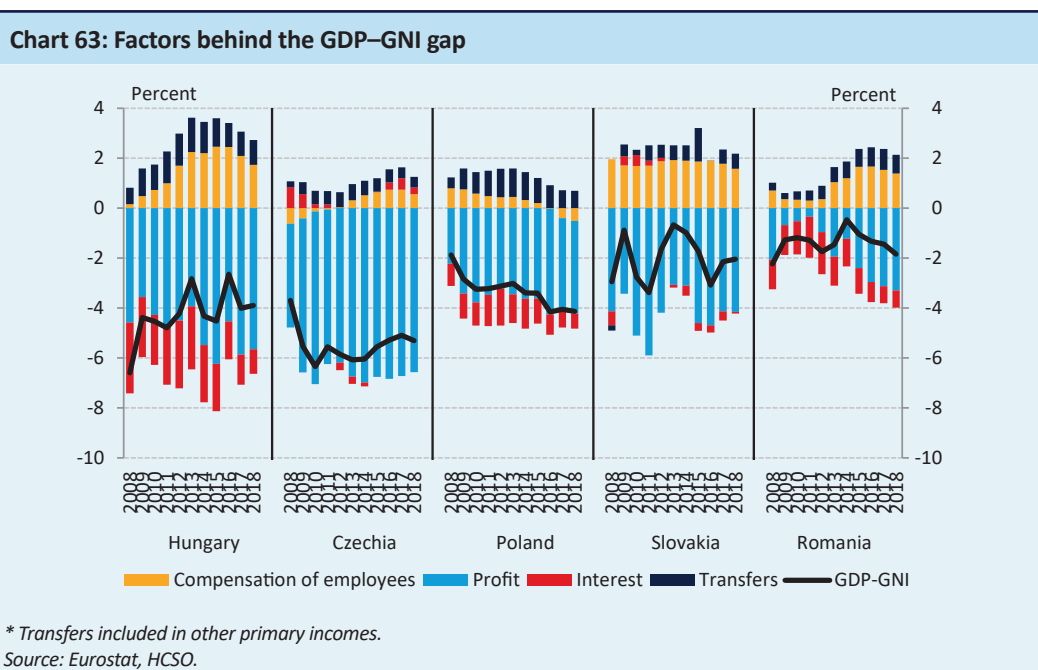
Chart 61: Net lending of the economy in a breakdown by sector (as a percentage of GDP)

* For the countries in the region, four-quarter data were available up to 2019 Q3. In Romania, other household receivables (from employers and insurers) also changed substantially in 2013, 2016 and 2017; the chart shows the basic trend without the outstanding values.
Source: MNB, Eurostat.

The credit growth of Hungarian companies has been significantly higher than in the regional countries for several years, but retail borrowing only reached the regional average at the end of 2019 (Chart 62). By the end of 2019, net borrowing by Hungarian households had risen to 2 percent of GDP, broadly in line with the average in the region. At the end of 2019, household borrowing continued to accelerate at different rates in other countries in the region, with Romanian households as the only exception. Supported in part by central bank programmes, Hungarian non-financial corporations' borrowing rate amounts more than 2 percent of GDP and is thus above the region-specific value of around 1 percent of GDP. On balance, the high level of borrowing from banks put downward pressure on net lending in the countries in the region as well.



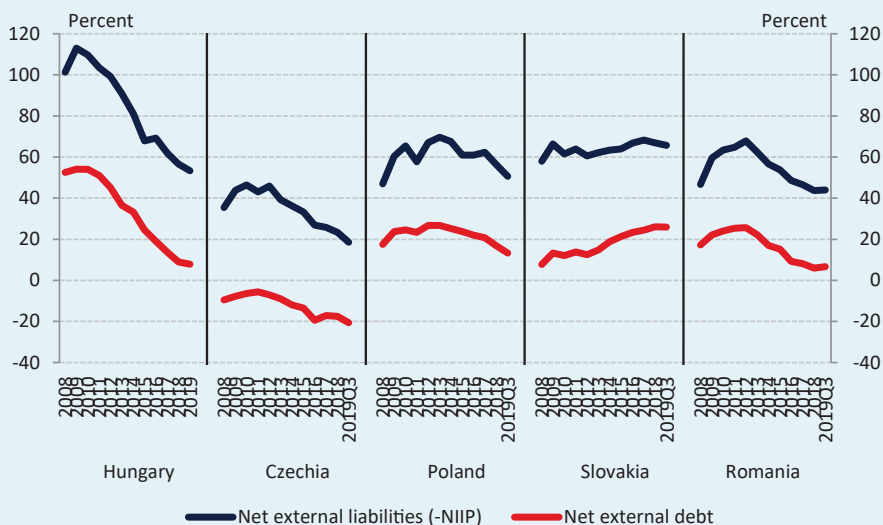
The 4-percent difference between Hungarian GDP and GNI roughly corresponds to the regional average. Compared to the pre-crisis level, the difference between production and income decreased only in Hungary among the countries of the region, and stabilised at around 4% of GDP in 2017-2018 (Chart 63). The high level of capital income (profit balance), which is a key factor in the GDP-GNI gap, is due to the high level of foreign direct investment in the regional countries. For this reason, the profit balance in the Visegrad countries is between 4 and 8 percent of GDP, whereas in Romania, which joined the EU at a later stage, it is already nearly 4 percent of GDP. In 2018, the profit of non-resident companies declined slightly in Hungary, while in the other countries of the region tended to remain stable. The interest rate balance weakens the GDP-GNI gap less and less in the regional countries: the declining interest rate deficit was supported not only by the declining interest rate level, but also by the expansion of domestic financing. Workers' incomes and the transfer balance reduce the GDP-GNI gap in the region, which is explained by inflows of EU funds and the income of those working abroad for less than a year. However, it should be noted that, unlike in other countries of the region, the wage balance of employees temporarily working abroad turned negative in 2017 in Poland, followed by a further wage balance deficit in 2018. The moderating pick-up effect of the wage balance on the GDP-GNI gap may have been related to the rising wages of migrant workers whose numbers are increasing in the region.



5.5. External debt indicators

The decline in net external debt indicators typically continued in the region in 2019 and Hungary's net external liabilities and debt are in line with levels observed in regional countries (Chart 64). Thanks to the steady decline since 2009, Hungary's net external debt fell to close to 53 percent of GDP by the end of 2019 and was already lower than the Slovak figure, but still slightly above the Polish, Romanian and, to a greater extent, the Czech values. In terms of net external debt, Hungary experienced the strongest adjustment since the crisis, falling from an extremely high level of over 50 percent of GDP to below 8 percent of GDP by 2019. Except for Slovakia, the net external debt of the other countries in the region has been declining since the crisis, but due to the significant decline in Hungary, only the net external debt of the Czech Republic is lower than the Hungarian figure. Among the regional developments in 2019, it is worth highlighting that in 2019 Romania saw a reversal of its net external liabilities and debt which had been declining since 2012, while Polish debt indicators declined more dynamically in 2019 than in previous years.

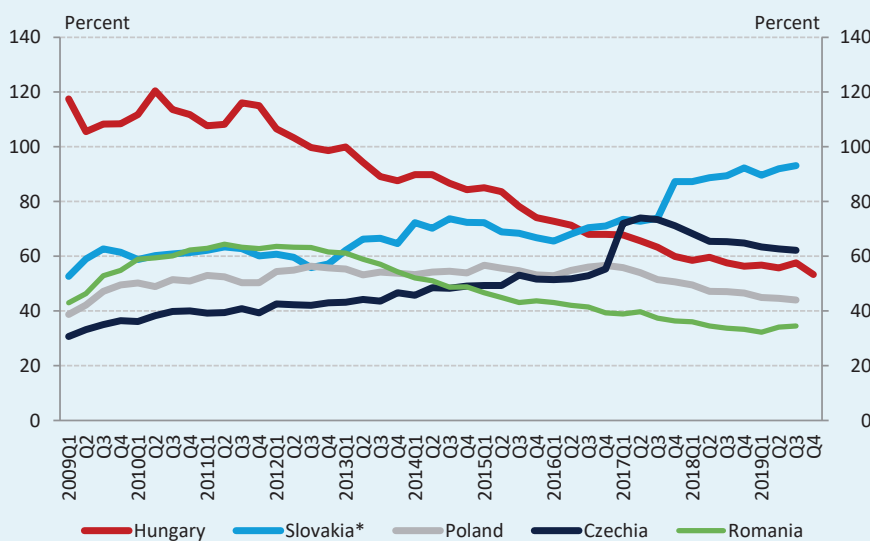
Chart 64: Developments in net external liabilities and external debt (as a percentage of GDP, net external debt without intercompany loans)



* For the countries of the region, the data set is until 2019 Q3.
 Source: MNB, Eurostat (data for Hungary without SPVs).

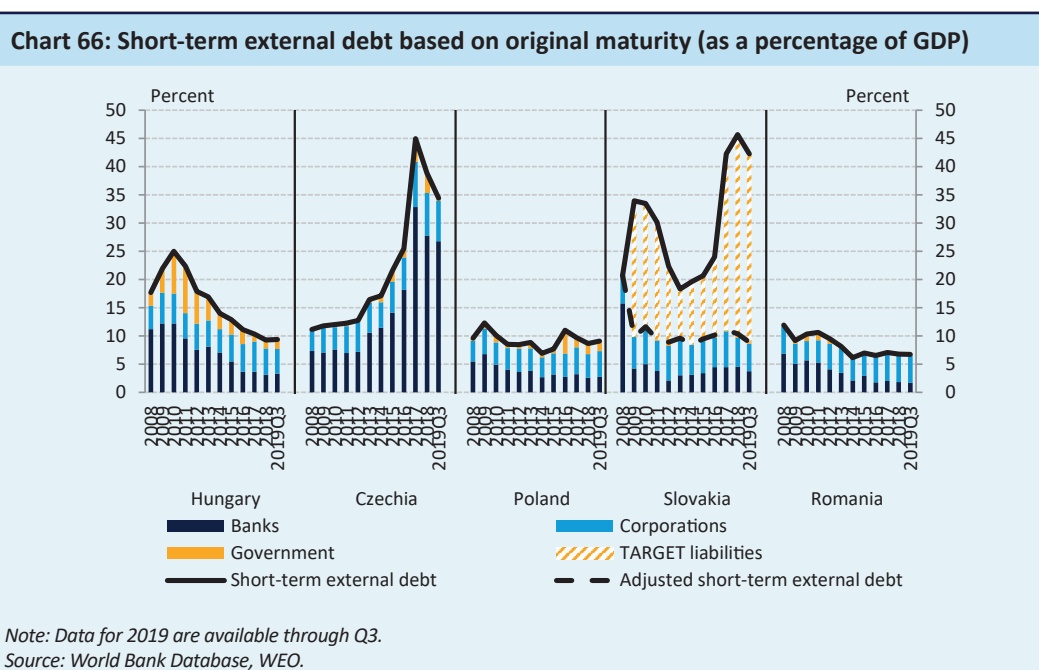
Hungary's gross external debt to GDP ratio remains average in the region (Chart 65). While Hungary's gross external debt was outstandingly high in the region at the time of the outbreak of the financial crisis, thanks to the gradual reduction in recent years it is already in the middle segment of the region. Other countries in the region did not have such an adjustment, and the indicator has even increased in the Czech Republic and Slovakia. The gross external debt of the Czech Republic was increased indirectly by the central bank's foreign exchange market intervention, through the gross external debt of the banks, but the debt ratio has started to decline recently since the removal of the exchange rate peg in 2017. The increase in Slovakia's gross external debt was caused by the increase in TARGET liabilities arising from joining the euro area. In 2019, Hungarian figure increased slightly, not because of transactions, but mainly due to revaluation effects due to a decline in yields, which is considered to be favourable from a sustainability point of view. In the rest of the region, the indicator in Slovakia continued to grow in 2019, while in Romania, the previous decline turned into an upward trend, similar to the situation with net external liabilities and debt.

Chart 65: Developments in the gross external debt of the countries in the region (as a percentage of GDP, excluding intercompany loans)



* The increase in Slovakia's gross external debt was also due to the debt increase related to the euro area payment system.
 Source: Eurostat.

Hungary's short-term external debt based on original maturity, is in line with the region's level due to the decline since 2010 (Chart 66). Hungary's short-term external debt by original maturity,⁸ like gross external debt, has declined significantly since 2010, and by the end of 2019 its value as a percentage of GDP had fallen below 9 percent. According to international comparisons, short-term external debt by original maturity shows similar dynamics as gross external debt. In the Czech Republic, the short-term external debt of the banking system increased following the crisis, mainly due to central bank foreign exchange intervention, which started to slowly decline after the exchange rate peg was removed. In Slovakia, the initial increase after the crisis was caused by the TARGET liabilities due to joining the euro area, but in 2019 both this technical item and the adjusted short-term external debt by original maturity decreased. In Poland, after declining over the last two years, the indicator rose again, mainly due to the growing short-term external debt of companies. In Romania, short-term external debt by original maturity did not change noticeably: it remained broadly unchanged and in 2019 it was close to the 2015 level of 7 percent of GDP.

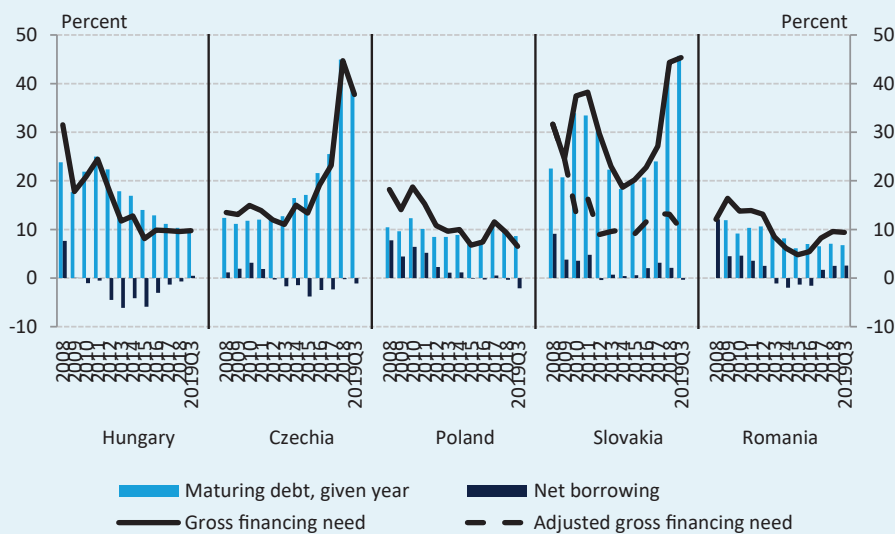


Similar to previous years, Hungary's gross financing need was around 10 percent of GDP in 2019, which can be considered favourable in regional terms (Chart 67). Gross financing demand based on short-term external debt by original maturity⁹ in Hungary was similar to the previous year at around 10 percent of GDP: the decline in net lending was offset by a decline in maturing debt. Romania's gross financing need is similar to that of Hungary: however, while Hungarian financing needs have typically declined in recent years, Romania's gross financing needs have been rising since 2015, mainly due to net lending turning negative. In Slovakia, the gross financing need was gradually increasing, mainly as a result of the TARGET liabilities due to joining the euro area. The indicator for the Czech Republic was increased by central bank intervention, while the removal of the exchange rate peg also positively affected the gross financing requirement. Poland's gross financing needs declined more substantially over the course of 2019, supported not only by a larger improvement in its net lending, but also by a decline in maturing short-term external debt.

⁸ There is no data available on shrinking debt for countries in the region.

⁹ For purposes of comparability, we used the short-term external debt based on original maturity to calculate the gross financing need.

Chart 67: Changes in gross financing need (based on short-term external debt by original maturity, as a percentage of GDP)



Source: MNB, Eurostat, World Bank Database, WEO.

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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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