REPORT ON THE BALANCE OF PAYMENTS

2021

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

REPORT ON THE BALANCE OF PAYMENTS

2021

APRIL

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 2064-8707 (print)

ISSN 2064-8758 (on-line)

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

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

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

The analysis was prepared by the Directorate Monetary Policy and Financial Market Analysis. Contributors: Anna Boldizsár, Gábor Horváth, Balázs Kóczián, Péter Koroknai, Orsolya Nyári, Balázs Sisak, Daniella Tóth and Noémi Végh. The Report was approved for publication by Barnabás Virág, Deputy Governor.

The Report is based on information pertaining to the period ending 23 March 2021.

Summary

Despite the impacts of the pandemic, the external balance indicators of the Hungarian economy improved in 2020: a surplus was registered on the current account balance again, while net lending exceeded 2 percent of GDP. Despite the pandemic's negative economic impacts, the favourable trend was also supported by growth in the trade surplus in the second half of the year, in addition to improvement in the income balance and the higher absorption of EU transfers compared to the previous year. In conjunction with net lending, the economy's external debt ratio stabilised close to the historically low level registered one year ago. Hungary's net lending exceeded the typical average of the region in 2020 as well.

After temporarily deteriorating, the current account and net lending rose in the second half of the year. At the beginning of the year, the pandemic-induced decline in the tourism balance, the dip in export dynamics due to weaker export demand and supply difficulties, and import-intensive healthcare procurements led to a deterioration in the trade balance. Due to the second wave of the pandemic, the services surplus contracted in the second half of the year as well, but this impact was overcompensated by the decreasing domestic absorption, recovering industrial production and the net export-increasing effect of the improving terms of trade. At the same time, the decrease in the income balance deficit – connected to lower corporate profit – and the higher absorption of EU transfers compared to the previous year improved net lending.

In 2020, the impact of debt inflow was more or less offset by the net outflow of portfolio equity investments, while net foreign direct investment did not change significantly. In particular, domestic companies' investments abroad rose significantly, which – in conjunction with declining reinvestment resulting from lower corporate profits – more or less offset the FDI inflow of almost EUR 2.4 billion, which was only modestly lower than the previous year, according to the underlying trends. The decline in net portfolio equity investments mainly reflected domestic agents' rising investments abroad, but non-residents' investments in Hungary also fell slightly.

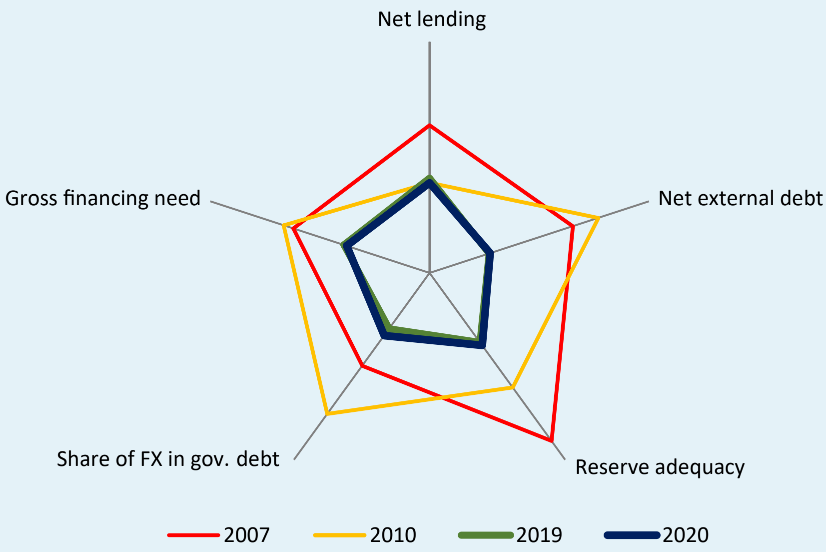
The net external debt ratio stabilised close to its historic low, at below 8 percent, as a combined result of an increase in this indicator for the government and corporations and a decline for the banking sector. With the expenditures related to the containment of the pandemic and purchases of government securities by non-residents, the government's net external debt rose while that of the banks declined. The banking sector's net external debt was once again negative at the end of 2020, i.e. banks' external assets slightly exceeded their external debts. The economy's gross external debt rose to 58 percent of GDP, with the issuance of foreign currency government securities, the rise in non-residents' forint government securities holdings and corporations' higher external liabilities as the main contributors. Short-term external debt, which is of crucial importance in terms of Hungary's external vulnerability, amounted to EUR 21.5 billion at the end of 2020, while foreign exchange reserves reached almost EUR 34 billion. Accordingly, reserves remain much higher than the level expected and deemed safe by investors.

In conjunction with declining tax revenues due to the pandemic, the costs of prevention in healthcare and the funds used to restart the economy, the government's borrowing requirement expanded significantly in 2020. This effect was counterbalanced by the rise in private sector's financial savings: moderate consumption and strengthening precautionary motives boosted household financial savings, while corporations' net lending also rose. With the high deficit and declining GDP, the downtrend in government debt that had been observed in previous years was interrupted: however, the ratio of non-residents' government debt holdings continued to fall, and from 2021 the debt ratio may once again embark on a declining path. One significant factor in the latter process was the continuing strong household demand for government securities, which provided stable funding for the general government during the crisis as well, reducing its vulnerability.

According to the most important indicators, Hungary's external balance position remained stable in 2020, despite the negative effects of the pandemic (Chart 1.). The external balance position is significantly better than in the year preceding the 2008 crisis, indicating that the Hungarian economy was in a much more favourable position when the crisis caused by the pandemic hit: Hungary's external borrowing requirement, external debt ratios and the exchange rate risk of households and of the government were substantially lower than before the outbreak of the 2008 crisis. Net lending rose moderately in 2020, and further improvement may be expected considering the mid-year dynamics and the Inflation

Report forecast. Along with stable net lending, the net and gross external debt-to-GDP ratios remain low, while in parallel with the substantial increase in foreign exchange reserves, reserve adequacy is also extremely high, exceeding EUR 12 billion. The rise in the budget's borrowing requirement and the foreign currency bonds issued due to the favourable funding opportunity moderately increased the foreign currency ratio within government debt, but this impact was mitigated by the fact that households raised their financial savings and government securities holdings even in the difficult economic situation.

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. Values closer to the centre – in practical terms, the shrinking of the 'net' – signal lower vulnerability for the given indicator.

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 exceeded the typical average of the countries in the region in 2020 as well. Developments in the countries' external balance position were largely influenced by the impact of the lockdowns due to the coronavirus. The countries of the region were characterised by rising net lending: following the typical decline in the second quarter, in the second half of the year trade balances increased in most countries of the region, the impact of which was corroborated by the fall in foreign companies' profits and rising absorption of EU transfers. Domestic absorption typically declined in the region, and in line with this the private sector's net financial savings rose, while the government's borrowing requirement rose significantly due to the falling revenues resulting from the pandemic, the measures to counter the negative economic impacts and the costs of prevention. In 2020, the fall in net external debt indicators typically continued in the region. In a regional comparison, Hungary's net external liabilities and debt correspond to the level observed in the other countries.

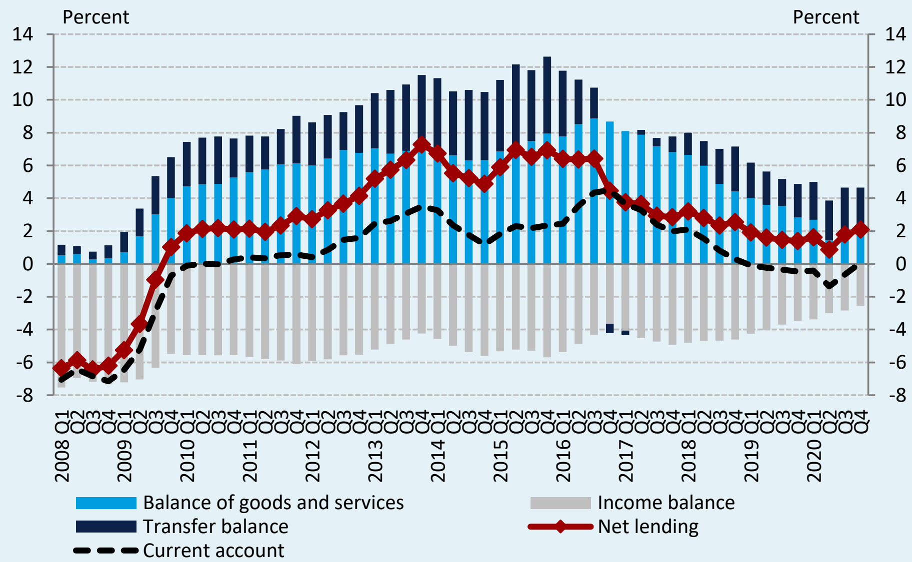
Contents

1 Real economy approach

Despite the impacts of the pandemic, external balance indicators of the Hungarian economy improved in the second half of 2020: the current account turned into a surplus, while net lending exceeded 2 percent of GDP. The evolution of the external position was primarily determined by trade balance developments: the trade balance deteriorated significantly in the first half of the year, due to the declining services balance resulting from the pandemic, the dip in export dynamics owing to the fall in export demands and the supply difficulties, and the import-intensive healthcare procurements. The significant decline in the services balance surplus continued in the second half of the year, but this was more than offset by the lower import-intensity resulting from falling domestic use, rising exports in parallel with the pick-up in industrial production and the improving terms of trade. Meanwhile, the decrease in the income balance deficit connected to lower corporate profits also improved net lending. The slightly higher absorption of EU transfers compared to previous year also continued to contribute significantly to the favourable external position.

According to the real economy approach, the economy's external balance indicators fell sharply in 2020 H1 and then rose in the second half of the year to exceed the level observed at the end of last year: consequently, the current account balance turned into a moderate surplus in 2020, while net lending amounted to 2.1 percent of GDP (Chart 2). According to seasonally unadjusted figures, net lending in Q4 amounted to EUR 968 million, with a surplus of EUR 185 million on the current account and EUR 783 million on the capital account. According to the four-quarter data, the impacts of the pandemic significantly reduced net lending in the first half of the year. After falling below 1 percent, it gradually rose in the second half of the year, to exceed 2 percent of GDP by the end of the year. Changes in the external position were primarily determined by the developments in the goods and services balances (for more details, see below), while the steady decline in the income balance deficit – resulting from shrinking corporate profits – supported an improvement in net lending throughout the year. The transfer balance improved the external balance position during the year, typically by almost 2.5 percent of GDP. On the whole, the result of these developments was that the decline in the four-quarter current account balance as a percentage of GDP changed to a rise in the second half of the year, and the current account balance changed to a minimal surplus during the year. Thus, despite the fact that imports related to the prevention of the pandemic significantly reduced the balance and industrial production fell due to the restrictions at the beginning of the year, the four-quarter current account balance started to rise in the second half of the year, and by the end of the year it already showed a surplus.

Chart 2: Developments in net lending and its components (four-quarter values as a percentage of GDP)

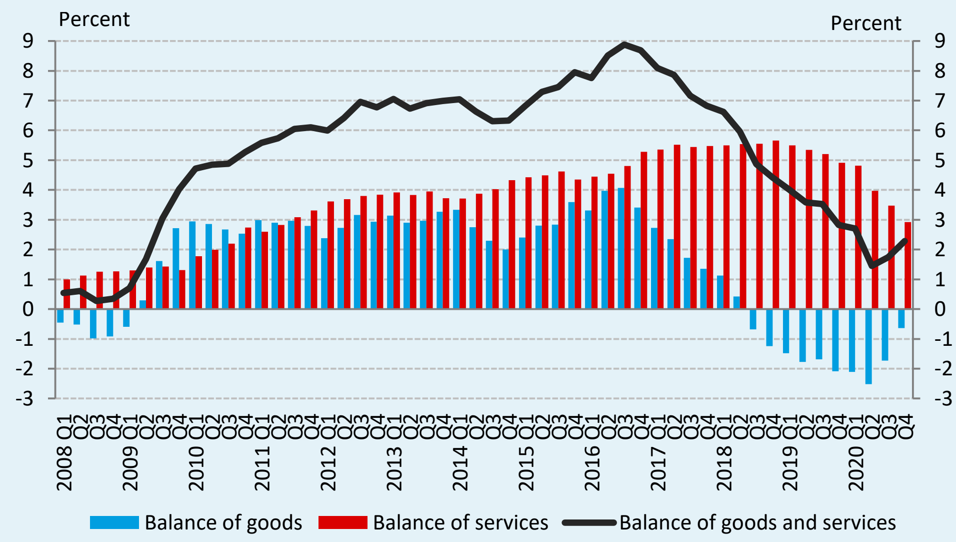


Source: Unless otherwise indicated, the source of the charts is the MNB.

1.1 Trade balance

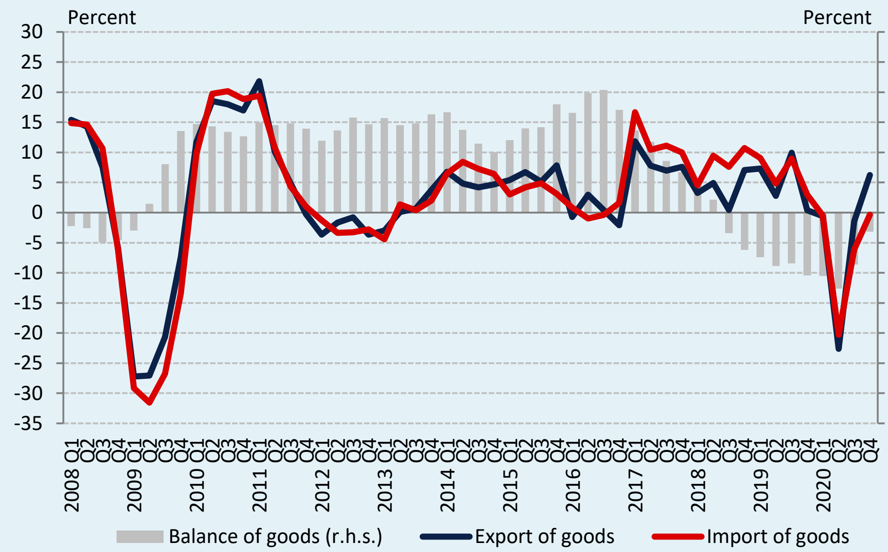
In 2020 Q4, the trade surplus amounted to 2.3 percent of GDP, with a decline in the services surplus and a significant decrease in the goods deficit during the year (Chart 3). The trade balance underwent major changes in 2020: while the indicator deteriorated sharply in the first half of the year owing to pandemic-related expenditures, it was characterised by a gradual improvement in the latter half of the year. In the first half, the impacts of the pandemic were felt more strongly: the services surplus started to decline, mainly due to tourism and transportation services, while the goods balance deteriorated further on the heels of weaker export demand, interruptions in supply chains and import-intensive healthcare procurements. The services balance surplus also continued contract sharply in the second half of the year, but this was more than offset by lower import-intensity resulting from the falling domestic use partly due to the lockdown, rising exports in parallel with the upturn in industrial production and improving terms of trade thanks to declining oil prices.

Chart 3: Developments in the balance of trade and its components (four-quarter values as a percentage of GDP)



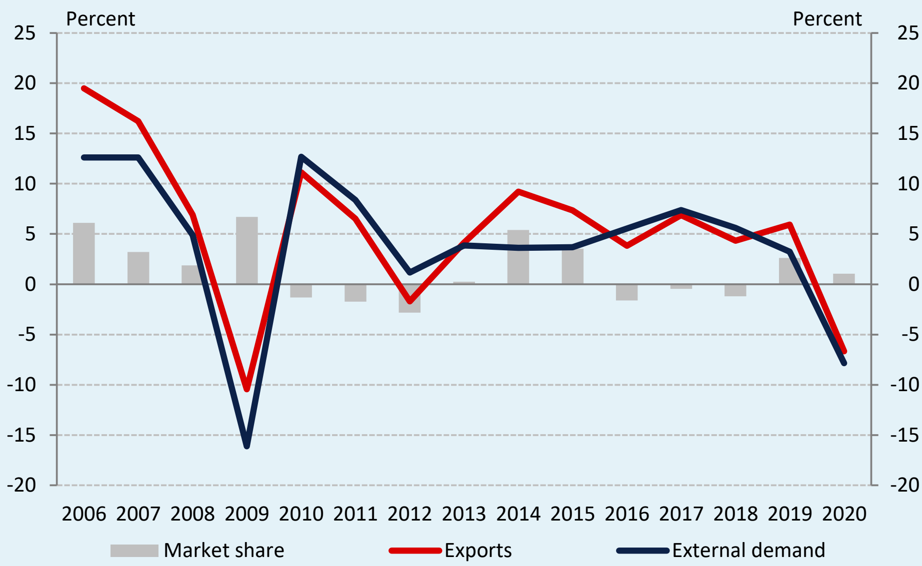
Growth in goods exports plunged during the year and then bounced back by the end of the year: export growth, which once again showed an increase at the annual level, significantly exceeded growth in imports (Chart 4). Starting from end-2016, along with exports, the dynamic growth in investments was a key factor behind the growth rate of goods imports, with investments expanding at an even faster pace than exports. Due to the pandemic, export growth fell to the same degree as during the 2009 crisis, but – in line with strengthening foreign demand in parallel with the lifting of lockdown measures abroad – the recovery was much faster than observed 11 years ago. As a result of the quick rebound in industrial production, the value of goods exports already exceeded its prior-year level at year-end, while the moderate domestic absorption resulting from the lockdowns and adjustment by domestic sectors continued to curb growth in imports. As a result of the foregoing, following the negative gap seen in previous years, export growth exceeded import growth to an increasingly large degree, which was also reflected in the rapid decline in the goods deficit.

Chart 4: Annual growth in goods exports and goods imports and the goods balance (four-quarter values as a percentage of GDP)



Due to weakening external demand related to the pandemic, exports of domestic companies fell substantially (Chart 5). In spring 2020, the increasingly severe pandemic caused problems in international supply chains, which also had negative impacts on domestic companies' external trade opportunities. The collapse of Hungary's export markets was reflected in falling exports. However, export prospects improved in the latter half of the year, mitigating the annual rate of decline. On the whole, despite the decline in exports, the Hungarian economy's export market share rose moderately last year.

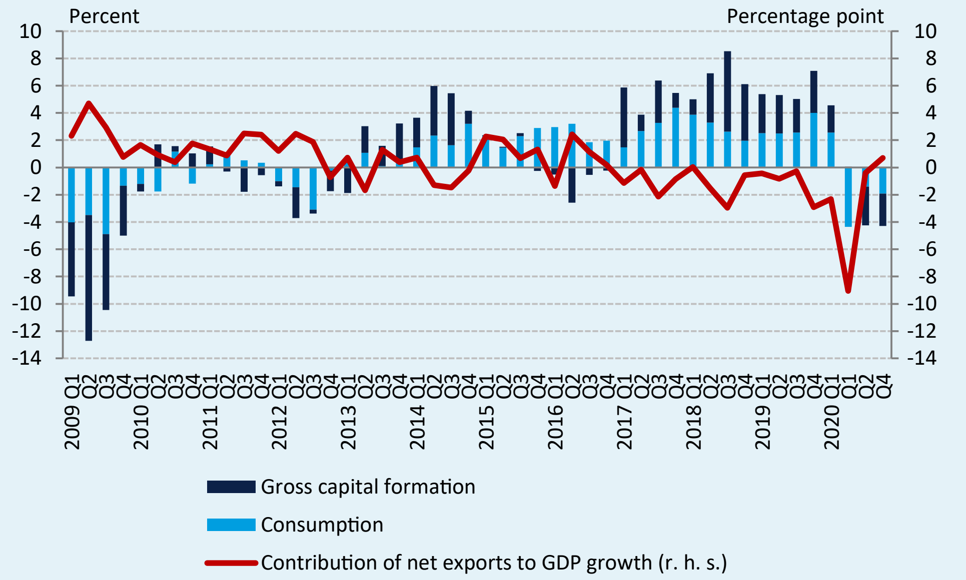
Chart 5: Real growth in exports and external demand* and developments in Hungary's export market share



Weighted by export markets.

In 2020, due to the pandemic, domestic absorption items steadily declined from the second quarter, while – after a dramatic fall in the second quarter – net exports already made positive contribution to GDP in the second half of the year (Chart 6). Developments in domestic absorption items in 2020 were determined by the coronavirus pandemic. Following the introduction of the lockdowns, consumption fell considerably, and after the easing of the curfew measures the decline continued, albeit to a lesser degree. In the increasingly uncertain external environment, growth in investments stopped in the second quarter and started to decline from the third quarter. The growth contribution of net exports fell significantly in the second quarter, but the recovery in global supply chains caused a strong rebound. The recovery in net exports was also supported by developments in domestic absorption items that mitigated import growth.

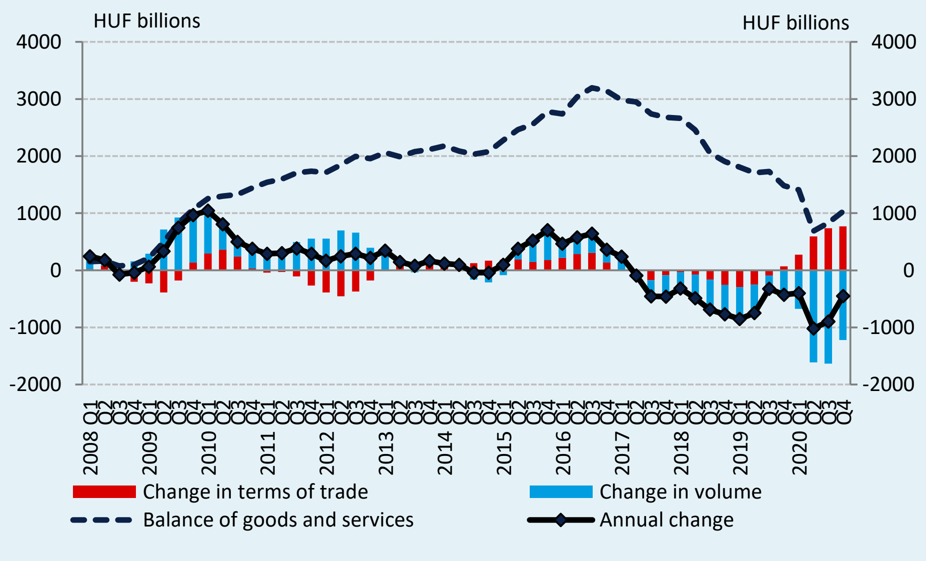
Chart 6: Contribution of domestic absorption and net exports to GDP growth



Source: HCSO.

Following the spring decline, the trade balance started to rise slowly, with the largest contributions coming from the terms of trade in mid-year and the volume effect in the final quarter of the year (Chart 7). As a result of the coronavirus pandemic, the volume effect weakened significantly in the two middle quarters of the year, which contributed to the substantial fall in the trade balance. In parallel with this, due to the decline in fuel prices, the terms of trade improved somewhat, mitigating the fall in net exports. At the end of the year, although the terms of trade no longer improved, this item still made a positive contribution to the trade balance. By contrast, the deficit declined due to volumes, which resulted in a slower decrease in the trade balance.

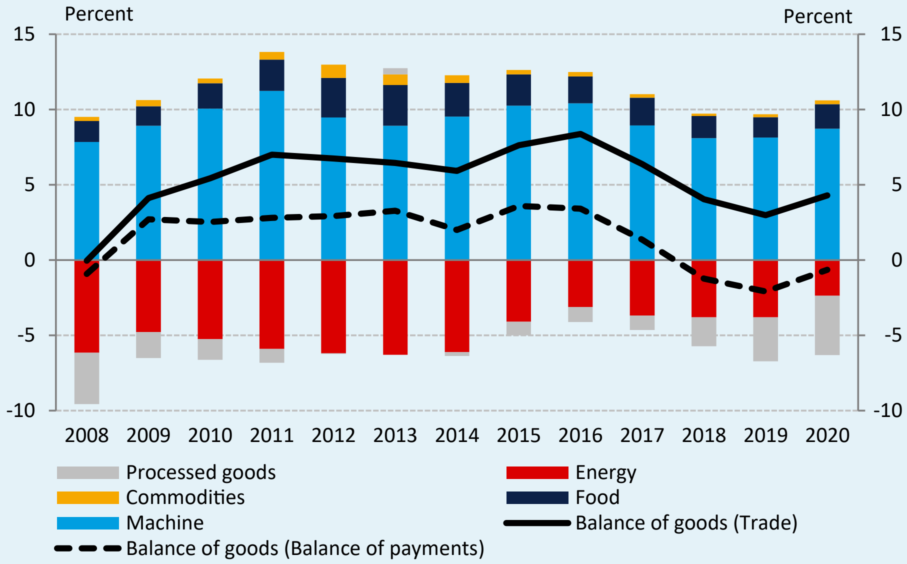
Chart 7: Developments of trade balance factors according to GDP (year-on-year)



Source: HCSO.

In 2020, the growth in the goods balance amounted to 1.5 percent of GDP, which is primarily attributable to the fall in net imports of fuels and the rise in net machinery exports (Chart 8). In previous years, the decline in the balance was primarily attributable to the fall in the net balance of machinery (due to the strong investment dynamics), whereas a turnaround was seen in the machinery and equipment trade balance in 2020. In particular, in line with weaker consumption and investment due to lockdowns, the typically 8- to 10-percent growth in machinery imports observed in previous years decelerated to nearly 1 percent in 2020, and thus the machinery and equipment trade balance rose even in the face of the decreasing export dynamics resulting from the pandemic. After the stagnation typically seen in previous years, net energy imports – in line with the reduction in oil prices – dropped significantly in 2020, and thus the negative effect of this item on the trade balance was 1.4 percent lower than in the previous year. Improvement in the goods balance was curbed by the deterioration in the balance of processed goods. In terms of consumer goods, it is worth mentioning that this range of products also includes various imported items related to investment.

Chart 8: Net external trade in goods by main groups (as a percentage of GDP)



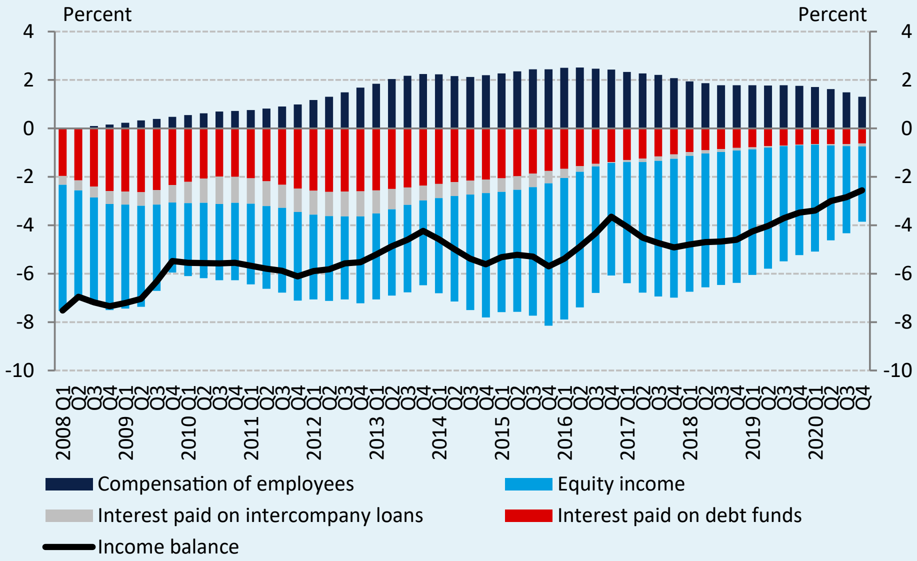
Note: The difference between trade in goods according to the trade balance and the balance of payments depends on the different requirements of the methodologies and the content of data sources. We obtain the trade in goods figures of the balance of payments by means of adjustment factors derived from the external trade statistics (for more details, see the publication on the methodology of the balance of payments statistics). The two types of data have been similar in recent years, so they are suitable for analysing the trends.
Source: HCSO, MNB.

1.2 Income balance

The income balance deficit as a percentage of GDP declined further to 2.6 percent in 2020, mainly due to the fall in equity income (Chart 9). The profit of foreign-owned companies accounts for the bulk of the income balance,[1] the amount of which, as a percentage of GDP, declined significantly compared to previous year, falling by almost 1.5 percentage points, and thus by the last quarter of 2020 it amounted to 3 percent of GDP. Compensation of employees working temporarily abroad steadily declined during 2020. Since many employees may have lost their job abroad or were on forced leave as a result of the pandemic, in the final quarter their earned income only amounted to 1.3 percent of GDP. The interest balance of loans borrowed from abroad continued to drop slightly compared to end-2019, which is attributable to the low yield environment, in the context of stabilisation in external debt indicators in 2020, after their typical fall in previous years.

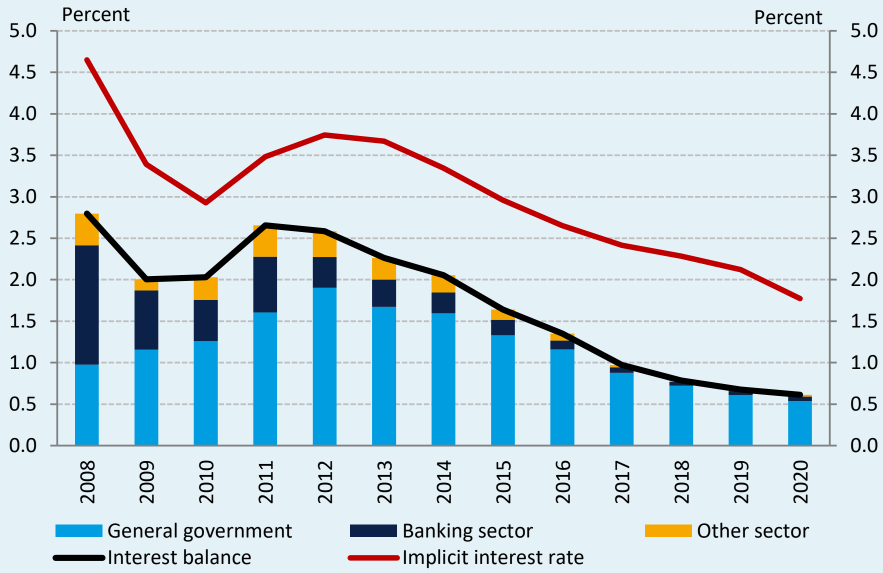
1 We only have limited quarterly data concerning the profits of foreign-owned companies. Therefore, the information on profit outflows is based on estimates. For more details, see the publication 'Methodological notes to the balance of payments and international investment position'.

Chart 9: Developments in the items of the income balance (four-quarter values as a percentage of GDP)



The downward trend in the net interest balance observed since 2012 continued in 2020, with this indicator falling to 0.6 percent of GDP by the end of the year (Chart 10). The decline in interest paid on external debt seen since 2012 continued in 2020 as well, supported primarily by the low yield environment: due to the continuous repricing, the low foreign yield environment and low forint yields, and supported by the MNB's securities purchases, the implied interest rate on external debt amounted to only 1.8 percent during the year.[2] In a breakdown by sectors, the value of banks' and other sectors' (mostly non-financial corporations') net interest balance as a percentage of GDP was close to zero in 2020 as well, similarly to the previous three years, i.e. the net interest expenditure is almost completely related to the interest balance of the general government, which amounts to 0.6 percent of GDP.

Chart 10: Changes in net interest expenditure (as a percentage of GDP) and in the implicit interest rate

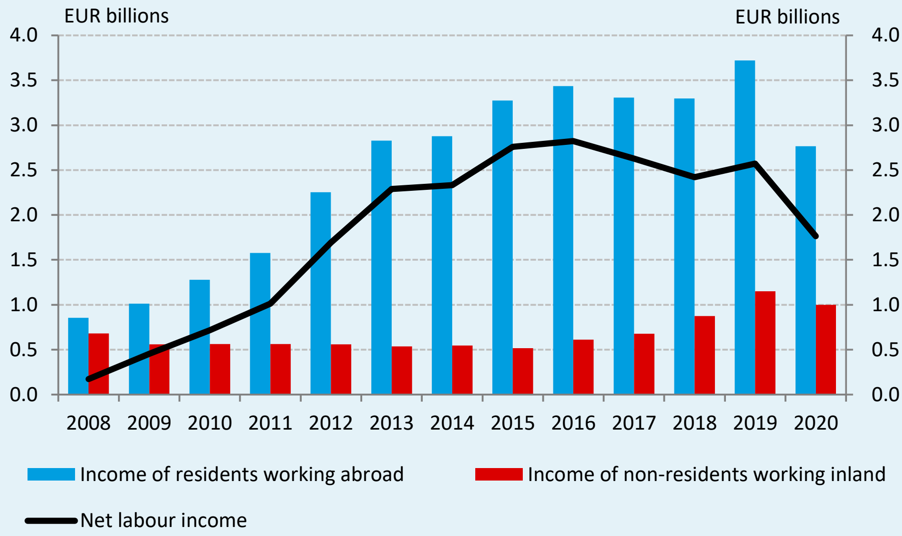


In 2020, the compensation of employees employed abroad declined significantly due to the pandemic, and thus following a temporary rise observed in 2019 this indicator fell once again (Chart 11). After the 2008 crisis, the compen-

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.

sation of employees working temporarily abroad rose dynamically, which helped improve the income balance. This trend reversed from 2016, and the balance started to decline, which is attributable to a decrease in the compensation of Hungarian residents working abroad temporarily, as well as to the rise in the compensation of foreigners working in Hungary for less than a year. In 2019, the indicator moderately rose, but in 2020 – as a result of the coronavirus pandemic – the compensation of those employed abroad dropped significantly. Although there was also a slight decline in the compensation of non-residents working in Hungary compared to the previous year, the compensation of Hungarian employees – employed in the manufacturing and service sectors, which were hit particularly hard by the pandemic – from abroad declined to an even larger degree due to the border closures, and thus the balance dropped to nearly the level last seen in 2012.

Chart 11: Compensation of employees working abroad temporarily

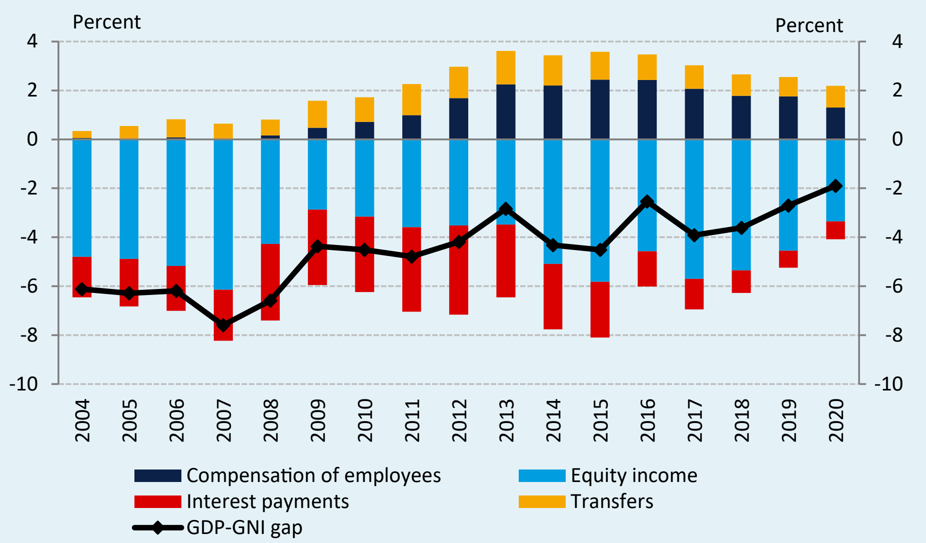


Source: HCSO, MNB.

Box 1: GDP-GNI gap

The narrowing of the GDP–GNI gap observed in previous years may have continued in 2020 as well, as a result of which the sectors' disposable income fell short of the income generated in Hungary by less than 2 percent of GDP (Chart 12). The difference between gross domestic product (GDP) and gross national income (GNI) shows the balance of income movements vis-à-vis the rest of the world, based on which conclusions can be drawn regarding domestic actors' actual disposable income. The large drop in the indicator in 2008 and 2009 was primarily attributable to the fall in profitability of companies in foreign ownership, as a result of which the difference, which had previously exceeded 6 percent of GDP, fell to 4 percent of GDP. Since then, until 2018 the gap was around 4 percent of GDP, followed by a steady decline in recent years, and – based on the available data, which for the time being are only based on estimates – it fell below 2 percent of GDP in 2020. This is once again mostly attributable to the fact that in conjunction with the deteriorating corporate profitability resulting from the pandemic, equity income may have declined. In addition – as a process manifesting itself over the longer run but being more persistent – it also helped reduce the GDP-GNI gap that the significant external debt before the crisis has gradually declined in recent years, the positive impact of which on the interest balance was also strengthened by the fall in yields.

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

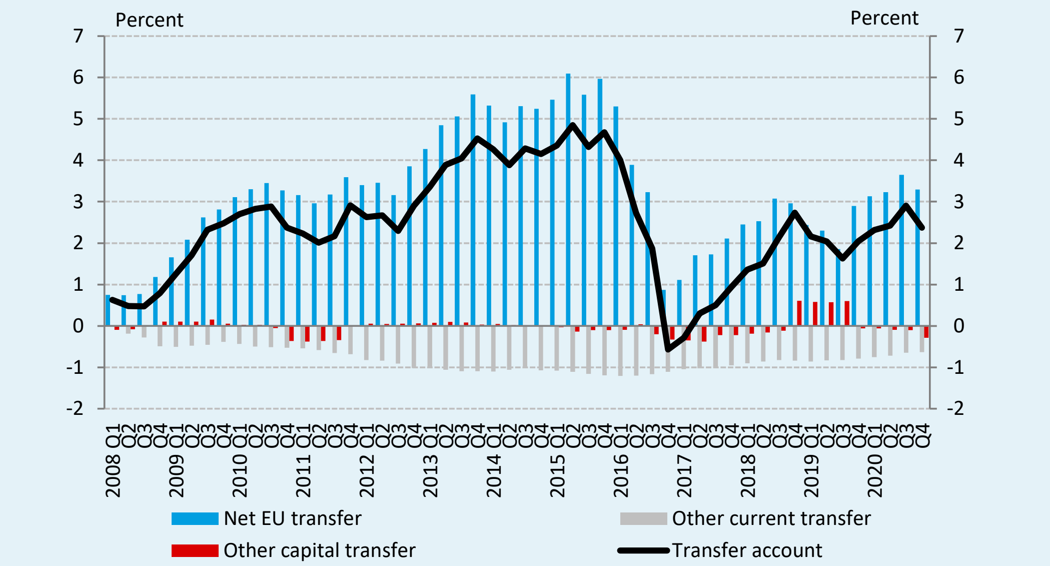


Note: At present, no official GNI data (published by the HCSO) are available for 2020. The data are based on the primary income of the balance of payments data release (excluding SPEs , containing an estimate for the profit of foreign-owned companies for the time being).

1.3 Transfer balance

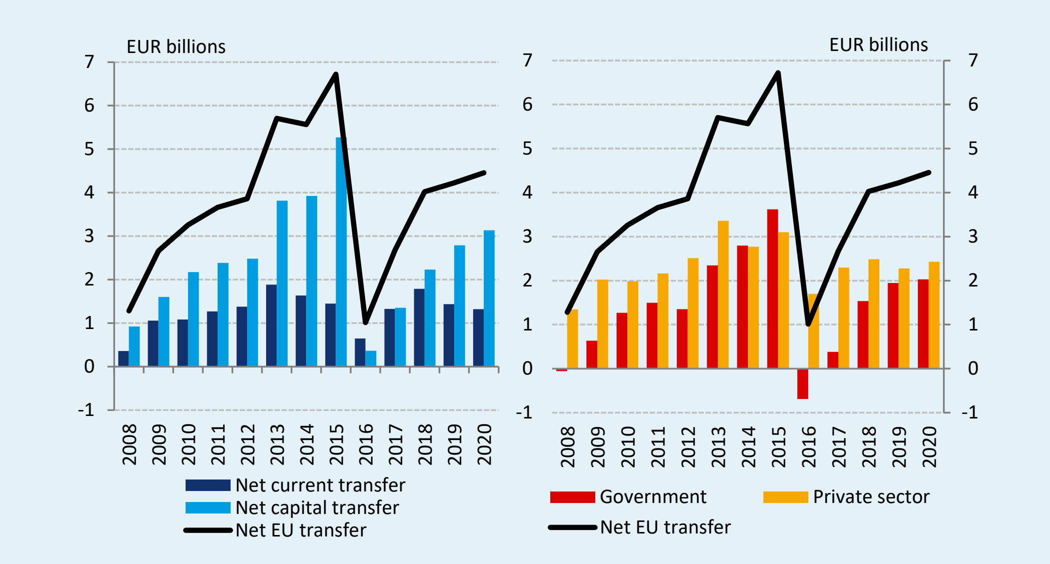
The transfer balance surplus rose to 2.4 percent of GDP in 2020: the impact of the high absorption of EU transfers throughout the year was increased by the decline in other current and capital transfer expenditures as a percentage of GDP at the end of the year (Chart 13). In 2019, a temporary downturn was observed in the four-quarter absorption of EU funds. However, at the end of 2019 the indicator already started to rise, and this trend continued in 2020 as well. Accordingly, the absorption of net EU transfers fluctuated at around 3 to 4 percent during the year, significantly exceeding the level observed in the previous three years. In addition, the transfer balance was also improved by the significant decline in the negative balance of other current transfers during the year, which reflected decreasing foreign tax payments due to the fall in the compensation of employees temporarily working abroad.

Chart 13: Developments in the transfer balance (four-quarter values as a percentage of GDP)



Absorption of EU-funds rose to EUR 4.5 billion in 2020, also supported by growth in government and private sector capital transfers (Chart 14). As a result of the EU programming period and the related rules on using funds, the absorption of EU transfers reached its low in 2016. Since then, the annual absorption of funds has been increasing year after year, supported by advance payments as well. Accordingly, after 2019 the absorption of EU transfers increased further in 2020. The rise was a result of the higher absorption of capital transfers usable for investments. In a breakdown by sector, in 2020 the larger part of the rising absorption was related to corporations and the smaller part of it to the general government.

Chart 14: Developments in net current and capital transfers with the EU and the breakdown thereof by sectors

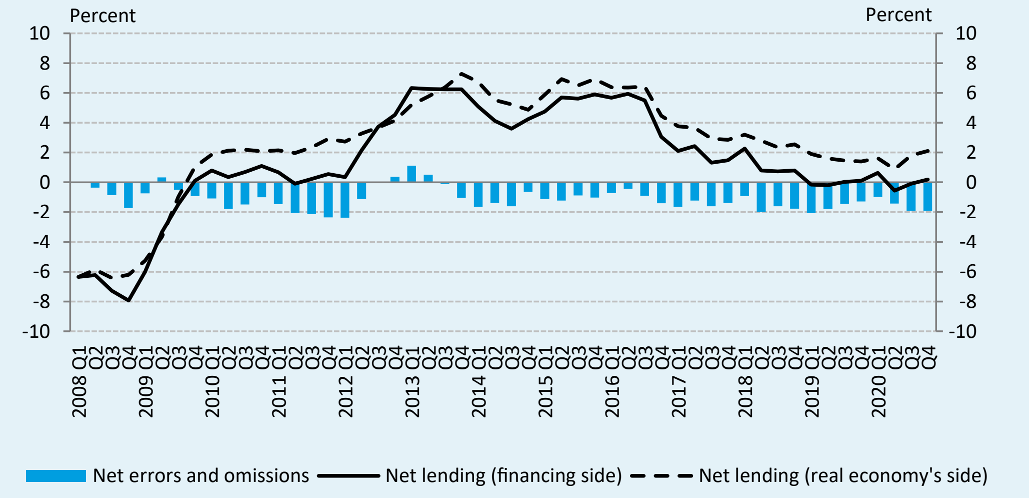


2 Financing approach

In 2020, net lending calculated on the basis of financing items amounted to 0.2 percent of GDP. The annual outflow of non-debt liabilities – with net FDI inflow close to zero – was attributable to the fall in portfolio equity investments, the larger part of which was connected to the growth in domestic companies' investments abroad, and the smaller part to the fall in foreign investments. At an annual level, net debt liabilities rose, with a larger contribution by the general government and a smaller one by corporations, while the banking sector's indicator fell sharply. The growth in the government's net external debt was related to the rise in non-residents' holdings of forint government securities, expenditures connected to the pandemic and the foreign exchange reserves reducing effect of central bank swap instruments; the latter also contributed to the considerable fall in the banking sector's net external debt, primarily reflected in the decline in external liabilities.

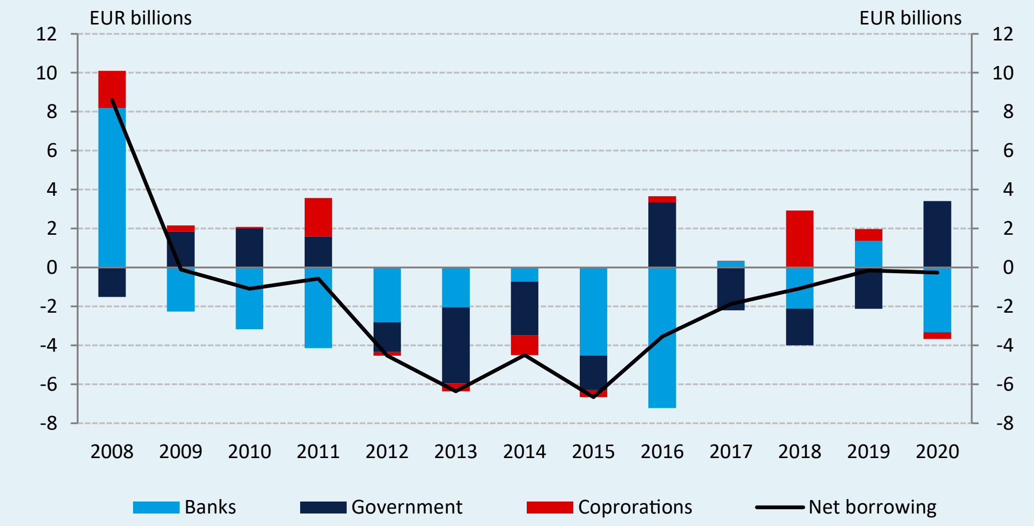
In 2020 Q4, the four-quarter net lending of the economy according to the financing approach rose to 0.2 percent of GDP. The four-quarter net lending calculated on the basis of real economy data amounted to 2.1 percent of GDP, i.e. the balance position according to the financing approach fell significantly short of the real economy indicator (Chart 15). The difference between the two types of net lending i.e. the balance of net errors and omissions, was around 2 percent of GDP, which roughly corresponds to the average of previous years and also cannot be regarded as an outlier compared to the level typical of the countries of the region (for more details, see Section 5).

Chart 15: Developments in the two types of net lending (four-quarter data as a percentage of GDP)



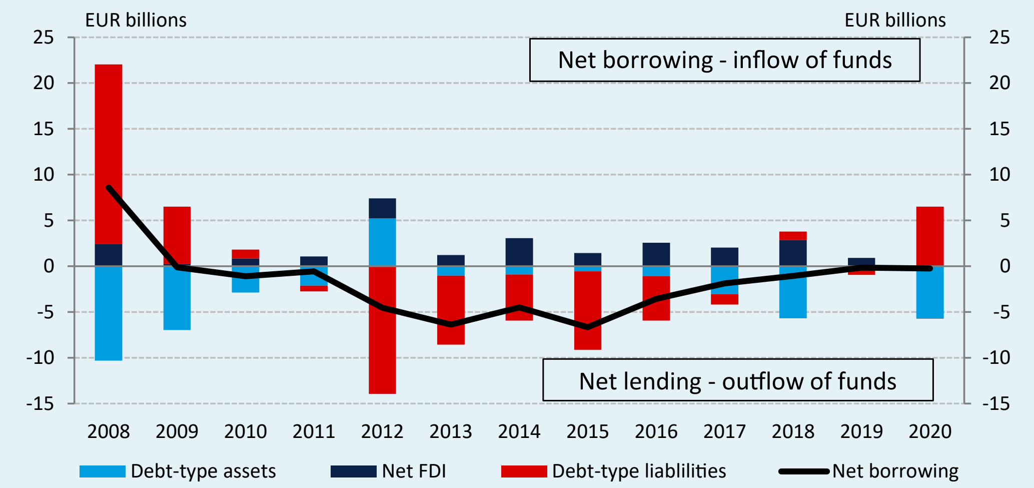
In 2020, the government's external borrowing was offset by the decline in private sector debts, and thus – due to the financing items – moderate net lending developed throughout the year (Chart 17). The pandemic significantly altered trends related to the domestic sectors' net borrowing. Net external outflow of funds, which declined steadily until 2019, reached a low level in 2020 as well, but the structure of net debts changed significantly. In the case of corporations, the net borrowing registered in the previous two years was followed by a moderate outflow of funds. On the one hand, although financing through growth in reinvested earnings continued, the declining corporate profit resulting from the pandemic was also reflected in the fall in reinvested earnings. On the other hand, at the end of 2020, Hungarian companies' investments abroad rose substantially, which also reduced net foreign direct investment. In the second half of the year, banks' outstanding net external debt also declined, which primarily impacted gross liabilities. In parallel with this, in connection with the rise in non-residents' forint government securities holdings, expenditures related to the pandemic and the foreign currency liquidity provided to banks at the end of the quarters on a temporary basis, the government's net outstanding debt rose sharply in the second half-year. The increase in the government's external liabilities was mitigated by the absorption of EU transfers this year as well.

Chart 16: Net inflow of funds by sector



In 2020, with net FDI inflow around zero, growth in foreign receivables remained significant; however, as a result of the foreign currency bond issuances, in contrast to previous years, external debt liabilities also expanded significantly (Chart 17). The economy's net debt liabilities rose by roughly EUR 0.8 billion in 2020: in addition to the foreign currency bond issuance, the large increase of EUR 5.7 billion in external assets was exceeded by the growth in external debt liabilities. The decline in foreign direct investment was offset by domestic companies' investments abroad, which resulted in net FDI close to zero.

Chart 17: Developments in foreign direct investment and debt liabilities*

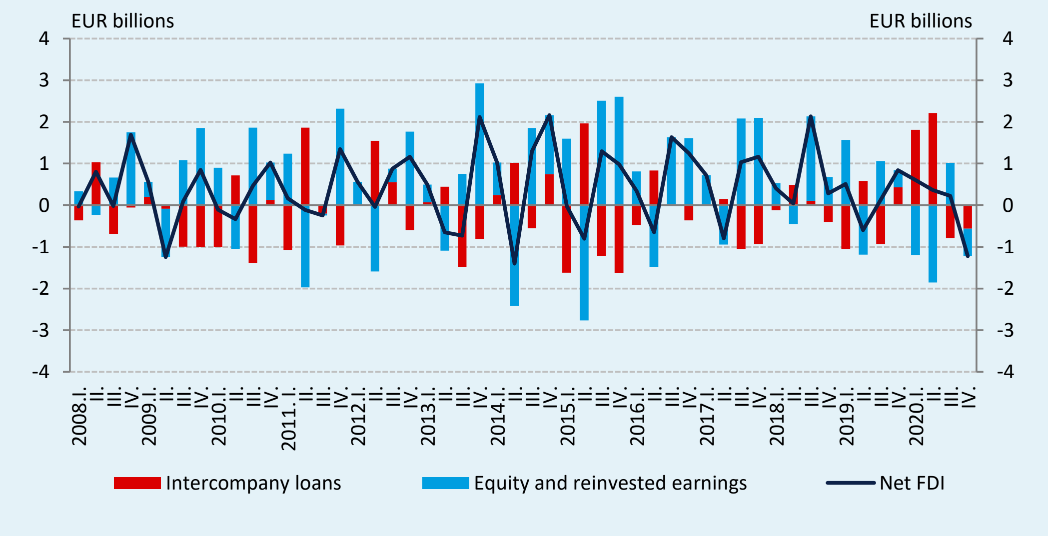


** In addition to the components presented in the chart, net borrowing also includes the equity transactions of portfolio investments and transactions associated with derivatives, as well as the non-debt receivable (bullion, equity securities) transactions of international reserves.*

2.1 Non-debt liabilities

In 2020, FDI inflow in Hungary was close to EUR 2.4 billion, while net FDI inflow was around zero (Chart 18). In the transactions net of capital in transit, foreign direct investment in Hungary showed an inflow of EUR 2.4 billion. This is slightly lower than in 2019, but can still be regarded as a substantial inflow. As regards the net inflow of funds, the effect of this was offset by domestic companies' investments abroad. As a result, in the first half of 2020 the outstanding and usual dividend payments significantly reduced equity investments. However, net FDI stock declined to a lesser degree than that, as the approved but unpaid dividend for the time being remained with the Hungarian subsidiary at many companies as intercompany loans. Thus, the trend observed after the financial crisis continued in 2020 as well, where in terms of the structure of foreign direct investment, the changes in equities and intercompany loans often offset one another, which resulted in a significant slowdown in net FDI inflows. Foreign direct investment decreased further due to the fact that as a result of the pandemic the profit of foreign companies fell significantly, which was also reflected in the lower level of reinvested earnings. The decreasing net FDI stock in the fourth quarter – and in parallel with this the rise in debt liabilities – mostly related to the investment of one large company abroad through bond liabilities. As the combined result of the foregoing, net FDI slightly decreased compared to 2019.

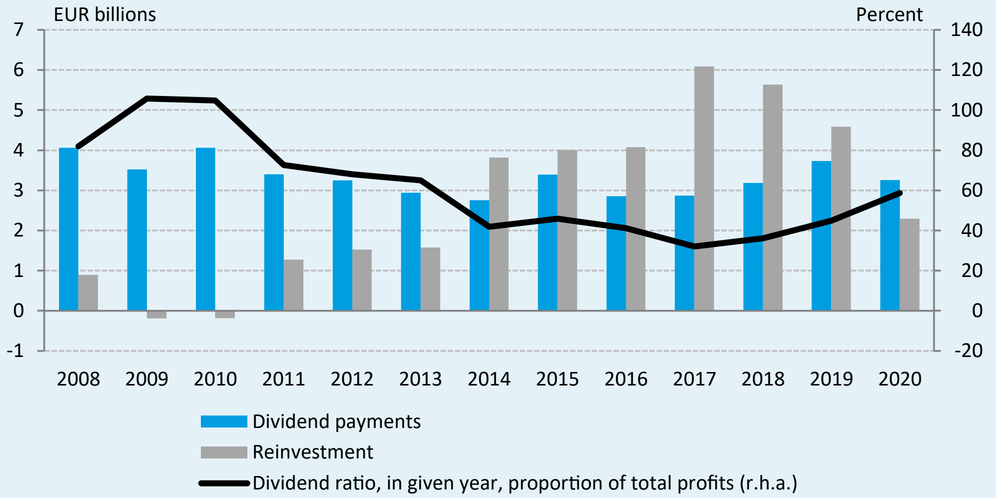
Chart 18: Developments in net direct investment (net of capital in transit)



In conjunction with foreign enterprises' decreasing profitability, reinvested earning declined, due to a rise in the dividend ratio. In 2020, the profitability of foreign-owned companies fell substantially, dropping to EUR 5.6 billion, as a result of the pandemic.[3] On the other hand, dividend payments – following a minor decrease – exceeded EUR 3 billion, and thus the dividend ratio rose to nearly 60 percent. In an international comparison, this ratio still represents significant reinvestment, since in most countries in the region the dividend ratio persistently exceeds reinvested earnings (for more details, see Section 5.6 of the October 2020 Report on the Balance of Payments). Despite the decline, the reinvestment of earnings presented in the balance of payments statistics continued to make a major contribution to the inflow of foreign direct investment (Chart 19).

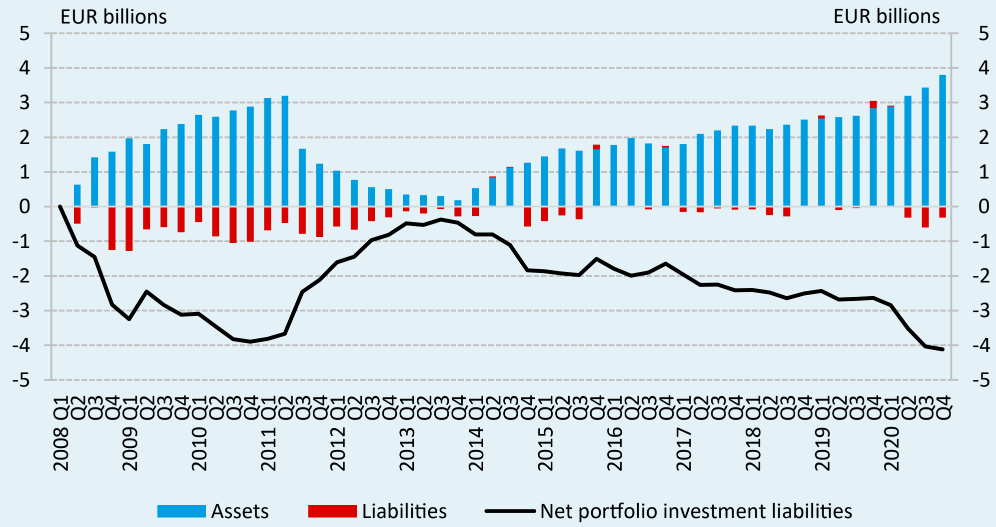
3 The profit of foreign-owned companies and the reinvested income shown in the income balance are based on an estimate for 2020, which will be replaced by actual figures based on corporate surveys together with the publication in September 2021

Chart 19: Distribution of profits generated by foreign-owned companies in Hungary



Net portfolio equity investments dropped by EUR 1.5 billion in 2020. The outflow of non-debt liabilities in 2020 mostly related to mutual fund shares and portfolio equity investments. The rise of almost EUR 1 billion in domestic actors' investments abroad contributed to this to a larger degree, while the fall of EUR 0.5 billion in non-residents' equity investments in Hungary contributed to this to a lesser degree. The significant growth in Hungarian investments abroad was primarily attributable to the rise in the – equity and mutual fund share – savings of domestic actors, mainly households. In the persistently low yield environment, all of this may be connected to the fact that domestic investors regarded the falling stock exchange prices resulting from the pandemic as a good entry point. The pandemic also impacted Hungarian stock exchange trends: on the whole, with unfavourable investor sentiment and significant turnover, the prices of most equities fell compared to the end of 2019.

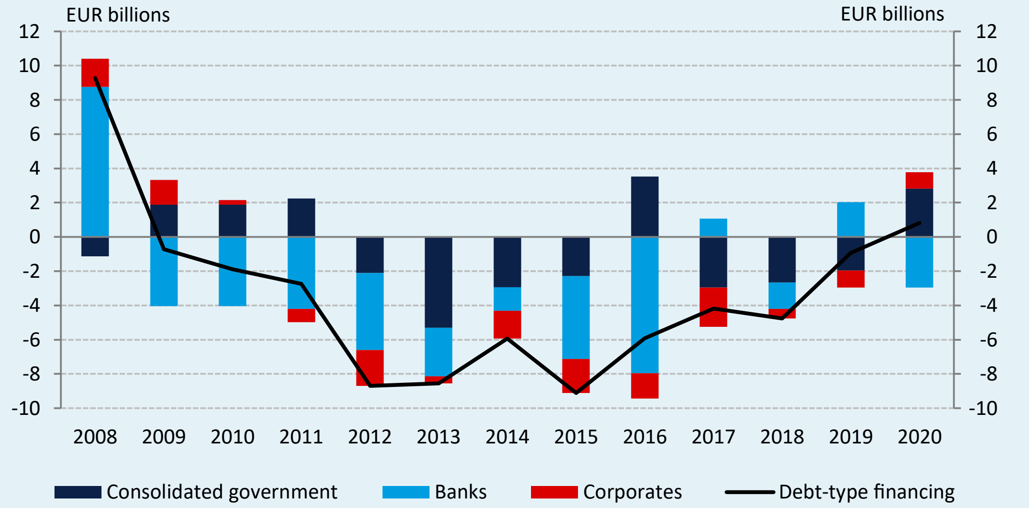
Chart 20: Developments in net portfolio equity and mutual fund share liabilities (cumulative transactions)



2.2 Debt liabilities

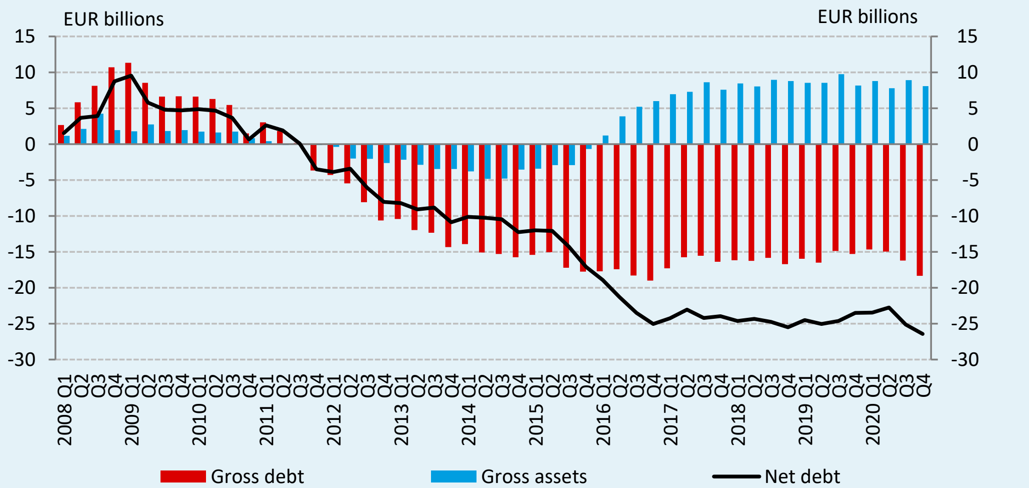
Due to transactions, the net external debt of the economy grew by EUR 500 million and by roughly EUR 800 million in Q4 and in the year as a whole, respectively, with the general government as the main contributor, while net external debt of the banking sector decreased (Chart 21). In 2020, in contrast to previous years, the economy's net external debt rose slightly, by roughly EUR 800 million. The net external debt of the consolidated general government rose by EUR 2.8 billion, which was offset by the fall of EUR 3 billion in this indicator for the banking sector. In parallel with this, corporations' net external debt rose by almost EUR 1 billion, which mostly related to the fall in foreign receivables.

Chart 21: Changes in the debt liabilities of individual sectors (annual transactions)



The banking sector's net external debt fell significantly in 2020, owing to the decline in external liabilities (Chart 23). Based on the financial accounts, non-financial corporations significantly increased their foreign currency deposits in the first three quarters, which was reflected in a rise in credit institutions' foreign currency assets; this was followed by an adjustment in the fourth quarter however. After rising in the first quarter, banks' debt switched over to a gradual decrease: for the year as a whole, credit institutions' gross external debt fell by roughly EUR 3 billion due to transactions. The drop in the banking sector's net external debt was also attributable to the decline in outstanding central bank forint liquidity providing swap contracts and the activation of the euro liquidity providing swap instruments, which contributed to the banking sector's debt outflow by increasing banks' foreign currency liquidity. In 2020, banks' long-term liabilities and short-term liabilities declined by more than EUR 2 billion and by almost EUR 1 billion, respectively.

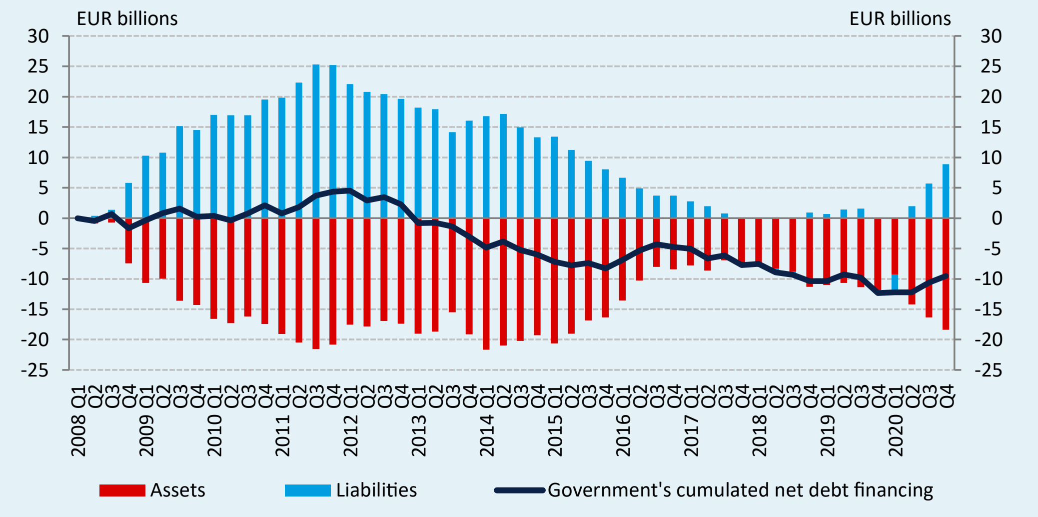
Chart 22: Developments in the banking sector's external debt and receivable transactions (cumulative transactions)



The net external debt of the consolidated general government including the MNB grew significantly in Q4, which was attributable to the rise in gross liabilities over and above the rise in foreign exchange reserves. Considering the year as a whole, the net external debt of the consolidated general government including the MNB was shaped by the following key factors:

- The **absorption of EU transfers** significantly **lowered net external debt** for the year as a whole and in the second half of the year.
- After the decline registered in the first half-year, **in the second half of 2020 non-residents' forint government securities holding rose significantly, expanding i.e. by roughly EUR 250 million** in the entire year.
- The foreign currency bond issuances performed during the year also increased foreign exchange reserves, in addition to gross debt, and thus had no effect on net external debt.
- **The government transfers incurred during the year in connection with the prevention of the pandemic reduced foreign exchange reserves,** which contributed to the growth in net external debt.
- The decrease in the central bank' forint liquidity providing swaps and – temporarily – the use of the euro liquidity providing swap instruments both reduced foreign exchange reserves, and thus contributed to the rise in the government's net external debt. The foreign currency liquidity provided to the banking sector through the instruments reduced banks' debt ratio.

Chart 23: Breakdown of the change in the net external debt of the consolidated general government including the MNB (cumulative transactions)



In 2020 Q4, the net external debt of non-financial corporations rose by EUR 700 million, with equal contributions from the rise in liabilities and the fall in external assets. In the last quarter, the bond issuance of the aforementioned large enterprise was also reflected in the growth in external liabilities. At the annual level, there was a major – roughly EUR 1 billion – increase in the net external debt of corporations, with the fall in foreign assets as the driving factor, while foreign liabilities rose to a smaller degree. Since 2016, liabilities increased by a mere EUR 0.7 billion, while external assets rose by more than EUR 5 billion.

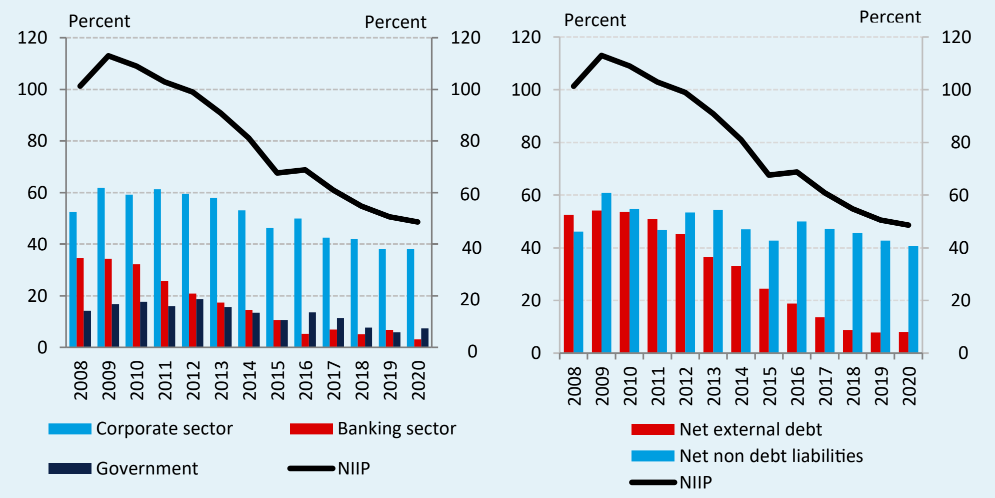
3 Developments in debt ratios

In 2020, the economic impacts of the pandemic also affected Hungary's external debt indicators; nevertheless, changes in the indicator relevant in terms of external vulnerability were moderate. Hungary's net foreign liabilities declined further with a minor outflow of non-debt liabilities, while – following a temporary decline at the beginning of the year – net external debt was close to the level registered at the end of last year, i.e. below 8 percent of GDP. In particular, with the moderate inflow of debt liabilities, declining nominal GDP and foreign currency yields, the revaluation of stocks – due the weakening forint exchange rate – reduced the debt ratio. The stable development of net external debt was the combined result of a rise in the indicator for the general government and corporations and a fall in the indicator for the banking sector. The rise in the government's net external debt was attributable to the fact that growth in foreign exchange reserves – partly due to the foreign currency healthcare expenditures – was more moderate than the rise in debts. Owing to the banks, the private sector's net external debt declined on the whole and was close to zero at the end of 2020. The decline in the banks' debt ratio was also attributable to the central bank euro liquidity providing swap facility at the end of the year, which – temporarily reducing the foreign exchange reserves of the MNB – contributed to the rise in the government's net external debt. Hungary's gross external debt rose to 57.8 percent of GDP, with contributions from the funding of the central bank's swap instrument, the government's foreign currency bond issuances, the rise in non-residents' forint government securities holding and the growth in corporations' external liabilities, while the banking sector's gross external debt – in conjunction with the use of the central bank swaps – declined. Short-term external debt, which is crucial in terms of Hungary's external vulnerability, amounted to EUR 21.5 billion at end-2020. In 2020, foreign exchange reserves rose significantly as a result of the foreign currency bond issuances, the inflow of EU transfers and other items, and thus the reserves still significantly exceed the level expected by investors.

3.1 Net external liabilities

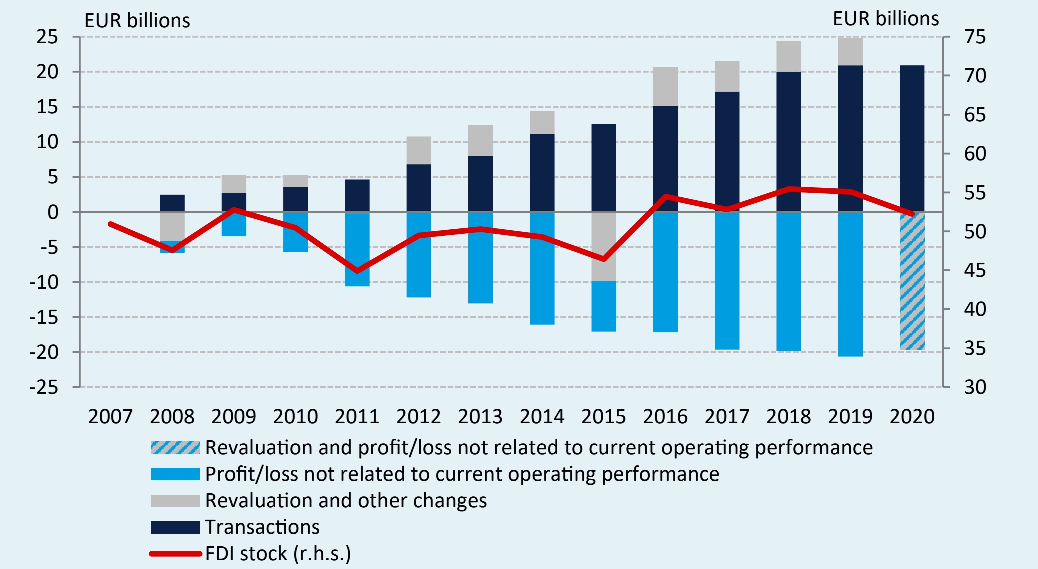
In 2020, Hungary's net external liabilities continued to decline, albeit at a decelerating rate, primarily driven by changes in non-debt liabilities (Chart 24). The gradual fall in net external liabilities, comprising external debt and non-debt liabilities (including foreign direct investment, portfolio equities and derivative liabilities), which has lasted since the crisis, continued in 2020 as well, and by the end of the year it fell to below 50 percent of GDP. The annual decline of roughly 2 percentage points in the ratio as a percentage of GDP was partly linked to the fall in non-debt liabilities, while net external debt remained near its historic low. The fall in net external liabilities is attributable to the banking sector, which was partly offset by the rise observed at the government, while there was no material change in corporations' net external liabilities.

Chart 24: Developments in net external liabilities (period-end values as a percentage of GDP)



After remaining relatively stable in previous year, the net FDI stock contracted in 2020, reflecting the impact of the revaluation of outstanding stocks. Transactions had more or less neutral effect on the net FDI stock, as the growth in domestic companies' investments abroad offset the impact of the foreign direct investment inflow to Hungary. On the whole, the revaluation of outstanding stocks reduced the net FDI stock (we will only receive information on corporations' profit/loss on non-recurring items in September). Based on trends from recent years, foreign direct investment due to transactions has gradually increased, while the rise in non-residents' net FDI stock fell short of that increase (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 2020, these two items reduced the FDI stock by nearly EUR 20 billion in total (for more details on profit/loss of non-recurring items, see the October 2020 Report).

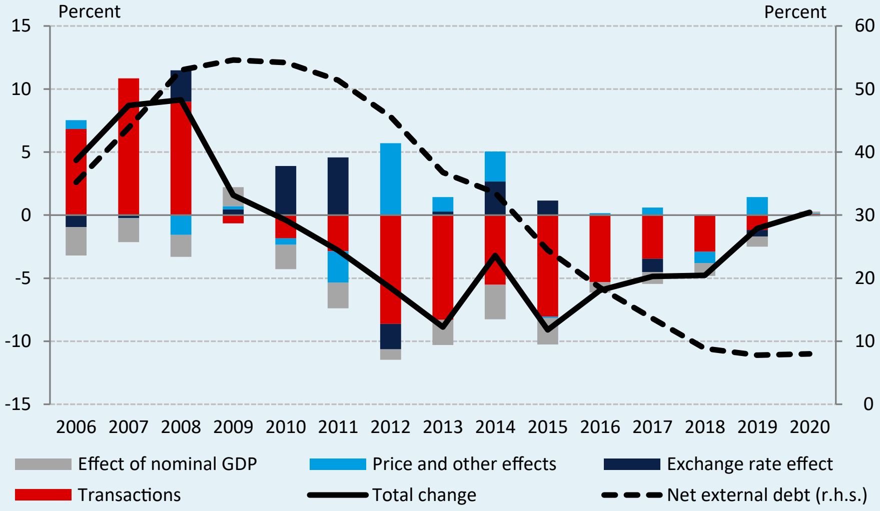
Chart 25: Decomposition of the change in net FDI stock (cumulative transactions and stock)



3.2 Net external debt

At the end of 2020, the ratio of net external debt to GDP was below 8 percent and thus close to the level registered one year ago. The debt ratio, which is near its historic low, is the combined result of the debt-increasing effect of the moderate inflow of debt liabilities and the fall in nominal GDP, mainly offset by the revaluation of outstanding stocks (Chart 26). Following a significant decline observed since the crisis, the debt ratio was relatively stable in the past 3 years, amounting to 8 to 9 percent of GDP. After the outbreak of the 2008 financial crisis, the impact of deleveraging was curbed in 2009 by the fall in nominal GDP 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 46 percentage points, and in addition, the growth in nominal GDP also contributed to the improvement in the indicator to a smaller extent. Compared to its historic low registered at the end of 2019, Hungary's net external debt rose minimally in 2020, by 0.2 percentage point, and it was around 8 percent of GDP at the end of 2020 as well. The moderate inflow of debt liabilities, the fall in nominal GDP and the decline in foreign currency yields (through the rise in the price of non-residents' government securities holdings) contributed to a rise in the debt ratio, which was roughly offset by the debt-decreasing effect of the forint exchange rate at the end of December, as this was weaker than at the end of 2019 (through the higher revaluation of the foreign currency receivables exceeding foreign currency liabilities).

Chart 26: Decomposition of the change in net external debt (as a percentage of GDP)



The changes in net external debt were attributable to the rise in the outstanding debt of the government and corporations, which was offset by the fall in the banks' indicator. The general government's net external debt-to-GDP ratio rose 1.7 percentage points from last year's low level, and thus stood at 9 percent of GDP at end-2020 (Chart 27). The general government debt ratio rose because growth in external liabilities exceeded growth in foreign exchange reserves. This was partly attributable to the increased foreign exchange expenditures of the government due to pandemic prevention measures and the procurement of assets, and partly to the temporary foreign exchange reserve reducing effect resulting from the use of the central bank's euro liquidity providing swap instrument and the fall in the outstanding forint liquidity providing foreign exchange swaps at the end of the year. In addition, the increase in non-residents' HUF-denominated government securities holdings also raised the net external debt. Corporations' net external debt rose moderately in 2020, as the fall in the sector's foreign receivables – related to liquid financial assets – exceeded the decline in its external liabilities due to transactions. The central bank's swap instruments also influenced changes in the banking sector's net external debt. The use of the euro liquidity providing swaps and the decrease in forint liquidity providing swaps both contributed to the major fall in banks' external liabilities – exceeding that in receivables – and thus the sector's net external debt dropped by 2.2 percent of GDP. As a result of the net debt outflow, banks' external assets exceeded their external liabilities again. Taking the banking sector and corporations together, it can be stated that the net external debt of the private sector has been persistently close to zero since 2018 (Chart 28).

Chart 27: Breakdown of net external debt by sectors (as a percentage of GDP, excluding inter-company loans)

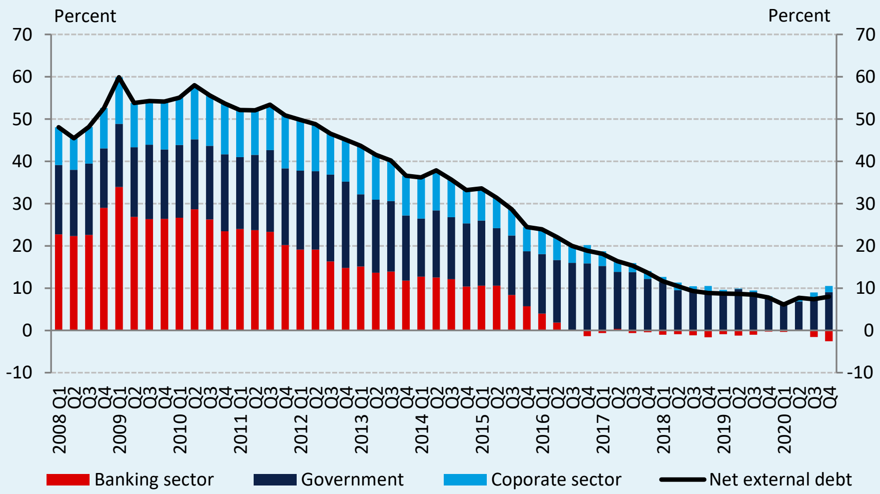
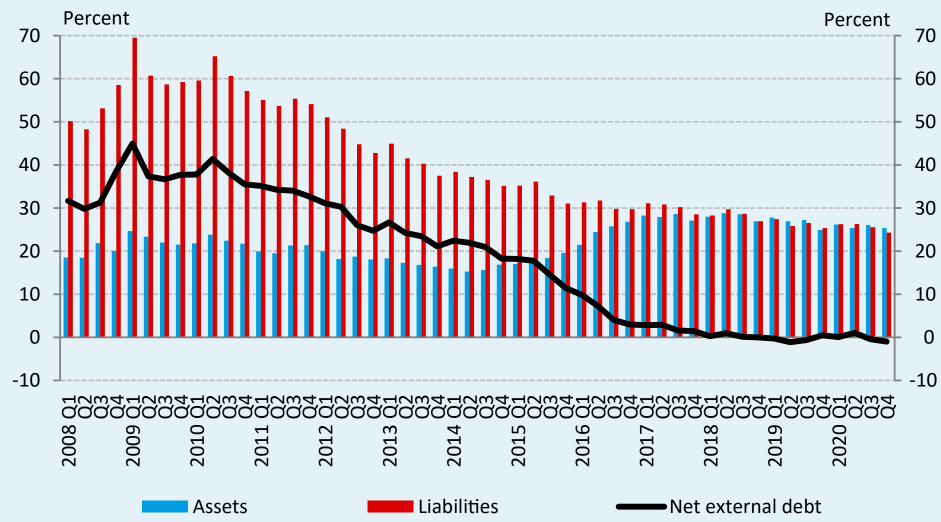


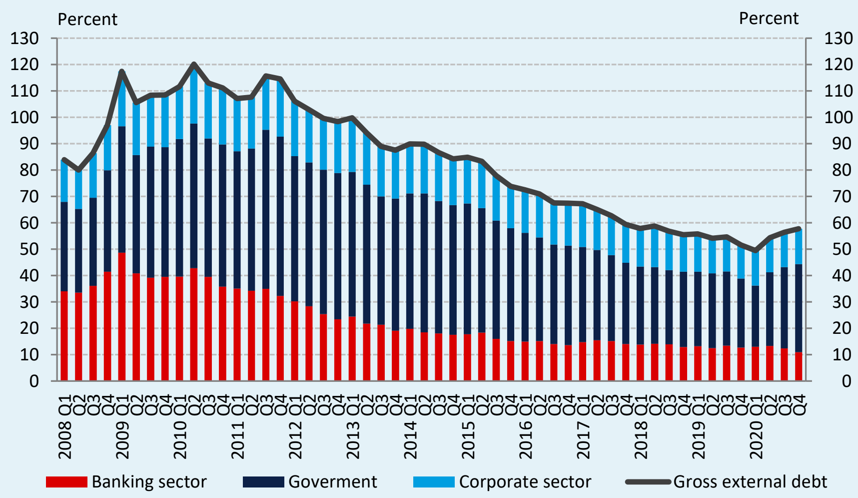
Chart 28: Developments in the private sector's external assets and debt (as a percentage of GDP)



3.3 Gross external debt

Hungary's gross external debt rose due to the general government and corporations, while the indicator for the banking sector declined (Chart 29). By the end of 2020, gross external debt advanced to 57.9 percent of GDP, which was mostly attributable to the rise in the government's debt ratio. The increase in the debt of the consolidated general government including the MNB as a percentage of GDP was attributable to the significant foreign currency bond issuances in 2020; in addition, the funding of part of the central bank's euro liquidity providing swap instrument also contributed to the higher debt ratio. To a smaller degree, the rise in corporations' debt ratio also boosted Hungary's gross external debt: in addition to the increase in the sector's external liabilities due to transactions, the revaluation arising from the weak forint exchange rate against the euro also generated rising balances. On the other hand, the banking sector's debt ratio declined in 2020 as a result of the fall in the sector's external liabilities, which was also attributable to the foreign currency liquidity provided through the central bank's swap instruments.

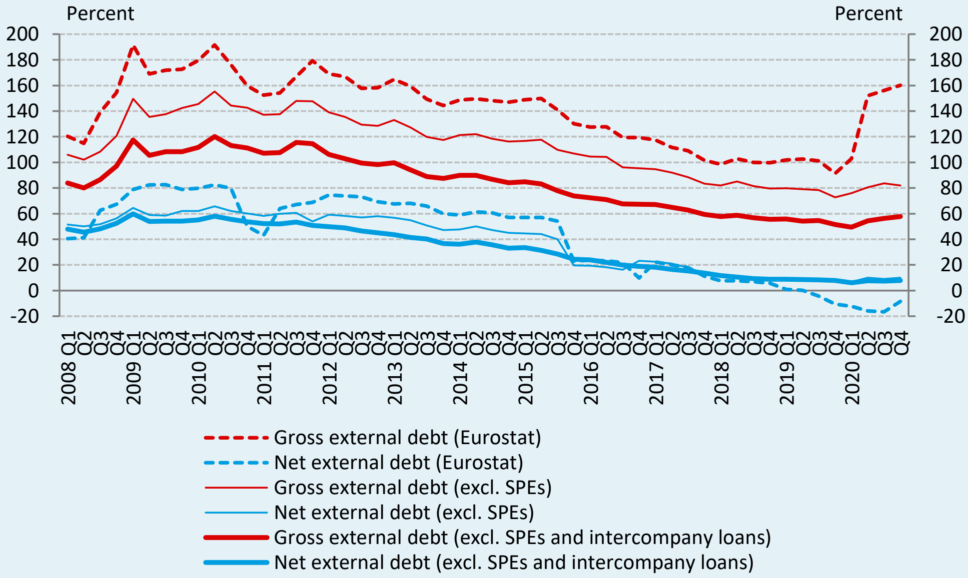
Chart 29: Breakdown of gross external debt by sector (market value as a percentage of GDP, excluding intercompany loans)



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

Regardless of SPEs and intercompany loans, net external debt reached a historical low, but in the case of gross external debt, the indicators including SPEs and intercompany loans also 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 they 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 investment. In accordance with 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. At the end of 2020, net external debt, calculated by Eurostat, amounted to 8.3 percent (i.e. according to the ratio also including SPEs, the stock of external assets exceeds that of external debt), while the net external debt ratio calculated without SPEs, but including intercompany loans stabilised close to the baseline indicator used in this report, i.e. around 10 percent of GDP (Chart 30). 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. However, in 2020 gross external debt calculated by Eurostat soared, which highlights the fact that the indicator which also takes into consideration SPEs not pursuing real economic activity in Hungary – and the change in it resulting from idiosyncratic factors – may conceal real economic trends.

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

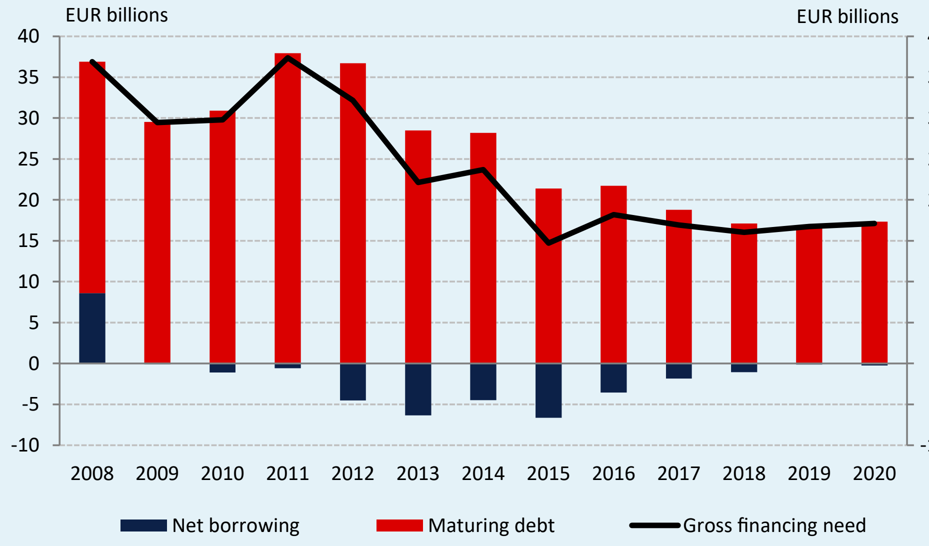


Source: Eurostat and MNB.

3.4 Gross borrowing need and reserve adequacy

Hungary's gross financing need amounted to EUR 17.1 billion in 2020. After a gradual decline lasting since 2011, the gross financing need stabilised at around EUR 16-17 billion in the past three years. At end-December 2019, short-term external debt – i.e. expiring in 2020 – amounted to EUR 17.4 billion, which represents a moderate increase of EUR 0.5 billion compared to the previous year's level (Chart 31). Net lending, showing Hungary's external funding need, calculated from the financial account items, amounted to EUR 0.3 billion. Accordingly, the gross financing need, which shows the value of the external liabilities of the Hungarian economy to be renewed in a given year amounted to EUR 17.1 billion.

Chart 31: Developments in the gross financing need



Compared to September 2020, the level of FX reserves increased by EUR 1.5 billion in 2020 Q4, and amounted to EUR 33.7 billion at end of the year. The development of reserves was affected by various factors, the most important of which were the following:

- The reserve-increasing effect of EU funds was some EUR 1.7 billion, resulting primarily from the payment by the European Commission of the performance-based invoices of the 2014–2020 EU budget cycle and to a lesser degree from agricultural subsidy programmes.
- The *net FX financing of the Government Debt Management Agency (ÁKK)* raised reserves by EUR 2.8 billion in total, the larger part of which – EUR 2.5 billion – is linked to the issuance of 10-year and 30-year euro bonds in November.
- The reserve-reducing effect of the *foreign currency transactions of the Hungarian State Treasury and other foreign currency expenditures of the Government Debt Management Agency* exceeded EUR 1 billion.
- The change in the stock of the forint liquidity providing FX swap instrument reduced the reserve level by nearly EUR 400 million. The outstanding swap contracts in forint amounted to EUR 4.5 billion at the end of December 2020.
- The reserves were also decreased by *revaluations* of other currencies stemming from their strengthening against the euro as well as by the revaluation of gold expressed in euro.
- On the other hand, the balance *of the euro liquidity providing swap instrument* and the *international repo drawdowns* reduced reserves compared to end of September.

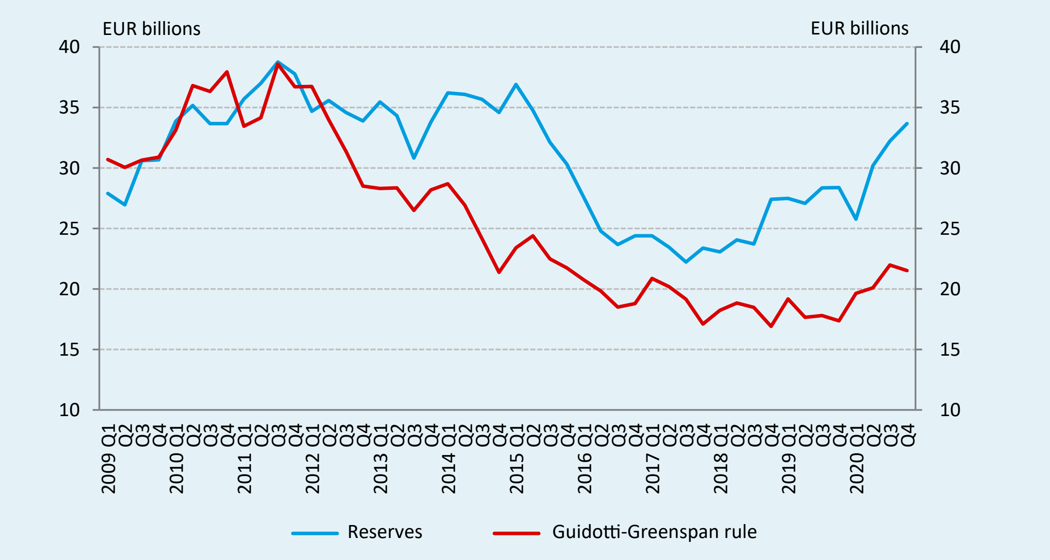
In the course of 2020, the MNB's international reserves rose by EUR 5.3 billion. The impact of EU transfers and the issuance of foreign currency bonds was only partly mitigated by the treasury's foreign currency expenditures and the fall in outstanding central bank's forint liquidity providing swap contracts. Foreign exchange reserves increased from EUR 28.4 billion registered at the end of December 2019 to EUR 33.7 billion by the end of 2020, due to the following factors:

- The annual net amount **of transfers from the European Commission related** to FX reserves exceeded EUR 4.2 billion.
- In addition, *net foreign currency funding by the Government Debt Management Agency in the amount of EUR 3.7 billion* contributed to the strong growth in reserves.
- Reserves were also increased *by the foreign currency deposits placed by Hungarian credit institutions.*

- In annual terms, the swaps providing the banking sector with euro liquidity reduced foreign exchange reserves, while the drawdown of international repos, used for their funding, had an opposite effect.
- These items were offset to some degree by the negative balances *of the Hungarian State Treasury's foreign currency expenditures – also including healthcare procurements – and the foreign currency interest expenditures.*
- In 2020, the fall of over EUR 2 billion *in outstanding forint liquidity providing swap contracts* generated a further decrease.

At the end of 2020, the MNB's international reserves exceeded the level of short-term external debt, which is closely monitored by investors, by EUR 12.2 billion. At end-December 2020, international reserves and short-term external debt amounted to EUR 33.7 billion and EUR 21.5 billion, respectively. Accordingly, the reserve adequacy compared to short-term external debt improved by EUR 2 billion in 2020 Q4 compared to the previous quarter, while the leeway above the Guidotti–Greenspan indicator, which is closely followed both by the central bank and investors, reached EUR 12 billion at the end of the year (Chart 32).

Chart 32: Short-term external debt of the Hungarian economy and international reserves

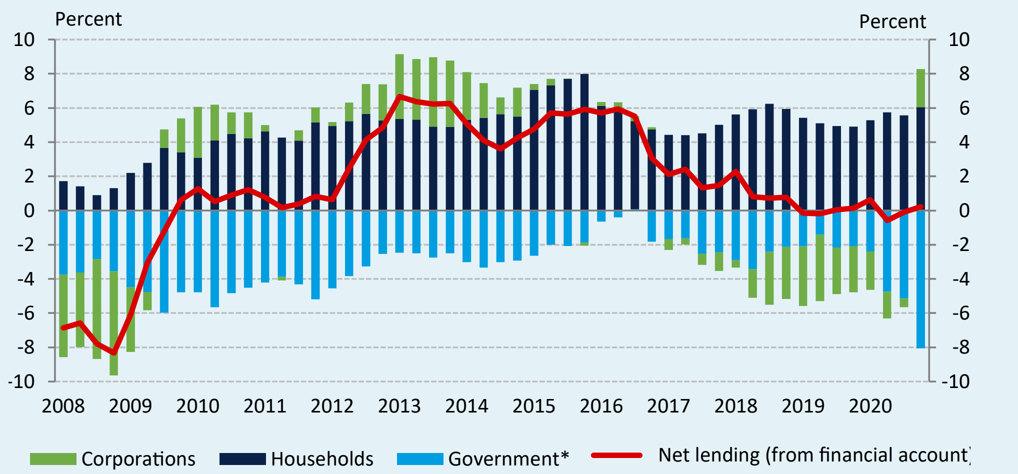


4 Savings approach

In 2020, the government's net borrowing rose as a result of falling revenues and sharply higher expenditures, due to the economic impacts of the pandemic. In parallel with this, the financial savings of the private sector rose; accordingly, Hungary's net external position calculated using the savings approach was roughly zero throughout the year. With the higher budget deficit and declining GDP, the downward trend in government debt that had been observed in previous years was interrupted: as part of this, the foreign currency ratio rose moderately, while the ratio of foreign investors' government debt holdings continued to fall. The latter process was mainly attributable to the unbroken robust household demand for government securities, which also provided stable financing for the general government during the crisis and reduced its vulnerability.

At the end of 2020, the structure of sectors' savings changed significantly: in connection with the pandemic, the general government deficit rose sharply, which was more or less offset by the growth in private sector's financial savings (Chart 33). 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 rose significantly in 2020. In addition to the falling tax revenues resulting from the contraction of the economy, net borrowing increased due to the rising costs of the economy protection and pandemic containment measures. With declining consumption due to the lockdowns, households' financial savings increased substantially (for more details, see the special topic of the January 2021 Report). In parallel with this, the corporate sector reduced its investments, as a result of which the four-quarter value of the net position shifted to net lending. The moratorium on loan instalments, which was introduced in spring 2020, lowered the repayment of private sector loan debts, at the same time the unspent part of the instalments also appeared in the accumulation of financial assets.

Chart 33: Net lending of specific sectors (four-quarter values as a percentage of GDP)



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

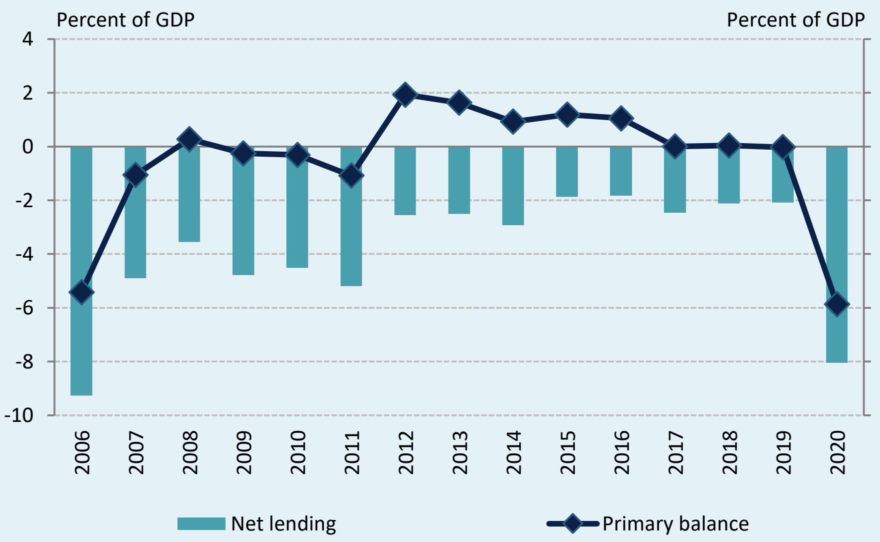
4.1 General government

The general government's net borrowing rose significantly in 2020. Based on preliminary financial accounts data, general government net borrowing amounted to 8 percent of gross domestic product in 2020 (Chart 34). The high budget deficit[4] was the consequence of the costs related to the containment of the pandemic, the measures of the Economy Protection Action Plan and the lower tax revenues stemming from the economic slowdown. The slower economic growth reduces tax revenues compared to the plans, while the fiscal measures provide the economy with

4 Data regarding the ESA budget balance is not yet available for 2020; however net lending calculated based on the preliminary financial accounts data usually only differs from the ESA balance to a minor degree.

additional funds, thereby boosting growth and resulting in countercyclical fiscal policy. In 2020, government interest expenses rose temporarily due to the growth in government debt and the downturn in economic growth, while the persistently low interest environment partially offset the growth in expenditures.

Chart 34: Developments in the net lending of the general government (as a percentage of GDP)

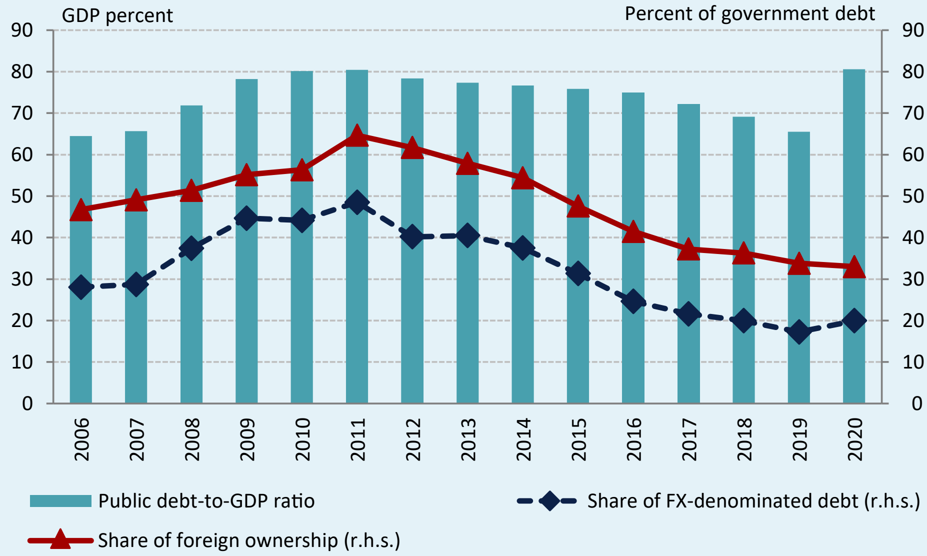


Note: 2020 data based on the preliminary financial accounts of the MNB.
Source: MNB and Eurostat.

The downtrend in the gross government debt-to-GDP ratio seen since 2011 was temporarily interrupted in 2020 (Chart 35). By the end of 2020, as a result of the higher expenditures due to the deteriorating economic environment resulting from the pandemic and the measures necessary to mitigate the economic impacts of the pandemic, government debt rose to 80.6 percent of GDP. In addition to the rise in the budget deficit and the economic slowdown, growth in liquid reserves (Single Treasury account and currency deposits) and the revaluation of foreign currency debt also contributed to the higher government debt.

As a result of the currency bond issuances, the foreign currency ratio of the government debt increased somewhat by end-2020, while the ratio of non-resident holdings in government debt continued to fall. In 2020, the Government Debt Management Agency carried out foreign currency issuance in the amount of HUF 1,650 billion, of which the net foreign currency bond issuance amounted to HUF 1,375 billion, while the gross foreign currency bond issuance exceeded HUF 2,300 billion. In June 2020, the Debt Management Agency issued international green bonds – for the first time in Hungary – in the amount of EUR 1.5 billion (HUF 517 billion), followed in September by two green bond issuances denominated in Japanese yen, in the amount of JPY 20 billion (HUF 58 billion). The special feature of green bonds is that the issuer may use the proceeds from those for the funding and refinancing of certain green expenditures of the central budget, in accordance with the Green Bond Framework. The aggregate market value of the green bonds amounted to HUF 671 billion at the end of 2020. With the foreign currency bond issuances, the foreign currency ratio of central government debt rose to 19.9 percent from 17.3 percent registered in 2019. One of the key objectives of the government's debt management strategy is to strengthen domestic financing, owing to which the ratio of non-resident holdings within government debt may have declined close to 33 percent by the end of 2020, continuing the trend seen since 2011. The moderate non-resident holdings and the foreign currency ratio are key to the decrease in external vulnerability and to Hungary's continuing favourable credit rating.

Chart 35: Developments in gross public debt, the proportion of non-resident holdings and the FX ratio

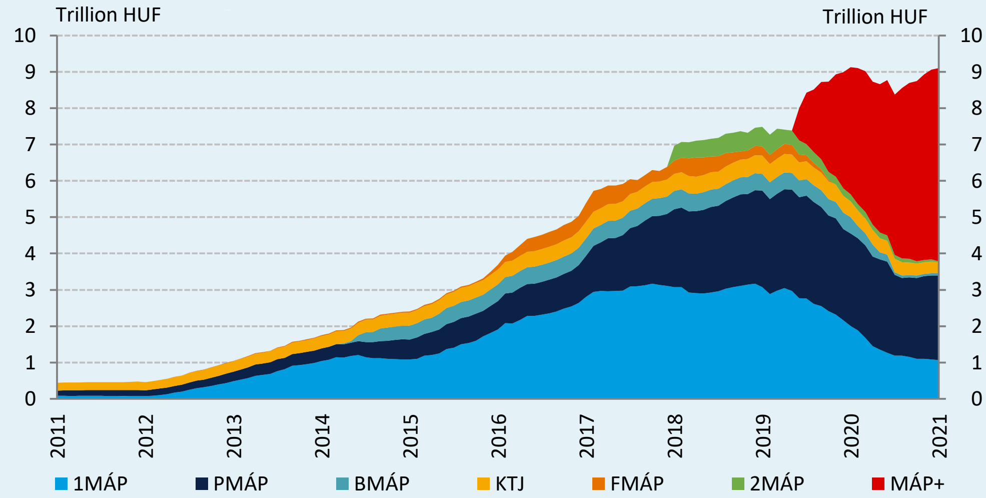


Note: Ratio of non-resident holdings based on nominal value; the 2020 value is an MNB estimate.
Source: ÁKK and MNB.

In 2020, households' government securities holdings continued to expand, with the Hungarian Government Securities (MÁP) Plus playing a significant role in this. The renewal of the retail government securities strategy in 2019 (the key elements of which include the introduction of MÁP Plus, the simplification of the product offering and the tax exemption of interest income) continues to support favourable changes in the debt structure. In 2020, household demand for government securities remained buoyant, but was more moderate than in 2019. On the one hand, it may be regarded as a natural phenomenon that demand declines after the initial momentum and the completion of portfolio restructuring, while on the other hand, the coronavirus, which appeared in spring 2020, and the related economic downturn and restrictive measures, also contributed to this. Although purchases of retail government securities declined and redemptions increased as a result of the uncertainties caused by the virus and the curfew measures, this proved to be only temporary.

It should be noted that MÁP Plus also guaranteed a stable positive return for households in the critical period of spring 2020, which may have contributed to the fact that while non-resident investors started to sell government securities, amidst major volatility, households' MÁP Plus holdings expanded. Based on the foregoing, it may be stated that the financing of government debt relying on domestic funds and MÁP Plus were key to the resilience of the government securities market even in the uncertain period caused by the coronavirus. Owing to this, the coronavirus and the sudden surge in net borrowing linked to the crisis management measures impacted the Hungarian economy in a much more stable position than in the 2008 financial crisis. On the whole, outstanding government securities held by households rose by more than HUF 1,000 billion in 2020, thereby exceeding HUF 9,000 billion by the end of the year, with MÁP Plus accounting for more than half of this (roughly HUF 5,200 billion). It should be added that in terms of developments in households' savings, the strengthening in households' propensity to save offsets the impacts of the economic difficulties caused by the virus. This saving trend is able to ensure that households' demand for government securities remains strong looking ahead as well, and that the share of government securities within savings stabilises at a high level.

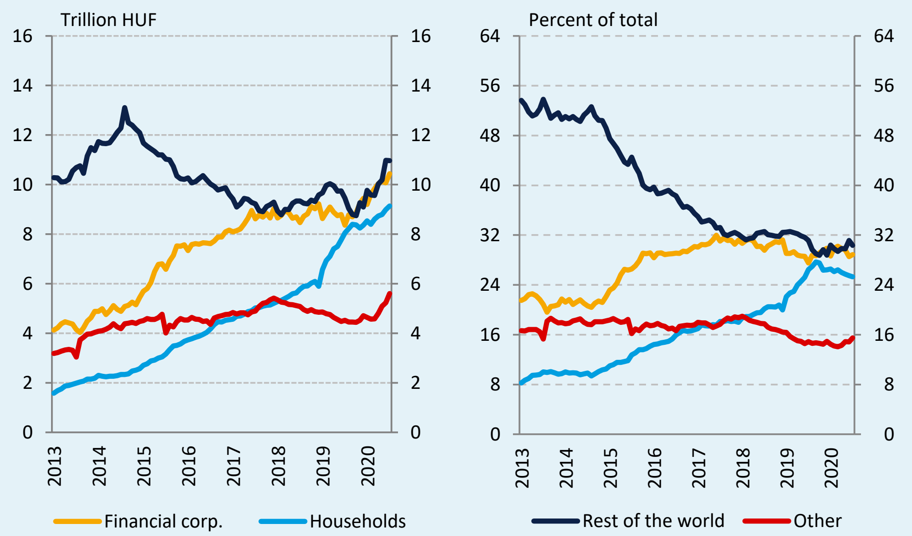
Chart 36: Retail government securities holdings



Note: Data are available until January 2021.
Source: ÁKK.

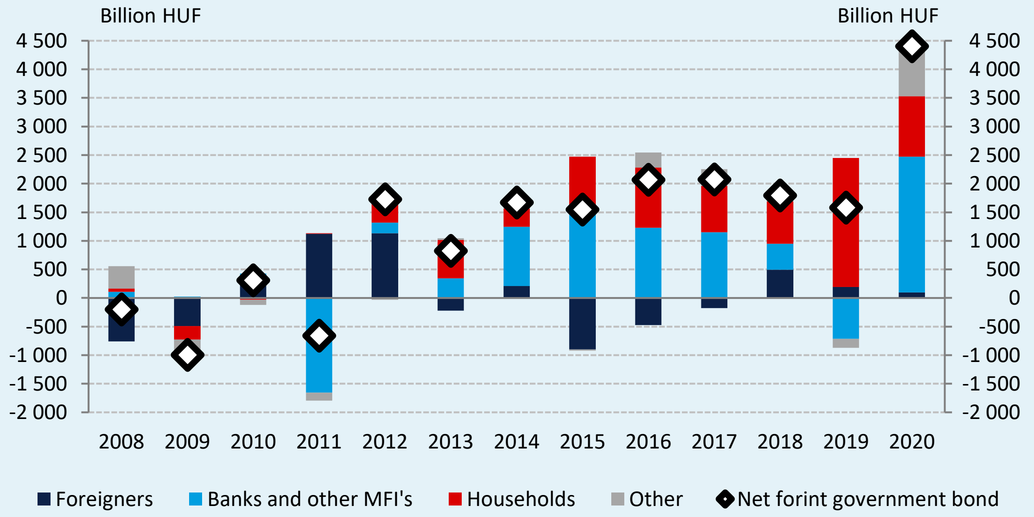
The government securities holdings of all holder sectors rose in 2020, while the ratio of domestic holdings increased, and as a result of the growth in longer-term government securities the average duration of the government debt also increased. Non-residents' holdings of Hungarian government securities (denominated in foreign currency and forint) expanded by HUF 1,500 billion in 2020 (Chart 37): of this, government securities denominated in foreign currency accounted for roughly 97 percent as non-residents' holdings of forint government securities rose by roughly HUF 50 billion, while their foreign currency bond holdings rose by almost HUF 1,460 billion. However, due to the increasing share of domestic sectors, non-residents' share within the total portfolio decreased moderately and was around 30 percent. The forint government securities holdings of the banking sector rose by roughly HUF 2,100 billion. With a view to fostering the efficiency of monetary policy transmission and maintaining the stable liquidity position of the government securities market, the MNB made targeted government securities purchases in the longer segment from May 2020. The central bank's government securities holding rose by roughly HUF 1,000 billion in 2020, accounting for 3 percent of the entire portfolio. With the increase in longer-term bonds, the duration of Hungarian government debt rose by more than 1 year to 5.2 years in 2020.

Chart 37: Government securities holdings of households, banks and non-residents



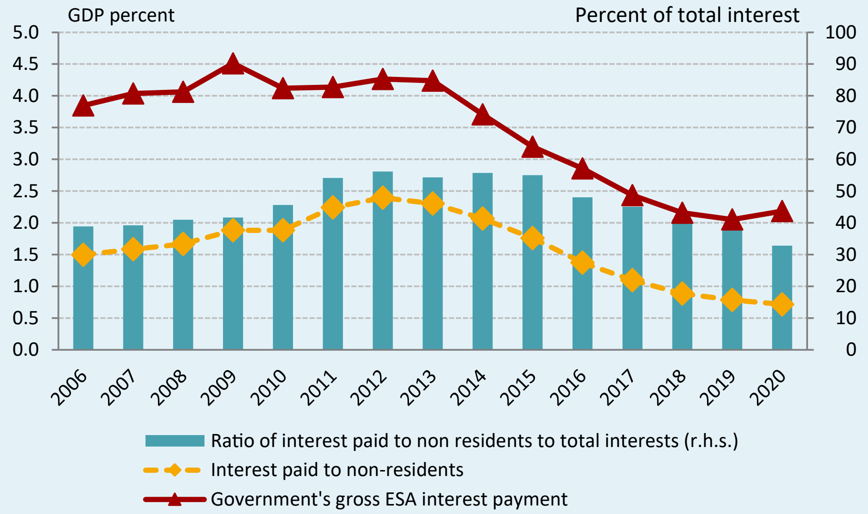
Source: MNB.

Chart 38: Changes in the forint government securities portfolio by sectors



In 2020, government interest expenses amounted to 2.2 percent of GDP. Interest expenditure remained low in historical terms, and the amount of interest paid to non-residents declined further (Chart 39). After a steady decrease for seven years, as a result of the rise in government debt and the decline in economic growth, government interest expenditures rose by 0.1 percentage point compared to 2019. However, the persistently low yield environment seen in recent years curbed the growth in expenditures significantly. Following the temporary rise in expenditures, due to the anticipated fall in government debt and the continuation of repricing to the low yield level, interest expenditure may decline moderately in the future. In 2020, government interest paid to non-residents fell to 0.7 percent of GDP, accounting for roughly 33 percent of the total interest expenditure. Last year, forint bonds accounted for the largest part of the increasing issuance, and thus the ratio of interest paid on these instruments rose within interest expenditures. As a result of the fall in non-residents' ownership share within government debt, 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, the decline in non-residents' debt holdings may continue in coming years, and thus the ratio of interest paid to them may keep falling.

Chart 39: Developments in the interest expenditures of the general government

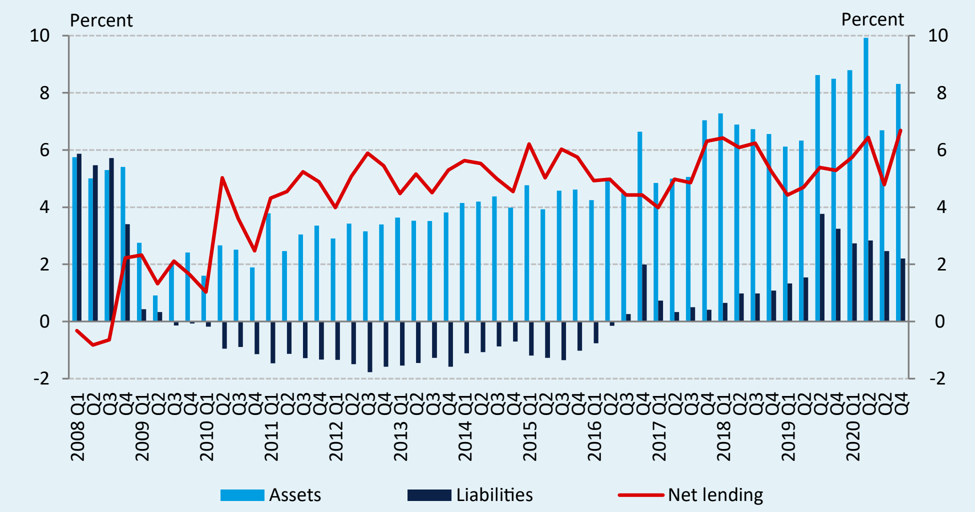


Note: The data do not contain the imputed interest expenditures incurred since 2012 on account of the pension system reform. Data for 2020 are MNB estimates.
Source: MNB and Eurostat.

4.2 Household sector

Based on the underlying trends, households' net lending rose to a historic high in 2020 Q4, advancing to 6.7 percent of GDP (Chart 40). Changes in households savings trends in 2020 were fundamentally determined by the pandemic. After the first wave of the pandemic subsided, the return of consumption postponed from the second quarter was reflected in lower accumulation of financial assets in the third quarter, which – even with moderately declining borrowing – resulted in a substantial fall in net financial savings. However, the worsening of the pandemic situation at the end of the year once again raised households' cautiousness, and seasonally adjusted net savings rose to 6.7 percent of GDP, reaching a historic high. Growth in borrowing was driven by the prenatal baby support loans: in parallel with the stable rise in housing loans, the drawdown of prenatal baby support loans gradually declined from a high level in the second half of the year.

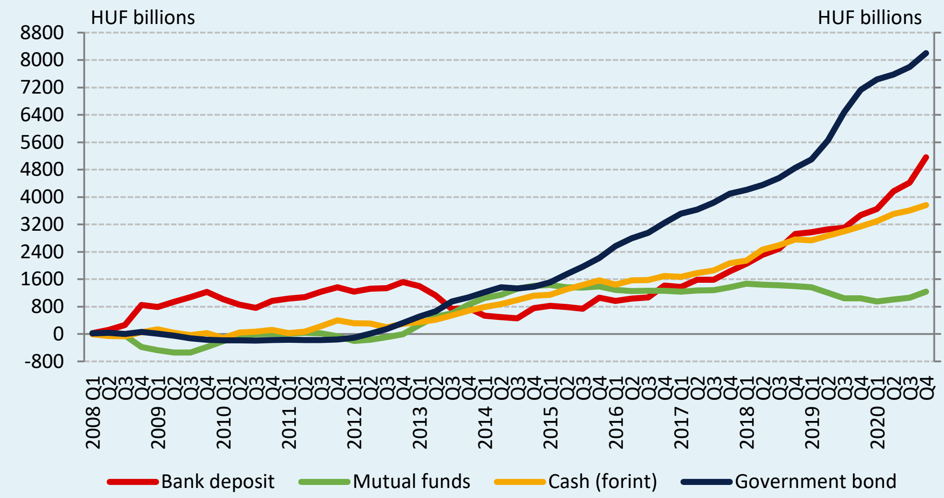
Chart 40: Net lending of households (seasonally-adjusted, revised* values, as a percentage of GDP)



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

Demand for retail government securities continued to surge in 2020, helping lower the external vulnerability of the state by financing the general government from domestic funds (Chart 41). The steady expansion in retail government securities holdings since 2012 continued in 2020 as well, mainly due to the new Government Security Plus (MÁP+), which provides a considerable yield advantage and high liquidity in the low yield environment. By end-2020, households' government securities holdings increased to more than HUF 9,100 billion, of which holdings of the MÁP+ accounted for nearly HUF 5,200 billion in half a year. Accordingly, households invested most of their new savings in government securities, but savings held in bank deposits also expanded considerably. Growth in cash savings was in line with trends from previous years despite the fact that cash demand surged temporarily in March, owing to the mounting uncertainties. Mutual fund share holdings rose moderately, which mostly impacted bond and real estate funds, in addition to equity and mixed funds. In the government securities market, MÁP+ had overwhelming dominance: savings in the new paper rose by more than HUF 2,000 billion, while holdings of Premium Hungarian Government Securities and shorter-term securities declined. Households' robust demand for government securities facilitated the domestic funding of the general government in 2020 as well, which is favourable with respect to Hungary's external vulnerability.

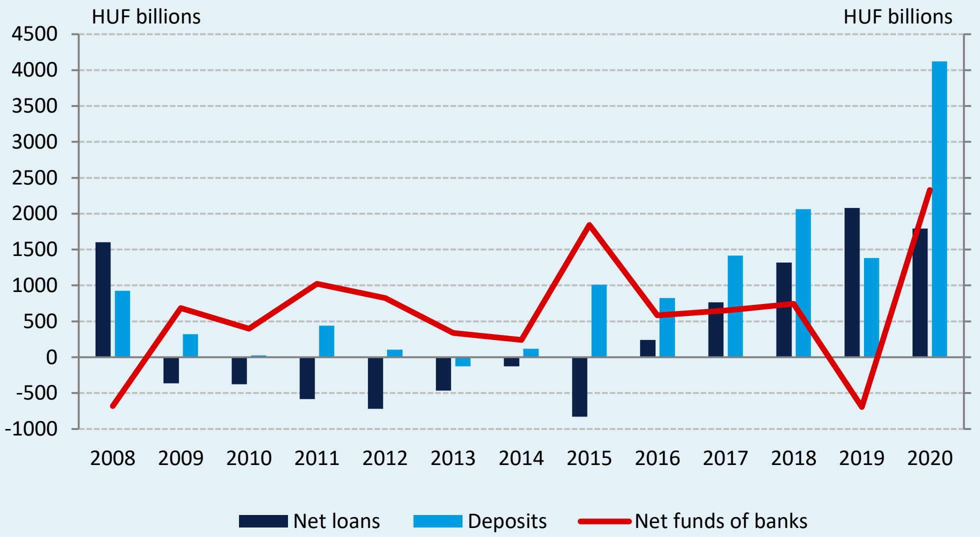
Chart 41: Developments in households' key financial assets (cumulative transactions)



Box 3: Developments in the private sector's bank loans and deposits

Private sector borrowing slowed down slightly in 2020, while new deposits almost trebled; accordingly, banks recorded net inflow of funds from the private sector. 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 (Chart 42). Growth in private sector net borrowing decelerated in 2020, which is mostly attributable to the pandemic. In parallel with this, the volume of new deposits rose once again following the interruption observed last year. The outstanding volume of new deposits is primarily connected to postponed consumption and investment, which may have been supplemented by the impact of the moratorium on loan instalments and the significant government spending at year-end. In accordance with this, net liabilities of banks grew significantly, i.e. in addition to lending by banks, new deposits of the private sector facilitated the financing of other bank operations (e.g. purchase of government securities).

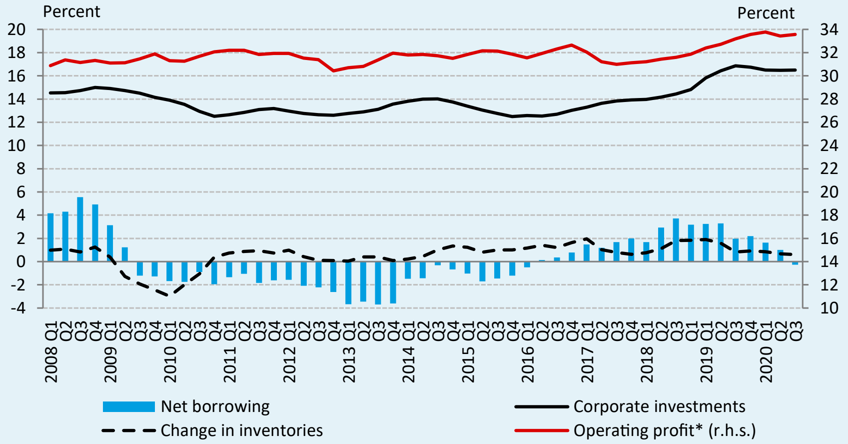
Chart 42: Developments in the private sector's bank loans and deposits



4.3 Corporate sector

Due to income and absorption factors, the net borrowing of the corporate sector dropped substantially, which contributed strongly to the stable external balance position even with the rising budget deficit. The operating profit of non-financial corporations fell during the year to a lesser degree than GDP, and thus the indicator as a percentage of GDP rose moderately, while corporations steadily absorbed their inventories due the economic impacts of the crisis. In parallel with this, owing to the fall in external and domestic demand, corporations' investment activity decelerated until the third quarter, contributing to the fall in net borrowing. As a combined result of these impacts, corporations' net borrowing gradually dropped to nearly zero during the year (Chart 43).[5]

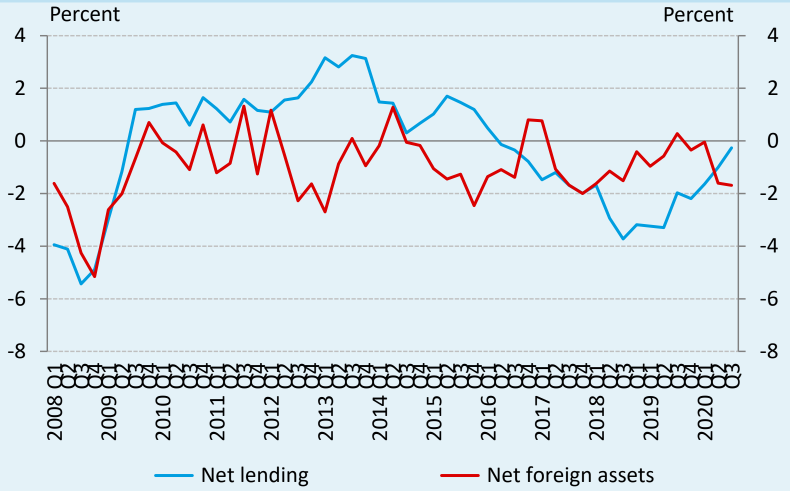
Chart 43: Non-financial corporations' net borrowing relative to GDP and its main factors (four-quarter values)



** Indicator adjusted for companies' interest and shareholder incomes. Data related to net borrowing are only available until the third quarter.*
Source: HCSO and MNB.

Despite the rising net lending of non-financial corporations, the negative value of the change in the sector's net foreign assets implies a substantial increase in foreign currency borrowing (Chart 44). The rise in corporate liabilities was attributable to the increase in bank loans and corporations' foreign – partly intercompany – loans, while liabilities from reinvested earnings also grew. Accordingly, the sector's declining net borrowing is attributable to the fall in domestic borrowing: the growth in bank loans was significantly outstripped by the rise in domestic bank deposits, which contributed to the growth in corporations' net savings.

Chart 44: Net lending and net external transactions of non-financial corporations (four-quarter data, as a percentage of GDP)



Note: For the corporate sector the latest data according to the financial accounts is from 2020 Q3.

5 Financial accounts for 2020 Q4 will only be published after the editorial deadline for this report.

5 Regional overview

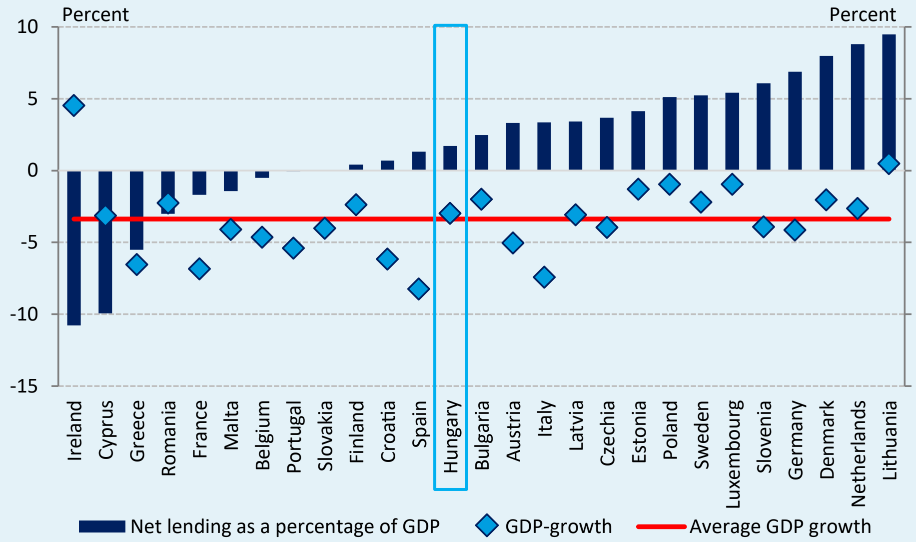
Hungary's net lending exceeded the typical average of the countries in the region in 2020 as well. Developments in the countries' external balance position were largely influenced by the impact of the lockdowns due to the coronavirus. With the exception of Romania, most countries in the region were characterised by rising net lending, attributable to growing trade balances and the impact of the improving income balance and transfer balance. Lockdowns and restrictions significantly influenced changes in net exports. The decline in tourism and transportation services exerted the largest effect on Hungary's services balance. Following the typical decline in the second quarter, in the second half of the year the trade balance increased in most of the regional countries, the impact of which was corroborated by the fall in foreign companies' profits and rising inflow of EU funds. Besides the external environment, regional developments also reflect the effects of internal factors: domestic absorption typically declined in the region, also driven by the drop in investment activity and the slowdown in consumption. In line with this, the private sector's net financial savings rose, while the government's borrowing requirement increased significantly due to the falling revenues resulting from the pandemic, the absorption of the negative economic impacts and the costs of prevention in all countries of the region. In 2020, the fall in net external debt indicators typically continued in the region, which is partly attributable to the faltering inflow of foreign direct investment. In a regional comparison, Hungary's net external liabilities and debt correspond to the level observed in other countries.

The regional overview section of our special topic presents the developments in Hungary's external balance in comparison to those of the countries in the region. In terms of the balance of payments figures, Hungary should primarily be compared to countries which are at a similar level of development and face similar challenges. Accordingly, our regional overview 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 Visegrád countries.

5.1 Brief overview of the situation in Europe

Hungary's net lending and economic decline in the pandemic situation was close to the EU average (Chart 45). In 2020, external balance developments and economic performance in EU countries were strongly influenced by the impacts of the lockdowns due to the pandemic. In the European Union, economic downturn was a general phenomenon, the rate of which was determined by the degree of the restrictions introduced in the individual countries, also depending on the severity of the pandemic (with the exception of Ireland, which for tax optimisation reasons from time to time showed extreme growth in previous years as well, while in 2020 the impact of Brexit may also have generated additional economic growth). The countries which faced explosive growth in the pandemic and were consequently forced to implement longer and stricter lockdowns (e.g. Italy, Spain) suffered sharper economic downturns, while the decline in economic performance was also more moderate in countries impacted by the pandemic to a lesser degree or with more resilient economic structure in terms of the lockdowns (e.g. Baltic states). Based on the chart, net lending was lower in the countries that suffered sharper economic downturns, which may be attributable to the impact of the decline in the trade balance on both indicators. Hungary's net lending, which falls short of the Polish and Czech figures but exceeds the Slovak and Romanian levels, was slightly above the average of the region. The degree of the economic decline in Hungary and the developments in the external balance position were in line with the trends observed in the EU.

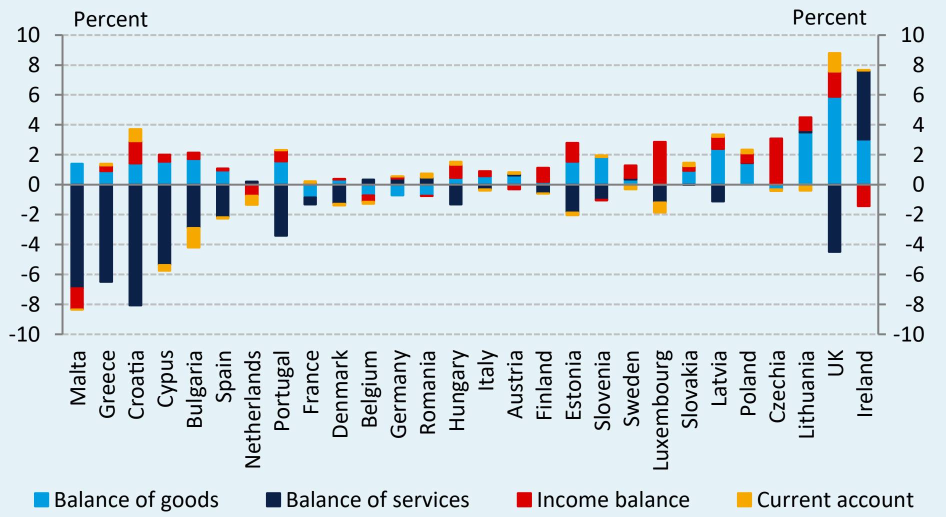
Chart 45: Developments in net lending and growth in 2020



** Annual volume changes in four-quarter GDP between 2019 Q4 and 2020 Q3.*
Source: Based on the European Commission's estimate.

The pandemic impacted the current account of the European countries depending on the factors primarily influencing the development of this item (Chart 46). In the economies that had high services surplus, particularly tourism, before the pandemic, the current account balance contracted significantly. In Croatia, Greece and Malta, as major tourism destinations, the fall in services exports reduced the current account balance by 6-8 percent of GDP. The goods balance improved in the vast majority of the countries, due to the lower imports resulting from weaker domestic absorption. Corporate profits, which fell as a result of the pandemic, also typically improved the external position of European countries via the income balance. In the case of the United Kingdom and Ireland, Brexit also may have influenced the services balance: in connection with the relocation of services companies from the United Kingdom, the balance of the UK may have decreased, while that of Ireland may have increased in the period under review.

Chart 46: Changes in the factors of the current account balance as a percentage of GDP in one year until 2020 Q3

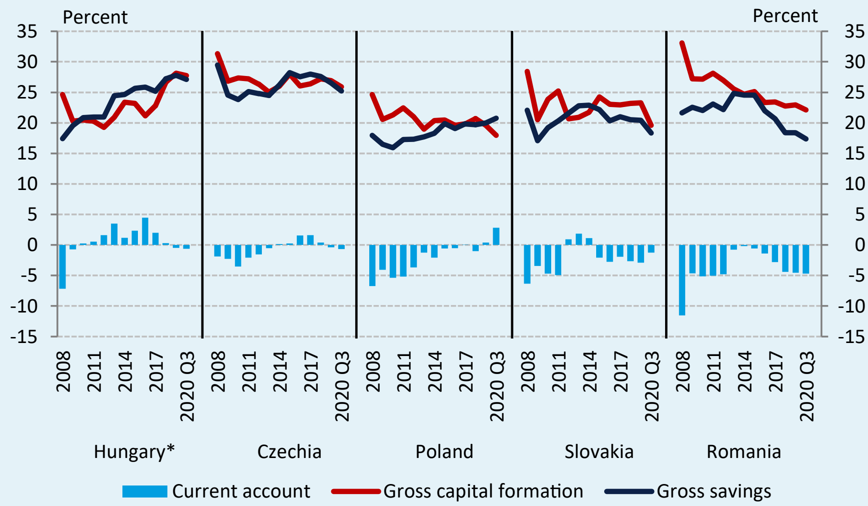


Note: changes in four-quarter values.
Source: Eurostat.

5.2 Gross saving and investment

As a result of the pandemic, gross capital formation expenditures declined in all countries of the region; however, due to the different developments in gross savings there were major differences in the degree of change in the external balance figures (Chart 47). An economy's current account balance is determined by the difference between gross savings (an indicator obtained as the difference between income and consumption) and the accumulation-type expenditures of the national economy (investment and inventories). After the outbreak of the 2008 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. In the past 2-3 years – with the exception of Poland – the current account balance typically declined. In connection with the slowdown in investment activity in 2020 due to the pandemic, the rate of gross capital formation declined in all countries of the region compared to the previous year, while the saving rates responded to the pandemic situation differently in the individual countries. Both the investment and savings rate continued to be the highest in Hungary: due to the more moderate consumption resulting from the restrictions and households' more cautious savings behaviour, there was only a slight decrease in the latter, which was also reflected in the relatively stable current account balance. In the Czech Republic – where both indicators are similarly high as in Hungary – both investments and gross savings decreased slightly. In Poland, along with decreasing gross capital formation, the saving rate continues to rise, and thus the current account shows an outstanding surplus in a regional comparison. In Slovakia, the decline in savings fell short of the decrease in gross capital formation as a percentage of GDP, which was accompanied by a decrease in its current account deficit. In Romania, the current account balance has been deteriorating since 2014, which is explained by the fact that gross savings have declined significantly with a moderate decrease in accumulation rate, which indicates a rise in consumption increasingly in excess of income growth.

Chart 47: Developments in gross savings and total investment ratios (as a percentage of GDP)*



** By 2020, the gross savings ratio will be derived from the accumulation and current account data. 2020 values in the rest of the region are based on WEO estimates.*
Source: MNB, HCSO, WEO.

5.3 Real economic factors of net lending

In the second half of the year, the external balance typically improved in the regional countries (Chart 48). Based on real economy data, Hungary's four-quarter net lending was below the Czech and Polish levels in 2020, but exceeded the previous year's Hungarian figure. The decline in Hungary's external balance position which characterised recent periods stopped in mid-2020, switching over to a rise in the second half of the year. Similar processes occurred in the region: net lending rose substantially in the Czech Republic and Slovakia in the third quarter of 2020, while it rose in Poland both in the second and third quarters, presumably as a result of the fall in capital expenditures. In contrast to the region, there was no significant change in the indicator in Romania in 2020, which still shows a borrowing requirement close to 3 percent.

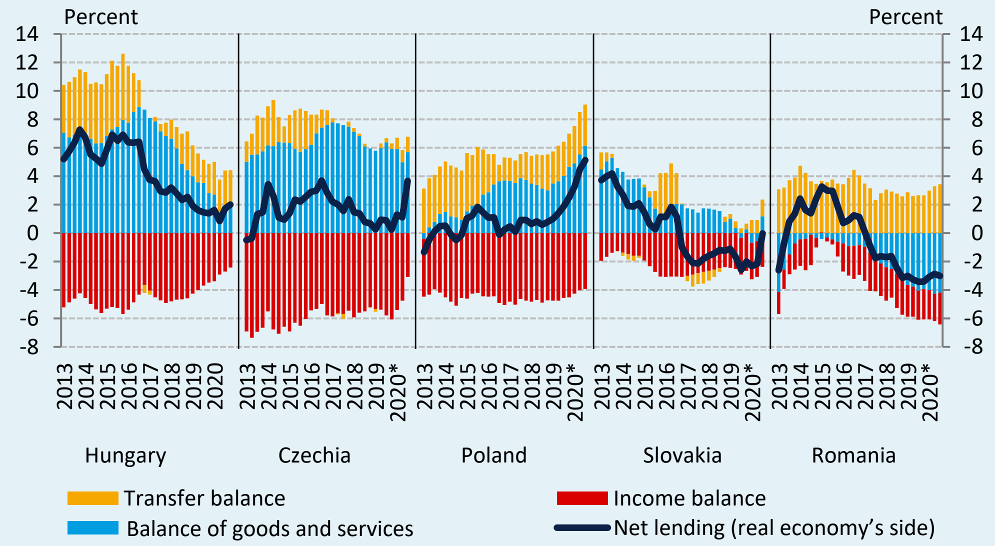
Changes in external balance indicators were determined by the following factors:

- Following the decline registered in recent years, **the goods and services** surplus as a percentage of GDP in Hungary continued to fall in the first half of 2020, due to the downturn in the tourism and transportation sectors as a result of the pandemic. On the other hand, the goods deficit rose significantly at the end of 2020, which partially offset the weaker performance of the service sector, and thus the trade surplus came close to the Q1 value, as it was less affected by the impacts of the pandemic. The trade balance in the Czech Republic and Poland is outstanding, at around 6 percent, supported by the relatively stable services balances as well as by the dynamically increasing goods balance in Poland and the goods balance returning to its previous level in the case of the Czech Republic. In Slovakia, the trade balance turned around in the third quarter, as the fall in the goods balance from the first half-year switched to a rise in the third quarter. In Romania, the previously high goods deficit rose slightly further, which was partly offset by the moderate improvement in services balance; thus the trade deficit somewhat increased compared to the end of 2019 (Chart 49).

- In recent years, Hungary's deficit on the income balance has steadily declined, with this trend continuing in 2020 as well: due to the pandemic, the profit of foreign companies operating in Hungary fell, contributing to the lower deficit. A similar trend was also seen in the Czech Republic and Poland, while in Slovakia and Romania income balance deficit has not changed 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, Poland and Romania among the regional countries in 2020. In Romania, remittances from long-term workers abroad also improved the transfer balance, in addition to the absorption of EU transfers. In the Czech Republic and Slovakia, the transfer balance also improved the external balance position, albeit to a lesser degree.

Chart 48: Net lending in the countries of the region (four-quarter values as a percentage of GDP)

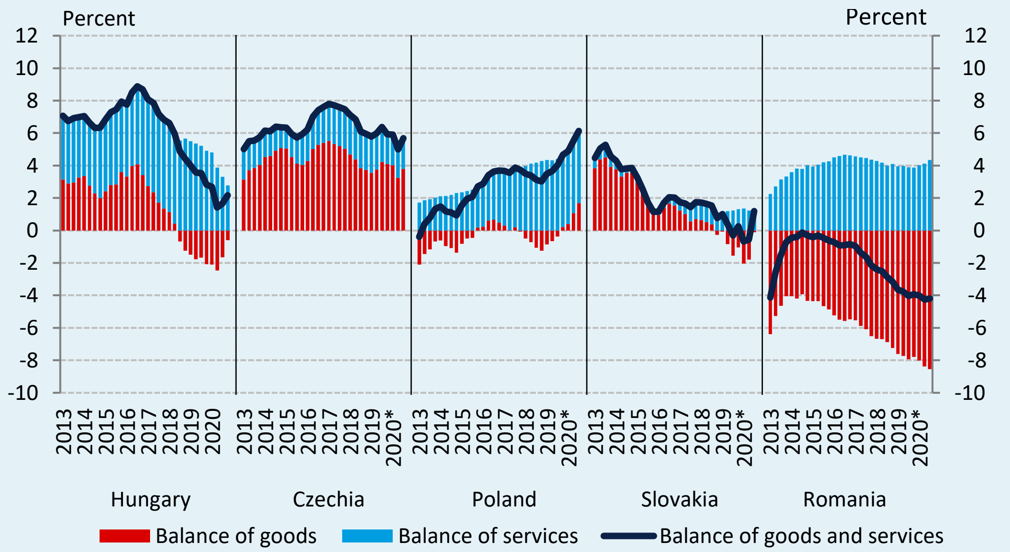


** The 2020 value is a four-quarter figure up to the third quarter.Source: Eurostat, national central banks.*

5.4 Trade balance

Changes in the goods and services balances of the countries of the region were largely influenced by the restrictions and lockdowns related to the pandemic in 2020 (Chart 49). Similarly to Hungary, in most of the regional countries exports to the European Union are significant within total exports, and thus the weakness of the German economy and the slowdown in trading partners' growth (and presumably the import-increasing effect of the healthcare procurements) in the second quarter reduced the trade balance in all countries of the region, with the exception of Poland, primarily due to the deterioration in the goods balances. Based on the available Q3 data for the region, the decrease in investments, the lifting of the restrictions in summer and the improvement in the terms of trade improved the trade balances, except in Romania, which was characterised by stagnating trade deficit. The services balance surplus in Hungary fell short of the level registered a year ago by more than 2 percentage points. On the other hand, in other countries of the region the services balances – in conjunction with their previous lower values and as a result of imports and exports declining to a similar degree – typically stagnated. Despite the pandemic situation, Poland's trade balance improved steadily in 2020, due to the rise in the goods and services surplus, which was partly attributable to the impact of declining imports resulting from weaker domestic absorption. The underlying reason for this may have been that services imports contracted more than services exports, as a result of which, the services balance continuously improved in 2020, contrary to the regional trends.

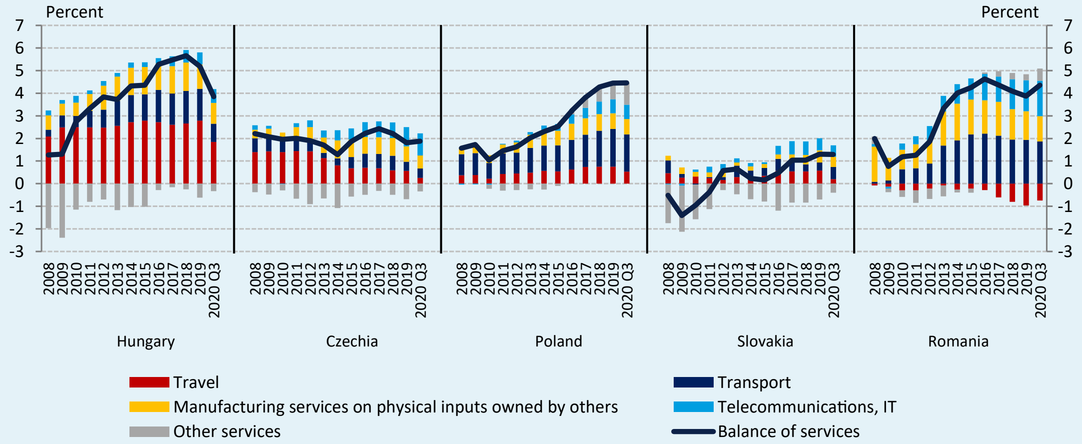
Chart 49: Distribution of the balance of goods and services (four-quarter values as a percentage of GDP)



** The 2020 value is a four-quarter figure up to the third quarter.*
Source: Eurostat.

In 2020, the strongest fall in services balance surplus within the region was registered in Hungary, while the neighbouring countries were characterised by stagnation (Chart 50). This was mainly attributable to the fact that in Hungary tourism accounts for outstanding weight within the services balance, and this sector was hit extremely hard by the pandemic-related restrictions. The value of the Hungarian transportation sector as a percentage of GDP also fell by almost half in 2020, while the net exports of the sector typically stagnated in the countries of the region (but rose moderately in Slovakia) compared to 2019. In the first half of the year, this may have been partly attributable to the quarantine rules and restrictions applicable to forwarding agents, the significantly stronger price competition, and the weight of the – drastically declining – air passenger transport, varying by countries, within the services balance. In Hungary, despite the crisis, the net balance of the infocommunication sector rose moderately, similarly to other countries in the region, and (manufacturing) processing also did not decelerate to the same degree as the tourism sector. In Poland, the impact of the decline in tourism and transportation services was offset by lower imports of other business services. On the whole, the services balance improved moderately, rising by 0.5 percentage point in Romania, while it stagnated in other countries of the region in 2020, which contributed to the relatively positive trade balance developments in the region.

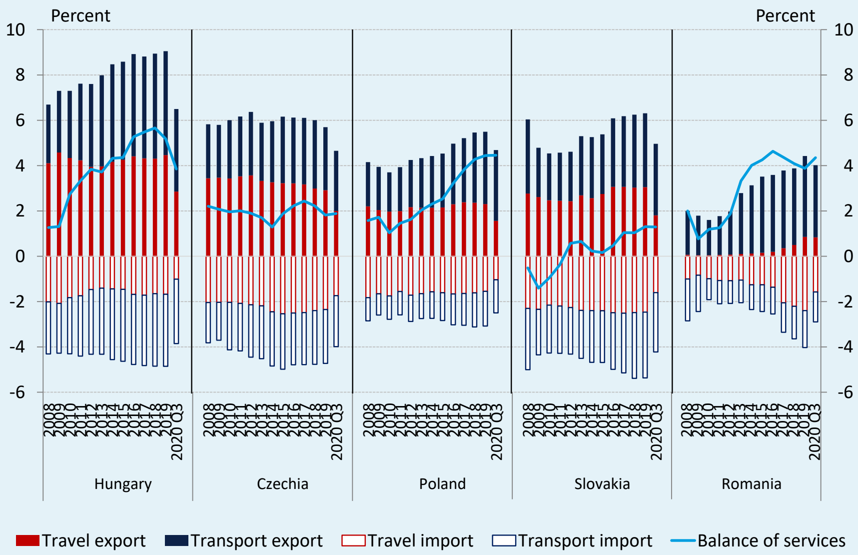
Chart 50: Development in the main items of the services balance in the region (as a percentage of GDP)



Source: Eurostat.

Comparing the performance of the two most important service sectors for Hungary – i.e. tourism and transportation – it can be seen that the pandemic had different impacts on the services balance mostly via export growth, while import factors developed similarly in the region. The two sectors' import ratio to GDP declined in all countries, albeit to differing degrees, as a result of the pandemic-related border closures and factory stoppages in the second quarter, thus contributing to the improvement in the services balances. Tourism imports in the region typically fell by 0.5-1 percentage point, while transportation imports declined to a smaller degree. On the other hand, trends in exports slightly varied in the individual countries. With the exception of Romania, where tourism exports were also previously moderate, the fall in tourism exports manifested itself in all countries albeit to a lesser degree than in Hungary: as a result, the gaps in the tourism-related revenues of the regional countries narrowed substantially. The difference in transportation exports was much larger: while Hungary registered a decline of 1 percentage point, the sector's exports stagnated in the neighbouring countries (Chart 51).

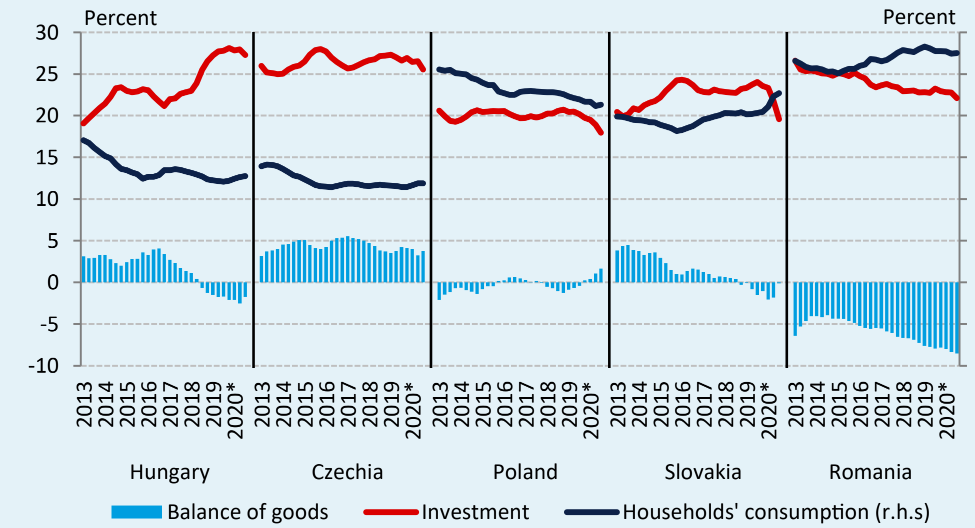
Chart 51: Developments in the tourism and transportation sectors within services balance (as a percentage of GDP



Source: Eurostat.

Investment activity throughout the region declined due to the pandemic, while household consumption varied in the individual countries (Chart 52). A slowdown in investments was a general phenomenon in the region, but to varying degrees. While the volume of investments as a percentage of GDP declined only moderately in Hungary, the Czech Republic and Romania (which is a positive development in terms of economic recovery), investment activity declined to a larger degree in Poland and Slovakia, where vehicle manufacturing accounts for a particularly high weight in industrial production. Hungary still has the highest investment ratio in the region, amounting to more than 27 percent of GDP, and compared to the end of 2019 it declined by less than one percentage point. On the other hand, households consumption expenditures as a percentage of GDP rose – with the exception of Poland and Romania – in the first nine months of 2020. However, this may be partly attributable to technical effects: if the fall in GDP exceeded the decline in consumption in the respective country, the consumption rate as a percentage of GDP rose, while the households' nominal consumption expenditures decreased. In Hungary, households' net financial savings remain extremely high, further supported by the large government spending and subsidies related to the pandemic, which are thus providing the economy with significant domestic funds.

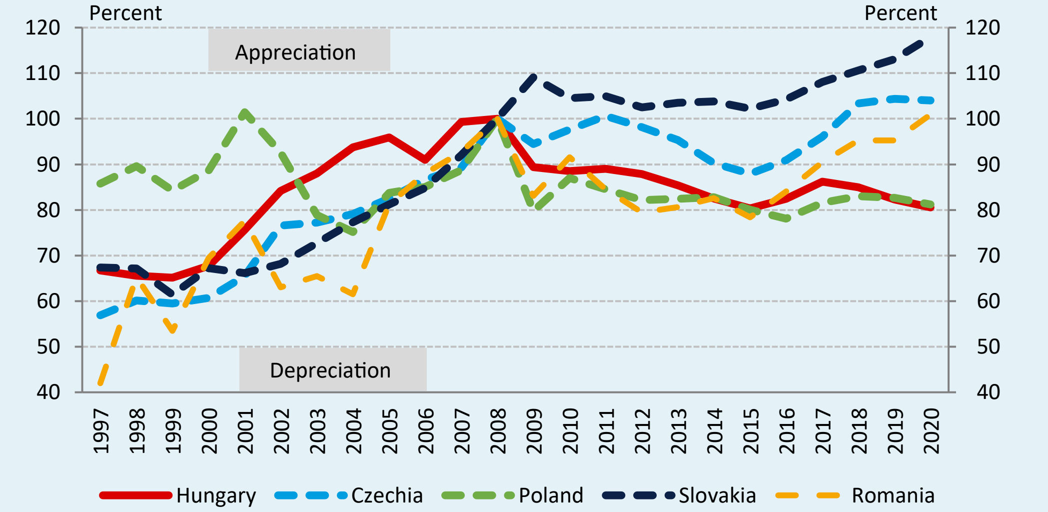
Chart 52: Household consumption and total investment (as a percentage of GDP)



** The data set is until 2020 Q3.*
Source: Eurostat.

The labour cost-based real exchange rate varied in the countries of the region in 2020 (Chart 53). The moderate fall in Hungary's labour cost-based real exchange rate is the combined result of opposite effects: Hungarian wage growth was still significant in 2020, and productivity also decreased during the pandemic, but the effect of these developments was offset by the depreciation of the forint exchange rate against the euro and the cut in the employer's contribution. In Poland, the labour cost-based real exchange rate decreased to a similar degree as in Hungary. The indicator in the Czech Republic was stable, indicating that the exchange rate based competitiveness of the country remained unchanged compared to the previous year. In Romania, wage growth continued to outstrip productivity growth, which was only partly offset by the depreciation of the Romanian leu, and thus the appreciation of the labour cost-based real exchange rate continued in 2020 as well. In Slovakia, similarly to the past years, the indicator rose further.

Chart 53: Changes in labour cost-based real exchange rate (2008 = 100; vis-à-vis 37 countries)



Note: Eurostat.
Source: European Commission.

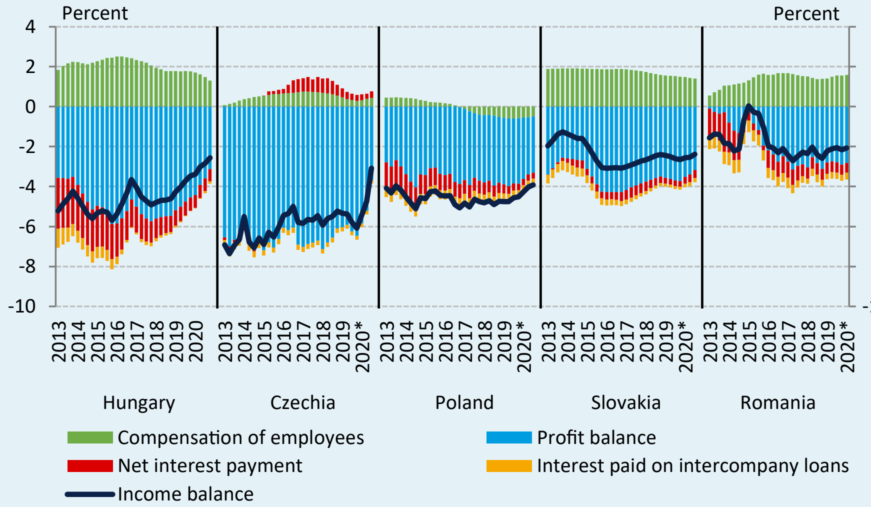
5.5 Income and transfer balance

The income balance deficit declined in the countries of the region in connection with the decreasing profits of foreign companies as a result of the pandemic (Chart 54). In the countries of the region, the income deficit typically declined in 2020, while in Romania it essentially stagnated. In the countries that showed an improvement, it was primarily the profit deficit that registered a decrease,[6] which is attributable to the lower corporate profitability resulting from declining export revenues due to the falling external demand caused by the pandemic. In the Czech Republic, the decline in the profit balance deficit was particularly high, at almost 3 percent. Non-resident companies have built up significant production capacities in all of the countries in the region, and therefore the largest portion of the income balance deficit stems from the profit balance of non-resident companies. In 2020, the balance of interest paid to the non-resident sector had no material impact on the income balance of the region's countries. The income balance deficit is usually reduced by the income of employees temporarily working abroad, but this declined compared to the previous year in Hungary, Slovakia and Poland, which may be attributable to the restrictions and lay-offs due to the pandemic. As regards temporary labour incomes, Poland is an exception, since in recent years it employed a large number of Ukrainian workers,[7] and the value of their income earned in Poland typically exceeds the income of Polish workers temporarily working abroad, which – uniquely in the region – increases the income balance deficit.

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

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

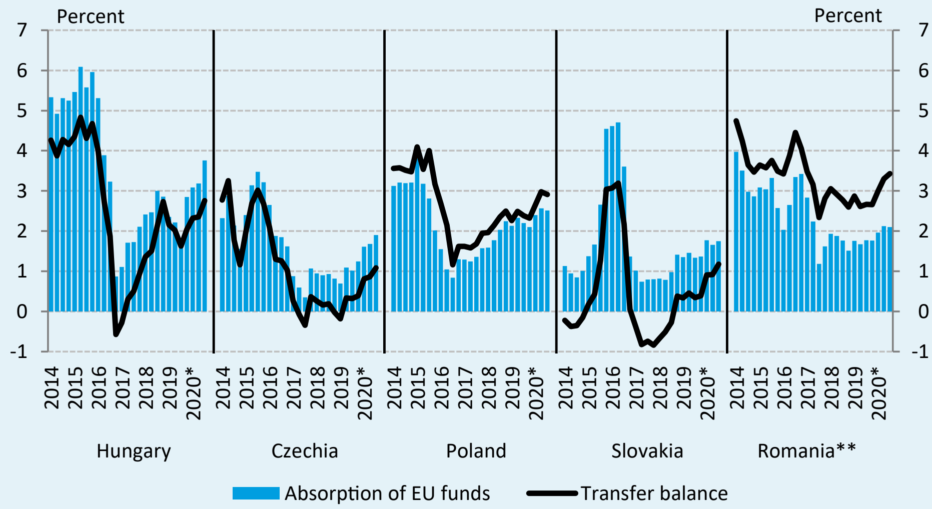
Chart 54: Developments in the components of the income balance* (four-quarter values as a percentage of GDP)



** The 2020 value is a four-quarter figure up to the third quarter.*
Source: Eurostat.

The inflow of EU transfers accelerated in the region as a whole in 2020, but Hungary remains at the forefront in the use of funds among the countries in the region (Chart 55). The transfer balance supports the external balance position to a varying degree, which is largely determined by the accelerating inflow of funds that may be absorbed in the EU 2014–2020 programming cycle towards the end of the cycle. The four-quarter absorption of EU transfers as a percentage of GDP has been on a rising trend in Hungary since 2016, and following a minor slowdown in 2019, in 2020 it rose to almost 4 percent of GDP, while the value of the index in Poland, after a gradual rise, was 2.5 percent of GDP. The absorption of EU transfers in the Czech Republic, Slovakia and Romania amounts to roughly 2 percent of GDP. In addition, in Romania the wages transferred home by employees permanently working abroad improved the Romanian transfer balance by more than 1 percent of GDP.

Chart 55: Transfer balance and the absorption of EU transfers in the countries in the region (as a percentage of GDP)

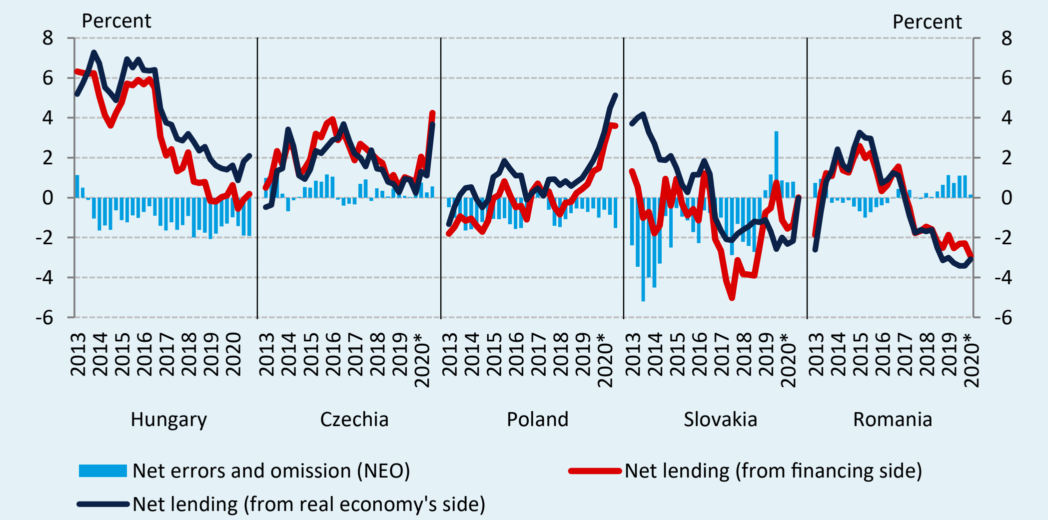


** The 2020 value is a four-quarter figure up to the third quarter.*
*** Data for secondary income is missing for 2019-2020.*
Source: Eurostat.

5.6 Financing side developments

Net lending calculated from the financing side also typically rose in the region. In Hungary and Poland, however, the rate of increase fell short of the rate registered in the real economy approach (Chart 56). The net external balance position calculated according to the two approaches typically shifted in the same direction in the region. In Hungary, in the Czech Republic, Slovakia and Poland, the rise in net lending based on the real economy approach was also reflected in the financial accounts, while in Romania the two indicators developed oppositely and showed similar net lending at the end of the year. The item "Net errors and omissions" (NEO) shows the discrepancy between net lending calculated from the financing side and from the real economy side, the changes in which related to 2020 also reflect different trends in the countries of the region. In Hungary, the index calculated according to the real economy approach has persistently exceeded the value obtained through the financing approach, and the difference in 2020 was close to the level observed in previous years, whereas the difference moved in the opposite direction in the Czech Republic, Slovakia and Romania.

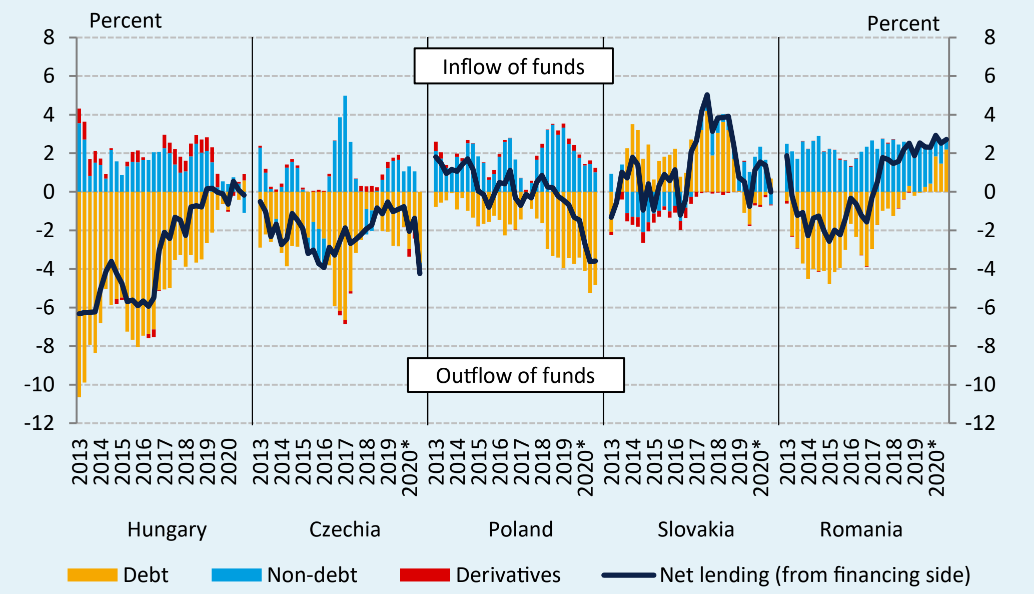
Chart 56: Net errors and omissions (four-quarter values as a percentage of GDP*)



** For the countries of the region up to 2020 Q3.*
Source: Eurostat, national central banks.

Based on the financial accounts, the inflow of non-debt liabilities was a general phenomenon in the region in 2020, while in the case of debt liabilities both inflows and outflows were observed (Chart 57). Financing trends vary in the region: while the outflow of funds increased in the Czech Republic and Poland, the balance was close to zero in Hungary and Slovakia, and the net inflow of funds increased in Romania. As regard the type of liabilities, the inflow of non-debt liabilities declined across the region, presumably due to the uncertainty related to the pandemic situation. Thus, the differences in the regional financing trends stemmed from the different developments in debt liabilities: in Hungary, the outflow of debt continued to decelerate, and by the end of 2020 – similarly to the case in Slovakia – this had turned into a moderate net debt inflow, while in the Czech Republic and Poland the outflow of debt liabilities rose. In Romania, in parallel with the growth in the borrowing requirement, the net inflow of debt accelerated, as a result of which, in addition to the fall in non-debt liabilities in 2020 the economy's borrowing requirement was mostly financed by debt liabilities, in contrast to the trends from former years.

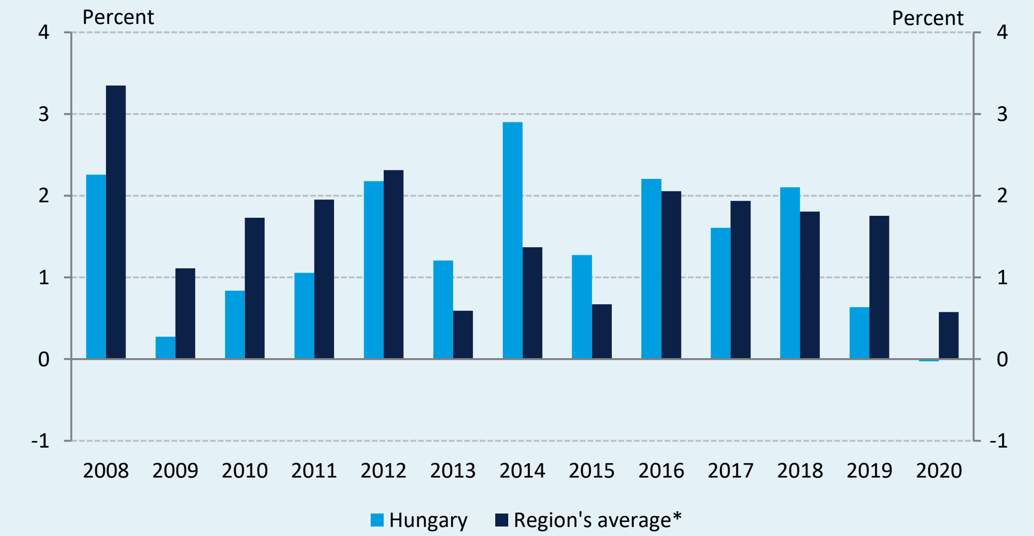
Chart 57: Net borrowing and the form of financing (four-quarter data, as a percentage of GDP)



** For the countries of the region, data were available up to 2020 Q3.*
Source: MNB, Eurostat.

Compared to the level observed in previous years, foreign direct investment as a percentage of GDP fell sharply in the region in 2020 (Chart 58). In the past ten years, net FDI inflows followed a similar pattern in the region's countries. 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. Between 2016 and 2018, FDI inflows in Hungary have fluctuated around 2 percent of GDP, similar to the average of the other countries in the region. Hungary's net FDI inflow declined in 2019 and then decelerated further in 2020, in line with the regional trends. 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 58: Net FDI inflows in the Visegrád countries (as a percentage of GDP)

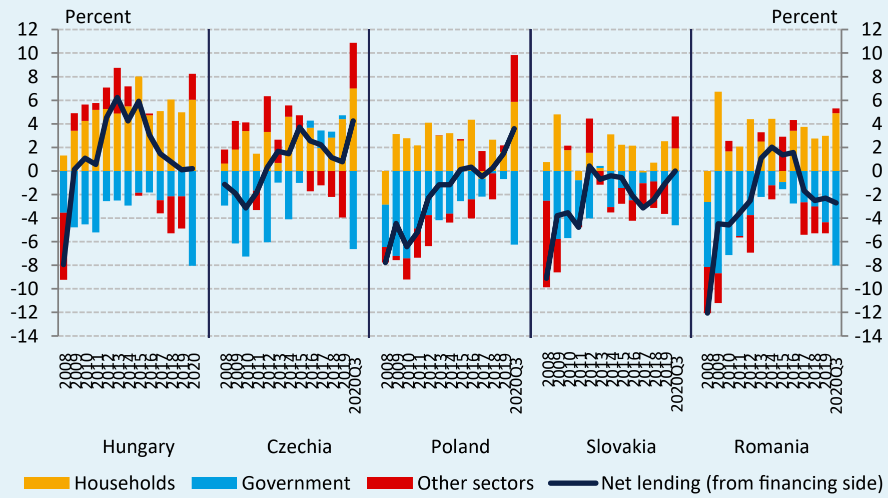


** For the countries in the region, four-quarter data were available up to 2020 Q3. (The regional average does not include Hungary.)*

5.7 Financial savings of individual sectors

As a result of the pandemic, savings trends followed a similar pattern in the region: the private sector's net financial savings typically offset the impact of the sharp increase in government expenditures (Chart 59). The net lending of the countries in the region generally increased in 2020: in parallel with the drop in consumption, households' net financial savings rose everywhere (with the exception of Slovakia), which was also attributable to the forced savings resulting from the lockdowns (for more details, see the special topic of the January 2021 Report on the Balance of Payments). The net financial savings of Hungarian households remained among the highest in the region. The negative economic impacts of the pandemic and the lockdowns also curbed corporations' investment activity, as a result of which corporations' borrowing requirement in the regional countries switched over to net lending, similarly to the period after the 2008 crisis. In parallel with this, due to the decreasing tax revenues in parallel with the contraction of the economy and the expenditure-increasing effect of economic reopening, budget deficits rose to an outstanding level everywhere, advancing to nearly 6-8 percent of GDP.

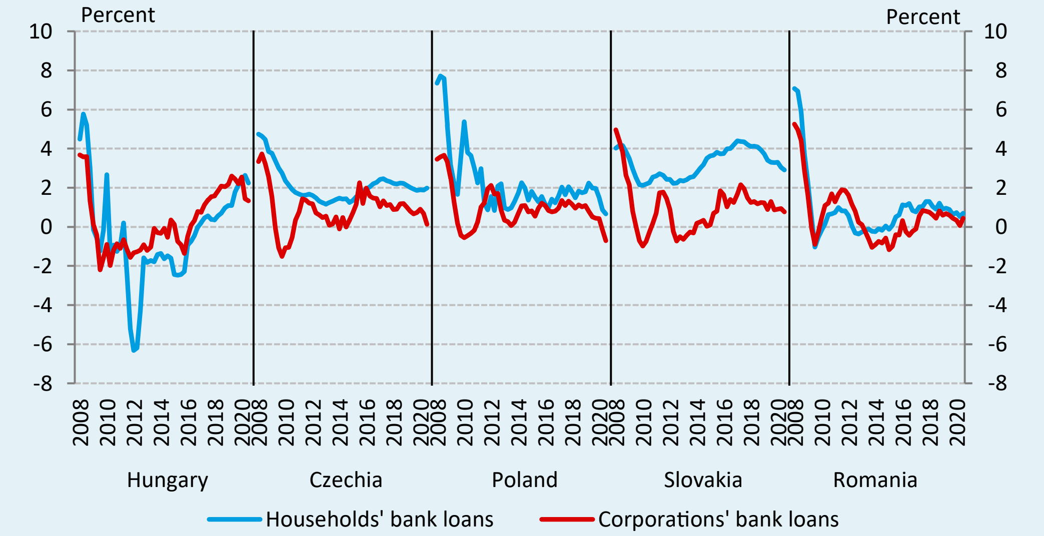
Chart 59: Net lending of the economy in a breakdown by sector (as a percentage of GDP)



Other household receivables (from employers and insurers) in Romania according to the baseline scenario without the outliers of 2013, 2016 and 2017.
Source: MNB and Eurostat.

In line with the decline in investment and consumption dynamics, corporations' and households' net new borrowing also declined in the countries of the region (Chart 60). The largest correction in the region both in corporate and retail lending was seen in Poland: households' net new borrowing dropped to nearly zero, while Polish companies became net repayers, which may have contributed to the impressive improvement in Poland's current account. The net new borrowing of Romanian and Czech companies fell to almost zero and that of Slovak companies also declined. Amidst the general decline, the borrowing of Hungarian non-financial corporations as a percentage of GDP fell to nearly 1 percent and was thus among the highest in the region, strongly supported by the central bank schemes (e.g. FGS Go!, Bond Funding for Growth Scheme) and the government's measures to improve funding (e.g. moratorium on loan instalments). Despite the fall, domestic corporate credit growth has been exceeding the rates in the regional countries for years, while borrowing by households only reached the regional level by the end of 2019. By the end of 2020, after an interruption in the rising trend, net borrowing by Hungarian households was close to 2 percent of GDP, which broadly corresponds to the average of the countries in the region. In 2020, net borrowing by households declined in all of the countries with the exception of the Czech Republic, albeit at different rates, with the most spectacular decline seen in Poland. Taken together, declining net borrowing contributed to the rise in net lending in the region.

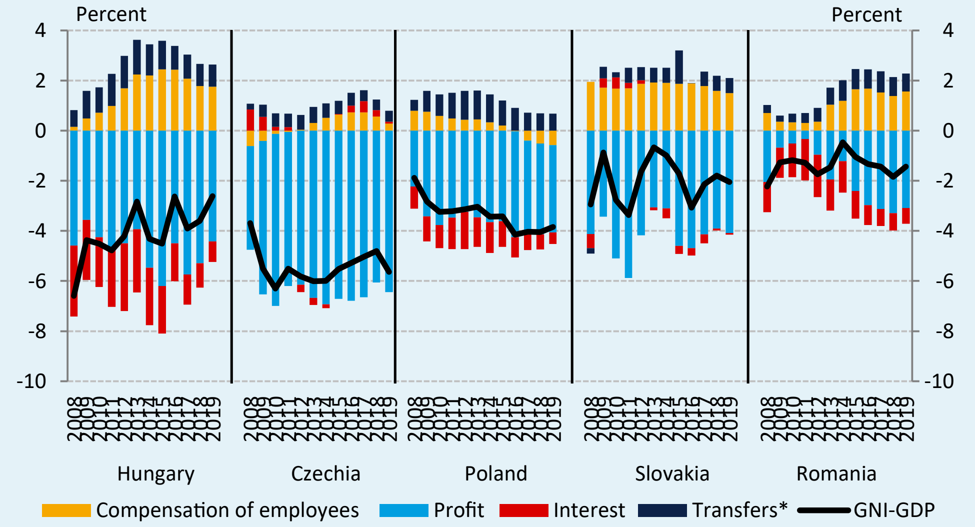
Chart 60: Four-quarter net borrowing of companies and households (as a percentage of GDP)



Source: ECB, Eurostat.

Hungary's GDP-GNI gap, which fell below 3 percent in 2019, more or less corresponded to the regional average, while the anticipated improvement in the income balance in 2020 across the region points to narrowing of the gap. Compared to the level before the 2008 crisis, the gap between production and income decreased to the largest degree in Hungary, which managed to work off the difference compared to the region in terms of this indicator. In 2019, the gap between GDP and GNI declined to below 3 percent of GDP (Chart 61). The high level of capital income (profit balance), which is a key factor in the GDP-GNI gap, is due to the significant amount of foreign direct investment in the regional countries. Due to this, the profit deficit in the Visegrád 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 2019, the profit of non-resident companies declined slightly in Hungary, while in the other countries of the region tended to remain stable. In 2020, the fall in domestic absorption and exports due to the pandemic significantly reduced corporations' profitability, which is reflected in the improved income balance and presumably also in the narrowing of the GDP-GNI gap. National income is reduced to a decreasing degree by the interest balance in the countries of the region, the improvement in which was also supported – in addition to the declining level of interest rates – by the penetration of domestic financing. Due to the compensation of employees working abroad and the inflow of EU funds, the primary transfers reduce the GDP-GNI gap in the region. Contrary to other countries in the region, in Poland the balance of the wages of employees temporarily working abroad is negative.

Chart 61: Factors in the GDP-GNI gap

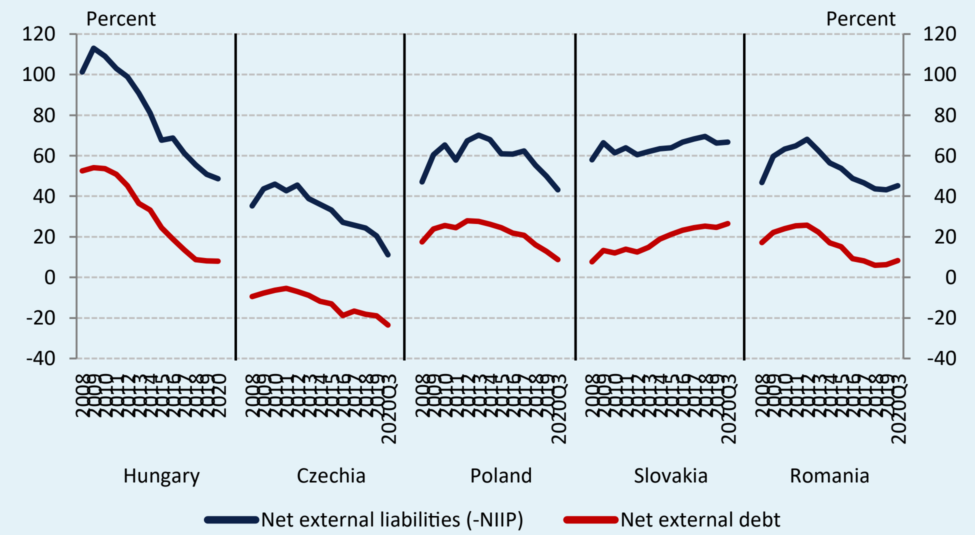


** Transfers included in other primary incomes.*
Source: Eurostat, HCSO.

5.8 External debt indicators

The decline in net external debt indicators typically continued in the region in 2020, and Hungary's net external liabilities and debt are in line with levels observed in the regional countries (Chart 62). Due to the steady decline since 2009, Hungary's net external debt fell below to 50 percent of GDP by the end of 2020 and is thus already lower than the Slovak figure, but still exceeds the Czech indicator, while its value is close to the Polish and Romanian levels. In terms of net external debt, Hungary experienced the strongest adjustment since the 2008 crisis, falling from an extremely high level of over 50 percent of GDP to below 8 percent of GDP by 2020. 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 (where foreign receivables exceed external liabilities). Among the regional developments in 2020, it is worth highlighting that in 2020 Romania saw a reversal of its net external liabilities and debt, which had been declining since 2012.

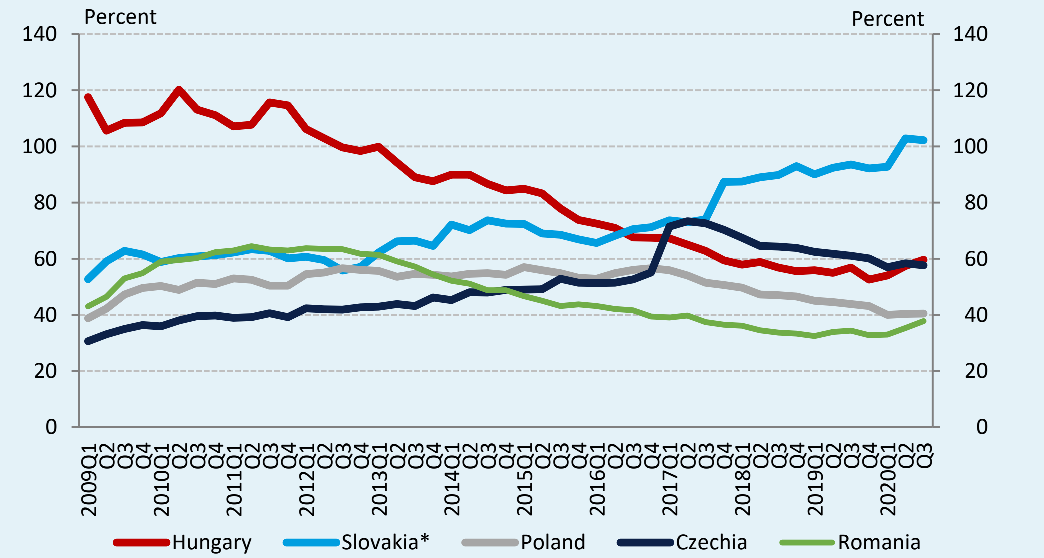
Chart 62: Developments in net external liabilities and external debt (as a percentage of GDP, debt without intercompany loans)*



** For the countries of the region, the data set is until 2020 Q3.*
Source: MNB, Eurostat (data for Hungary without SPVs).

In 2020, the gross external debt-to-GDP ratio rose in several countries in the region, with the Hungarian indicator close to the Czech debt ratio, but significantly lower than that of the euro area member Slovakia (Chart 63). At the start of the financial crisis, Hungary's gross external debt was particularly high in a regional comparison; however, due to the post-crisis deleveraging, it had fallen below the Czech and Slovak levels by 2016, reaching the mid-range for the region. However, in 2020 the previously typical downtrend halted in the regional countries, with the exception of Slovakia: in connection with the surging budget deficit, several countries issued large volumes of foreign currency bonds in 2020, while the fall in nominal GDP also contributed to the higher debt ratios. The growth in the Slovak gross external debt was caused by the TARGET liabilities accumulated as a result of the euro area accession, the rise in which may have been also attributable to the liquidity increasing measures of the ECB in 2020.

Chart 63: Developments in the gross external debt of the countries in the region (as a percentage of GDP, excluding intercompany loans)

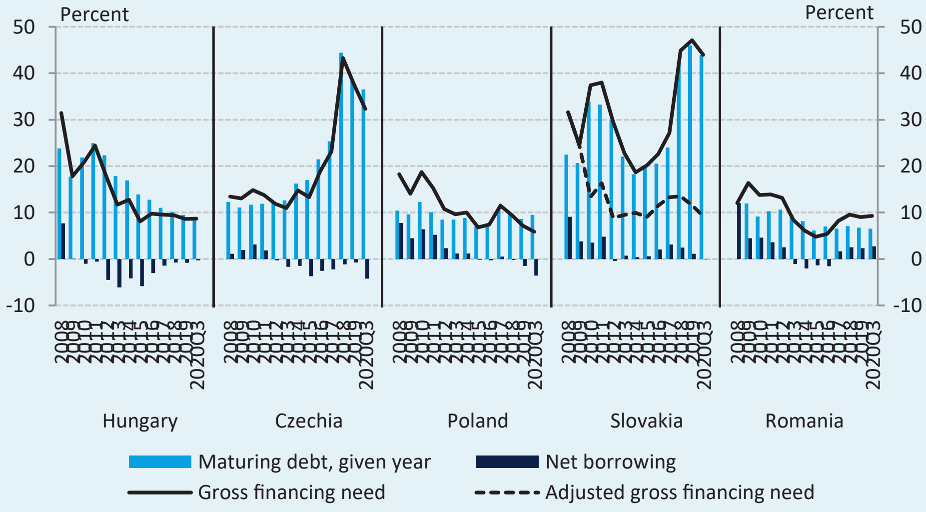


** The increase in Slovakia's gross external debt is also attributable to the debt increase related to the euro area payment system.*
Source: Eurostat.

Similar to the previous year, Hungary's gross financing need was around 9 percent of GDP in 2020, which can be considered low in regional terms (Chart 64). Gross financing demand based on short-term external debt by original maturity[8] in Hungary was similar to the previous year: the decline in net lending was offset by a decline in maturing debt. Romania's gross borrowing requirement is similar to that of Hungary: however, while Hungary's borrowing requirement has typically declined in recent years, Romania's gross borrowing requirement has been rising since 2015, mainly due to the rise in net borrowing. The gross financing need gradually increased in Slovakia, mainly as a result of the TARGET liabilities due to euro area accession, whereas in the Czech Republic the indicator was increased by the central bank intervention, and the removal of the exchange rate peg also positively affected the gross financing requirement. Poland's gross borrowing requirement continued to decline in 2020, which is attributable to a major improvement in net lending.

8 To ensure the comparability of data gross borrowing requirement is based on the short-term external debt based on original maturity.

Chart 64: Gross financing need (based on short-term external debt of original maturity, as a percentage of GDP)



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

List of Charts

Gábor Bethlen

(15 November 1580 – 15 November 1629)

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

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

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

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

REPORT ON THE BALANCE OF PAYMENTS

April 2021

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

©MAGYAR NEMZETI BANK

H-1054 BUDAPEST, SZABADSÁG SQUARE 9.