REPORT ON THE BALANCE OF PAYMENTS

2024

JULY

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

Letters 27
Gábor Bethlen

REPORT ON THE BALANCE OF PAYMENTS

2024

JULY

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1013 Budapest, Krisztina körút 55.

www.mnb.hu

ISSN 2064-8707 (print)

ISSN 2064-8758 (on-line)

Pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the primary objective of Hungary's central bank is to achieve and maintain price stability. 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 developments which are of critical importance for Hungary's vulnerability.

Given the lessons from the financial crisis and the recent period, a country's balance of payments and the trends therein indicating potential dependence on external financing are particularly important in the economic media. Developments in the external balance position are also closely monitored by market participants and analysts. The primary goal of the Report on the Balance of Payments is to inform market participants about 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: Judith Balázs, Balázs Forgó, Péter Koroknai, Rita Lénárt-Odorán, Zsuzsa Nagy-Kékesi, Balázs Sisak and Daniella Tóth. The Report was approved for publication by Barnabás Virág, Deputy Governor.

This Report is based on information pertaining to the period ending on 26 June 2024.

Summary

External balance indicators continued to improve in 2024 Q1, *as the quarterly current account surplus increased to a record level and its seasonally adjusted value amounted to 1.6 percent of GDP. The four-quarter balance showed an increase in the surplus to 1.3 per cent of GDP, while net lending rose to 2.2 per cent of GDP. The improvement in the annual external balance indicators* ***was driven primarily by an increase in the goods balance,*** *supported by improvements in the energy balance and the balance of other goods. The services surplus remained at a high level. The income balance deficit as a share of GDP narrowed somewhat in the first quarter, reflecting an improvement in the interest balance on foreign loans, while the profits of foreign corporations remained unchanged. With the 2014–2020 EU budget cycle having ended, the 0.3 per cent surplus on the transfer balance remains low, but contributes positively to the external position.* ***External balance indicators continued to improve in most countries in the region:*** *after that of Hungary, Poland and the Czech Republic, the net lending position of Slovakia also turned positive, while Romania's net borrowing still amounts to about 5 per cent of GDP.*

The economy's four-quarterly net borrowing according to the financial account also declined in 2024 Q1, in line with real output developments. In conjunction with the economy's nearly balanced net position, ***the FDI influx continued with EUR 1,2 billion and Hungary's net external debt kept decreasing by nearly EUR 1,4 billion during that quarter.*** *The net debt outflow was driven primarily by the general government sector, alongside the corporate sector, while the banking system's debt inflow increased.*

By the end of March 2024, net external debt had dropped to 9.8 per cent of GDP. *The decrease in the debt ratio was enabled by the above debt outflows, as well as revaluation, and, to a lesser extent, by an increase in the nominal GDP. Hungary's gross external debt equalled 64 per cent of GDP in the first quarter, similar to the level at the end of the previous year.* ***The stock of international reserves expanded sharply, reaching a historic high of EUR 46.4 billion.*** *At the end of the first quarter, the MNB's stock of international reserves exceeded* ***the level of short-term external debt, which is monitored closely by investors, by more than EUR 15 billion.***

Based on the various sectors' savings trends, the increase in the economy's net lending position resulted from a ***decline in the fiscal deficit,*** *in conjunction with a moderate reduction in the private sector's net lending position. The general government sector's four-quarter net borrowing fell by nearly one percentage point to 5.7 per cent of GDP.* ***The net financial savings of the private sector (households and companies) decreased somewhat at the same time,*** *as a result of declining corporate profitability at the start of the year and an upturn in household consumption. Household demand for government bonds slowed, while the stock of investment fund shares grew rapidly in an easing inflationary environment.*

In this Report's special topic, we explore the significant improvement in reserve adequacy in recent quarters, from the aspect of changes in short-term external debt. *Reserve adequacy in terms of the Guidotti-Greenspan ratio, which is a key focus for international investors, rose to a record high in 2024 Q1, also driven by a substantial reduction in short-term external debt.* ***All three sectors contributed to the decline in Hungary's short-term external debt, which was linked for the most part to the normalisation of the macro environment.*** *Shrinking margins and amortising debt played a key role in the decrease in the short-term public external debt stock. The MNB's short-term external debt also decreased at the same time, as turbulence in the financial market eased. The improvement in Hungarian banks' ratios was enabled by a gradual decrease in non-residents' speculative positions, that - thanks to the historical improvement in the external balance and the reduction in Hungary's external vulnerability – had no negative impact on financial market stability. The normalisation of energy prices led to shrinking corporate short-term external debt.*

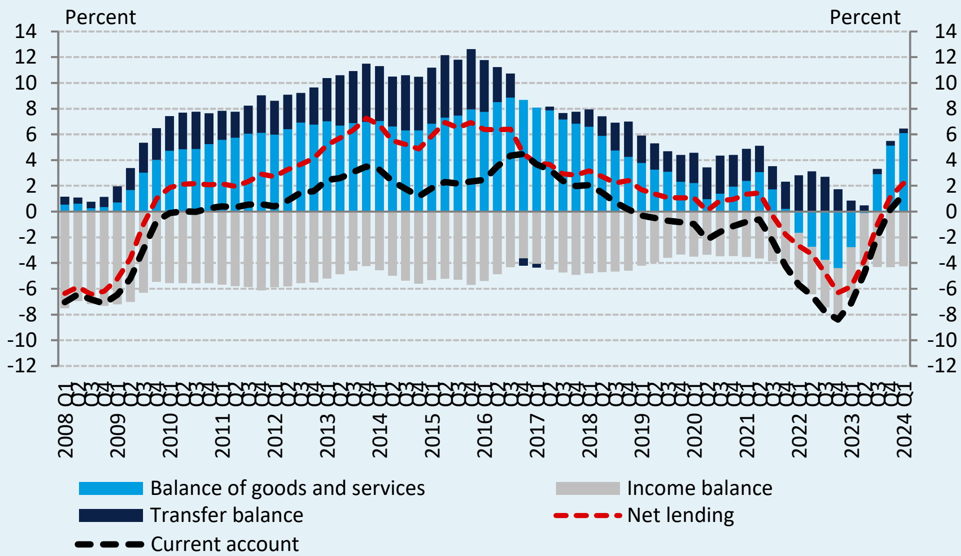
Contents

1 Real economy approach

The real economy approach shows that in 2024 Q1 Hungary's four-quarter net lending amounted to 2.2 percent of GDP, with the current account surplus reaching 1.3 percent of GDP and the four-quarter adjusted current account balance showing a surplus of 1.6 percent. The improvement in external balance indicators was mainly caused by an increase in the goods balance, and within this primarily in the energy balance, but the 'other goods balance' also continued to improve. The surplus on services and the transfer balance as a percentage of GDP remained unchanged compared to the previous quarter, while the income balance deficit decreased somewhat with the improvement in the interest balance. Similarly to Hungary, external balance indicators continued to improve in the first quarter across the countries in the region, with the exception of Romania.

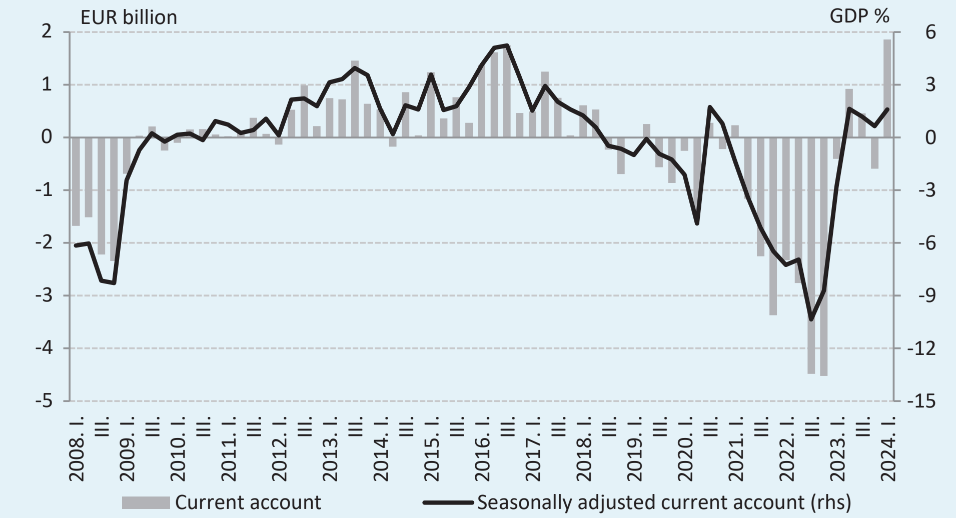
According to the real economy approach, in 2024 Q1 Hungary's four-quarter net lending amounted to 2.2 percent of GDP, while the current account surplus rose to 1.3 percent of GDP (Chart 1). Based on the quarterly data, which better reflect short-term developments, the economy showed a positive net lending position, similarly to the preceding quarters, amounting to 1.6 percent of GDP in 2024 Q1. According to unadjusted quarterly data, net lending in the first quarter amounted to EUR 2,146 million, consisting of a record current account surplus of EUR 1,860 million (Chart 2) and a capital account surplus of EUR 286 million. The improvement in the GDP-proportionate external trade balance played a key role in the increase in four-quarter net lending.

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



** Income balance: earned income, income on equity and income on debt. Transfer balance: capital account, other primary incomes and secondary incomes.*
All charts by the MNB unless otherwise indicated.

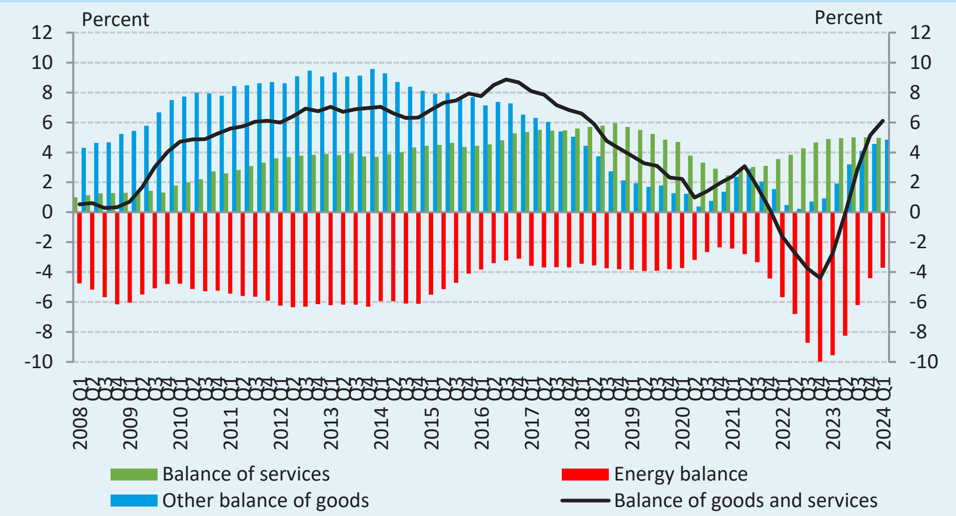
Chart 2: Nominal and seasonally adjusted quarterly current account balance



1.1 Trade balance

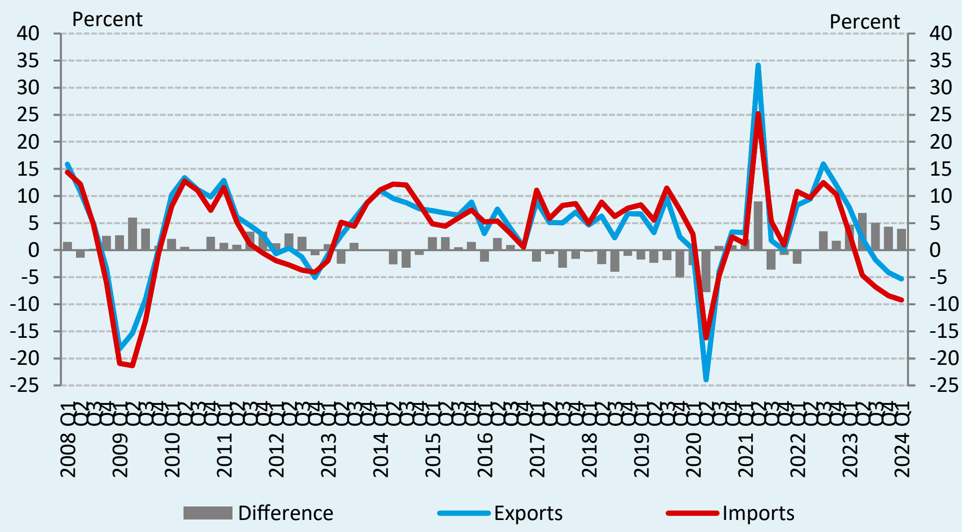
The four-quarter trade surplus reached 6.1 percent of GDP in 2024 Q1, buoyed by the continued, rapid year-on-year improvement in the balance of goods and a stable services surplus (Chart 3). The increase in the goods balance was still mainly driven by the correction in the energy balance in the wake of the energy shock in 2022. The improvement in the goods balance was also facilitated by a decline in other imports, which itself was triggered by shrinking gross accumulation. Export growth also supported the goods balance in the first half of the previous year, but this effect faded in 2023 H2 in the context of weak global economic activity. As a result of this and the upturn in household consumption, the increase in the 'other goods balance' observed since 2022 slowed down by the end of 2023. The four-quarter surplus on the services balance stabilised in early 2023, following a steady improvement after the COVID-19 pandemic, and again amounted to around 5 percent of GDP in the first quarter of this year. The improvement in the balance of services until the beginning of 2023 was driven by dynamic growth in tourism and a recovery in the balance of transportation services. Tourism remained the most dominant sector within the services balance, but its role diminished in the first quarter of this year, while the share of intellectual property fees and the surplus generated in the telecommunication and information services segment increased.

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



In 2024 Q1, export and import growth both continued to moderate, while the still high export-import gap contributed to an improvement in the trade balance (Chart 4). The poor performance of domestic industrial output across most manufacturing sectors exacerbated the year-on-year decline in export volumes. The drop in imports, in addition to the drag from lower exports, was due to a slowing, but still ongoing decrease in domestic absorption in the first quarter. The volume of exports shrank by 5.3 percent in year-on-year terms, while real imports fell by nearly 9.2 percent in the first quarter.

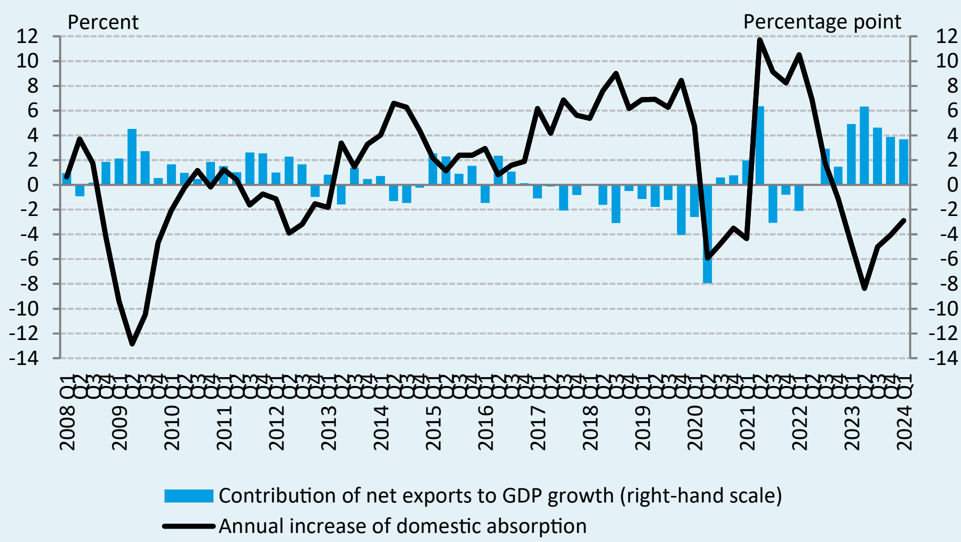
Chart 4: Annual real growth of exports and imports



Source: HCSO, MNB

In this context, the growth contribution of net exports decreased somewhat, but remained significant in the first quarter (Chart 5). The decline in domestic absorption continued to decelerate, as the upturn in household consumption that started in the preceding quarter continued, with real household income rising again after a period of high inflation. At the same time, the year-on-year decline in gross capital formation, which includes both investment and inventories, continued to accelerate during the quarter, suggesting – in view of the poor export performance as well – that the positive growth contribution of net exports is largely driven by lower gross capital formation.

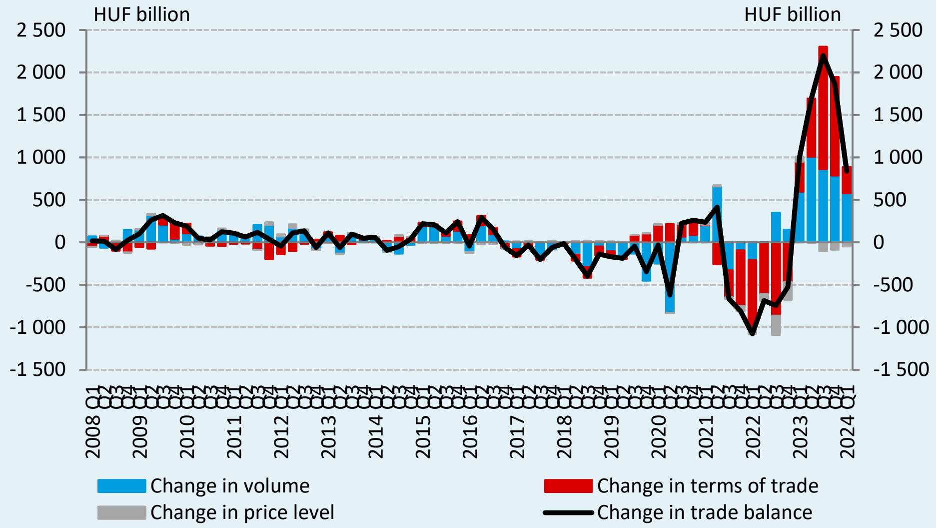
Chart 5: Annual rate of increase in domestic absorption and contribution of net exports to GDP growth



Source: HCSO

The positive year-on-year change in the external trade balance in 2024 Q1 is mainly the result of a change in volumes, while the improvement is also driven by the terms of trade effect, albeit to a much lesser extent than before (Chart 6). The external trade balance, which includes the balance of goods and services, mainly improved due to a year-on-year drop in imports, partly driven by subdued domestic demand. The continued moderation in energy prices contributed to an improvement in the terms of trade, with a positive impact on the nominal volume of net exports. The impact of the change in the terms of trade was much smaller in the first quarter than in previous quarters, but remained significant.

Chart 6: Changes in external trade balance factors according to GDP (year-on-year)



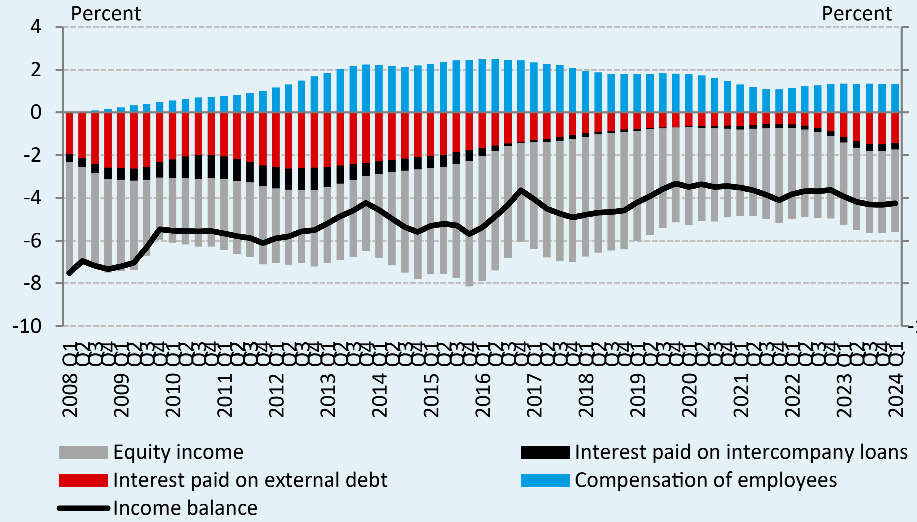
Source: HCSO

1.2 Income balance

The income balance deficit as a share of GDP decreased somewhat in 2024 Q1, reflecting an improvement in the interest balance on foreign debt (Chart 7). A major part of the income balance is accounted for by the profits of foreign-owned enterprises, which amounted to about 3.8 percent of GDP in 2023 and remained at that level in the first quarter of this year.[1] The deficit on net interest payments on external debt as a share of GDP, on the other hand, shrank by around 0.1 percentage point to 1.4 percent in the first quarter of this year, as a consequence of a decline in net external debt and falling domestic interest rates. The income of Hungarians working abroad on a temporary basis remained at the low level observed after the pandemic and thus continued to make only a moderate contribution to improving this indicator. As a combined result of the above factors, the current account deficit fell marginally, to 4.2 percent of GDP by the end of the first quarter.

[1] Since quarterly data on the 2023 profitability of foreign-owned enterprises operating in Hungary are limited, information on quarterly profit outflows is based on estimates until the receipt of corporate questionnaires at the end of the summer. For more detail, see the publication "Methodological notes to the Balance of Payments and Investment Position Statistics".

Chart 7: Development of income balance* items (four-quarter values as a percentage of GDP)

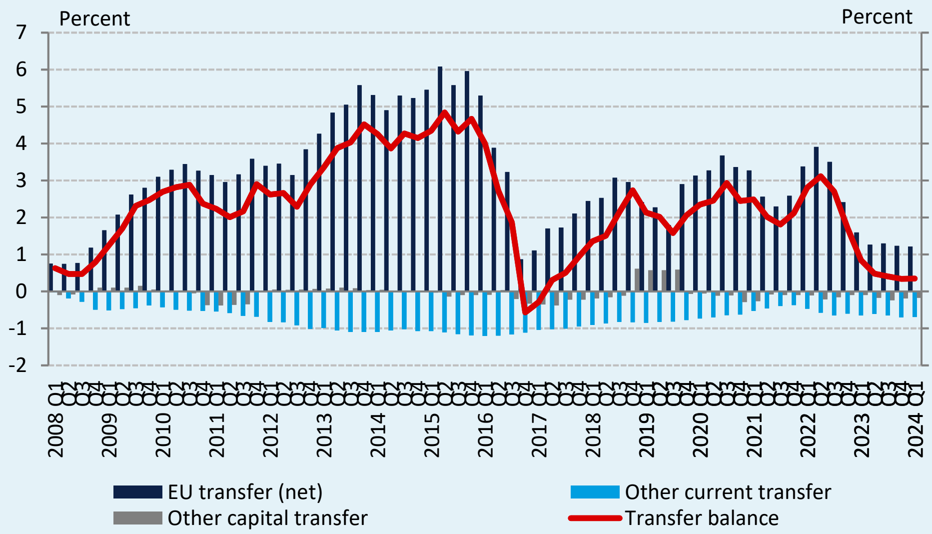


** Income balance: earned income, income on equity and income on debt.*

1.3 Transfer balance

The four-quarter surplus of the transfer balance as a share of GDP in 2024 Q1 remained at 0.3 percent of GDP in the previous quarter, mainly due to the continued low level of net EU transfers (Chart 8). The use of net EU transfers has averaged around 2.0–3.5 percent of GDP in recent years, but in 2023 the four-quarter net EU transfer balance fell to 1.2 percent of GDP by the end of the year and remained at that level during the first quarter of this year. This was due to the end of the 2014–2020 EU budget cycle and the delay in accessing the new seven-year cycle and the Recovery and Resilience Facility (RRF), which was set up to help with recovery from the COVID-19 crisis. Meanwhile, both the four-quarter balance of other current transfers and other capital transfers also remained broadly unchanged on a quarter-on-quarter basis.

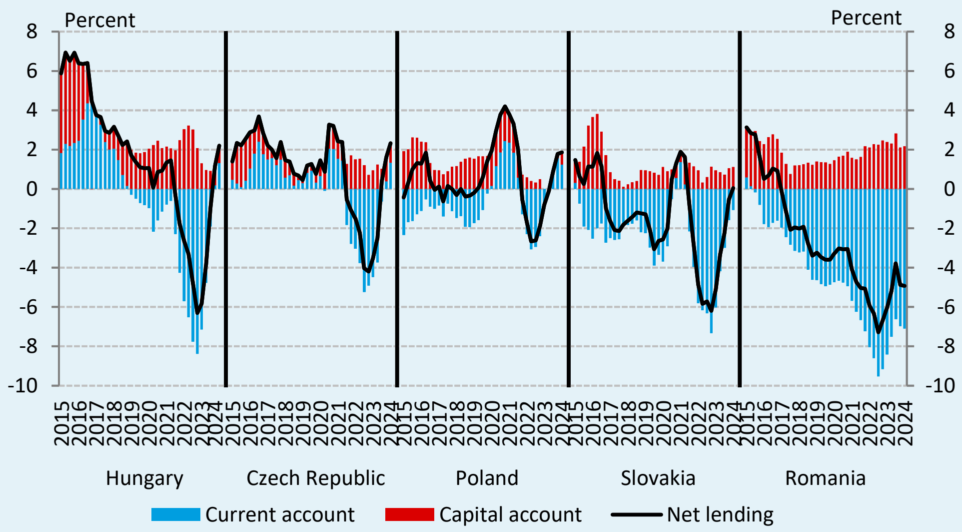
Chart 8: Four-quarter developments in transfer balance items (four-quarter values as a percentage of GDP)



1.4 Regional comparison

External balance indicators kept improving in the region, with the exception of Romania (Chart 9). The energy balance deficit continued to narrow in several countries in 2024 Q1. However, final consumption (including both household and government consumption) already increased on an annual basis in all of the countries in the region, while domestic absorption decreased only in the Czech Republic and Hungary. In line with the rise in consumption, the four-quarter current account balance deteriorated in Poland and Romania, but this was more than offset by an improvement in the capital account in Poland. Overall, the four-quarter net lending in the Czech Republic and in Poland was around 2 percent of GDP in the first quarter, similar to the level in Hungary. Slovakia's net lending was close to balance, while Romania's net borrowing amounted to about 5 percent of GDP.

Chart 9: Four-quarter net lending in the countries of the region (as a percentage of GDP)



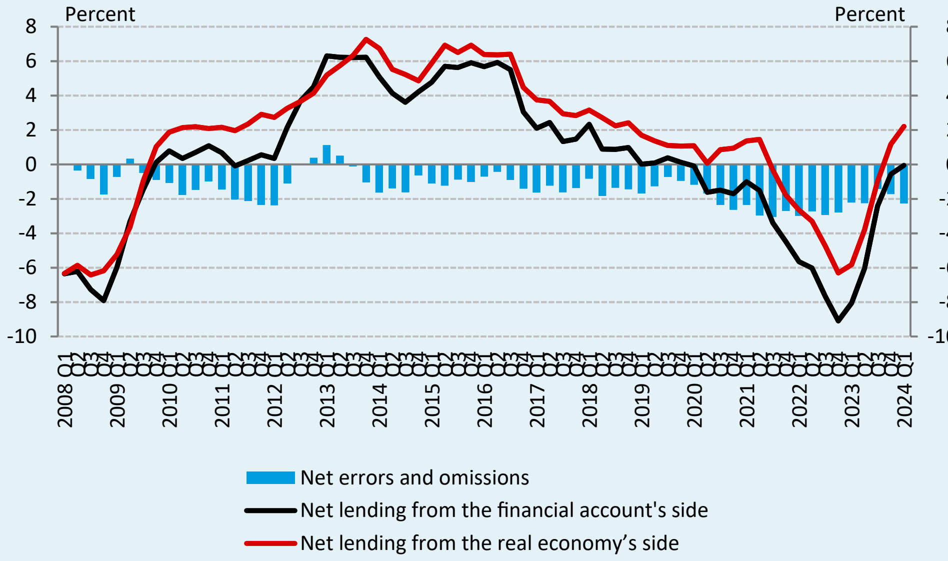
Note: Except for Hungary, the 2024 Q1 figures were calculated from monthly data.
Source: MNB, Eurostat

2 Financing approach and debt ratios

The economy's four-quarter financial balance sheet position also improved in 2024 Q1. Net inflows of FDI were significant, which paralleled the decrease in debt liabilities during the quarter. Based on the underlying trends, net external debt dropped to below 10 percent of GDP by end-March 2024, facilitated by transactions, revaluation and, to a lesser extent, nominal GDP growth. The reduction in net external debt was mainly related to a decline in the general government indicator, but the debt ratios of non-financial corporations also improved somewhat. After a marked decrease in 2023, the gross external debt ratio was unchanged at the beginning of 2024, remaining close to 64 percent of GDP. The level of international reserves was close to an historic high at EUR 46.4 billion at the end of the March, exceeding the level of short-term external debt, which is closely monitored by investors, by more than EUR 15 billion.

According to the financing data, the external balance position continued to improve in 2024 Q1. The four-quarter net borrowing of the economy declined from 0.6 percent to 0.1 percent of GDP in the previous quarter (Chart 10). While the net position in the financing approach continued to show net borrowing, the net borrowing according to the real economy approach continued to increase and exceeded 2 percent of GDP. Accordingly, the four-quarter external financing position calculated on the basis of both the real economic and the financing approach reflected an improvement over the previous quarter. The difference between the external balance indicators calculated according to the two approaches ('Net errors and omissions'[2]) was somewhat higher than in the previous quarters and amounted to 2.3 percent of GDP, with the difference retroactively reduced by the revision affecting households' financial instruments.

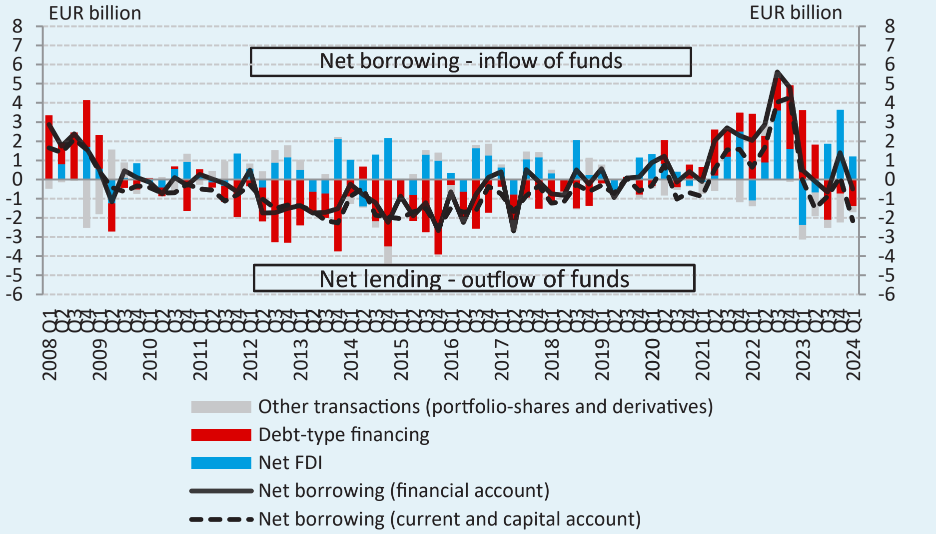
Chart 10: Two types of net lending (four-quarter data as a percentage of GDP)



According to the quarterly data, the net borrowing turned into net lending of EUR 0.5 billion in 2024 Q1, owing to a drop in net external debt accompanied by an increase in FDI (Chart 11). The decline in net external debt due to transactions was marginally higher than in the previous quarter, coming in at EUR 1.4 billion. Although the net FDI inflow of EUR 1.2 billion in 2024 Q1 fell short of the amount recorded in the preceding quarter, it was still significantly higher than the amounts observed during the first months of recent years.

[2] Trends in the balance of payments can also be analysed by examining the financing of real economy transactions. Indeed, the financial account shows what types of transactions were used by resident economic agents to finance transactions in the real economy that had an effect on net financial worth. While data derived from the real economy approach and the financing approach should be identical in theory, differences are likely to arise in practice due to non-integrated data sources, incomplete observation and the different treatment of the exchange rate, as indicated by the category of 'Net errors and omissions'.

Chart 11: Structure of net lending (unadjusted transactions)

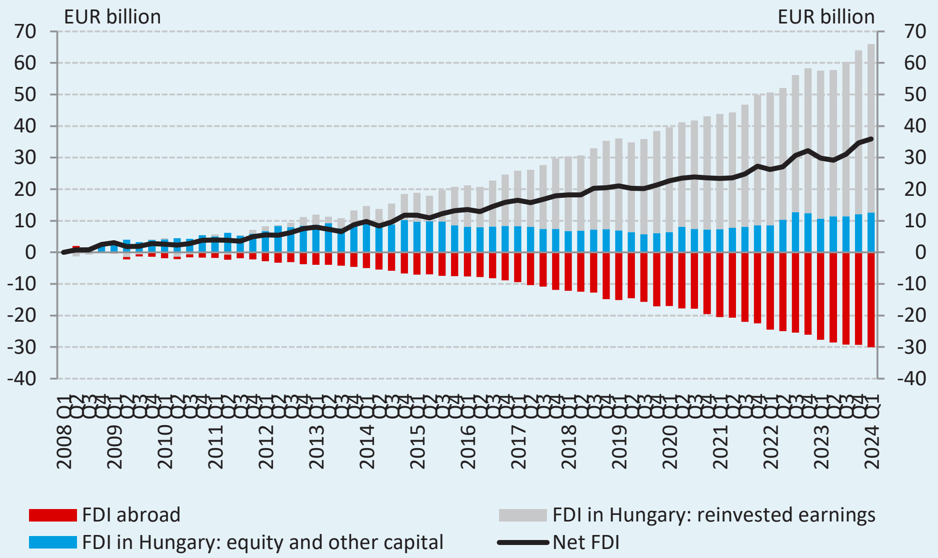


In economic terms, the fundamental development of the debt is not influenced by the conversion between account balance and bullion balances, and so this technical effect has been eliminated.

2.1 Non-debt type funds

FDI inflow continued in the first quarter, due mainly to reinvestment (Chart 12). Foreign direct investment in Hungary amounted to about EUR 2 billion in the first quarter, driven primarily by reinvested earnings, but also by a significant increase in the stock of intercompany loans. At the same time, domestic actors' investments abroad increased by a total of EUR 0.8 billion during the quarter. As a combined result of the above, net FDI inflow, which excludes pass-through investment, amounted to EUR 1.2 billion in 2024 Q1.

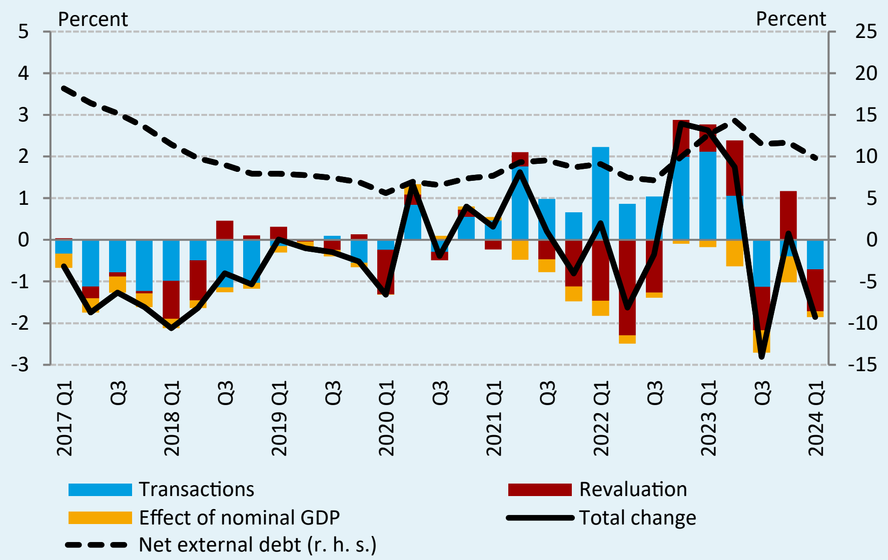
Chart 12: Developments in FDI, excluding capital-in-transit transactions (cumulative transactions)



2.2 Developments in debt indicators

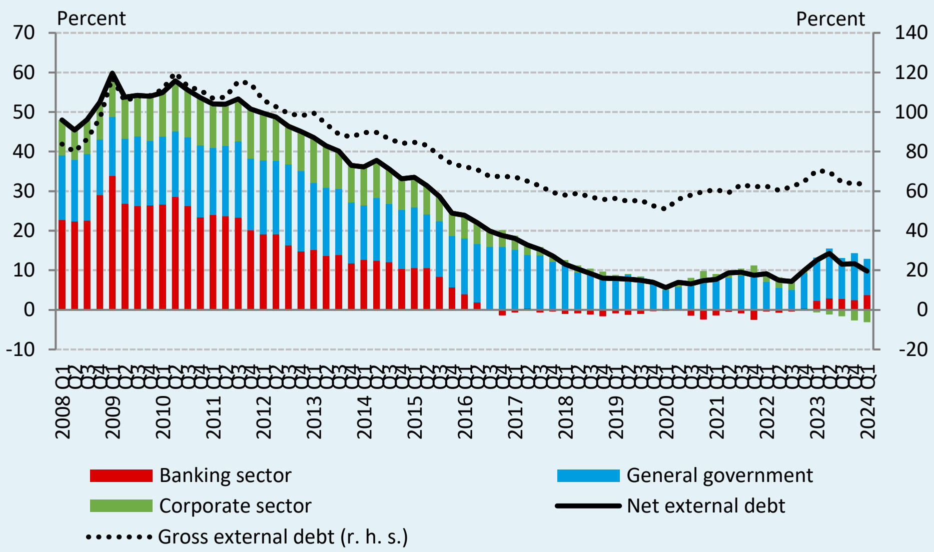
In 2024 Q1, according to the underlying trends, net external debt dropped to below 10 percent of GDP, after higher levels following the increase that started at the end of 2022. In addition to the substantial outflows of debt liabilities described earlier, the indicator was reduced by revaluation, primarily of portfolios of government securities held by foreign investors in connection with an increase in long-term yields, and was also influenced to some extent by the expansion of nominal GDP (Chart 13). Outflows of debt-type funds reduced net external debt by 0.7 percentage point, which was for the most part related to the general government sector and to a lesser extent to the corporate sector as well. The revaluation linked to changes in yields and exchange rates also reduced the value of the indicator by a significant 1 percent of GDP. The decline in nominal GDP reduced the net external debt as a percentage of GDP by 0.1 percentage point.

Chart 13: Components of the change in net external debt (as a percentage of GDP, excluding intercompany loans)



The decline in the net external debt ratio was mainly associated with the general government sector, but the debt indicator for non-financial corporations also improved moderately (Chart 14). The GDP-proportionate net external debt of the general government sector including the MNB decreased by 2.7 percentage points, mainly reflecting the impact of the outflow of government debt-type funds (e.g. a decrease in net debt in relation to a reduction in central bank discount bonds held by non-residents). In addition, revaluations linked to yield and exchange rate changes during the quarter also markedly reduced the debt indicator. The private sector's net external debt as a share of GDP rose by nearly 1 percentage point overall, due to a year-end correction in the bank debt ratio, while corporate net external debt declined. Banks' net external debt was driven by the increase in foreign liabilities, while higher receivables moderated the indicator to some extent. No change was observed, however, in the situation that has been prevailing since the end of 2022: the banking sector's foreign liabilities still exceed its foreign receivables, i.e. the sector's net debt indicator remains in positive territory, in contrast to the negative, close-to-zero level from after 2017. Corporate net external debt as a percentage of GDP decreased by 0.4 percentage point: foreign receivables rose, mainly in connection with an increase in commercial loans. At the same time, foreign debt also increased, although less markedly. The net external debt indicator for companies remained somewhat negative at the end of the first quarter, i.e. the foreign assets of the sector exceeded its foreign liabilities.

Chart 14: Breakdown of net external debt and gross external debt (as a percentage of GDP, excluding intercompany loans)



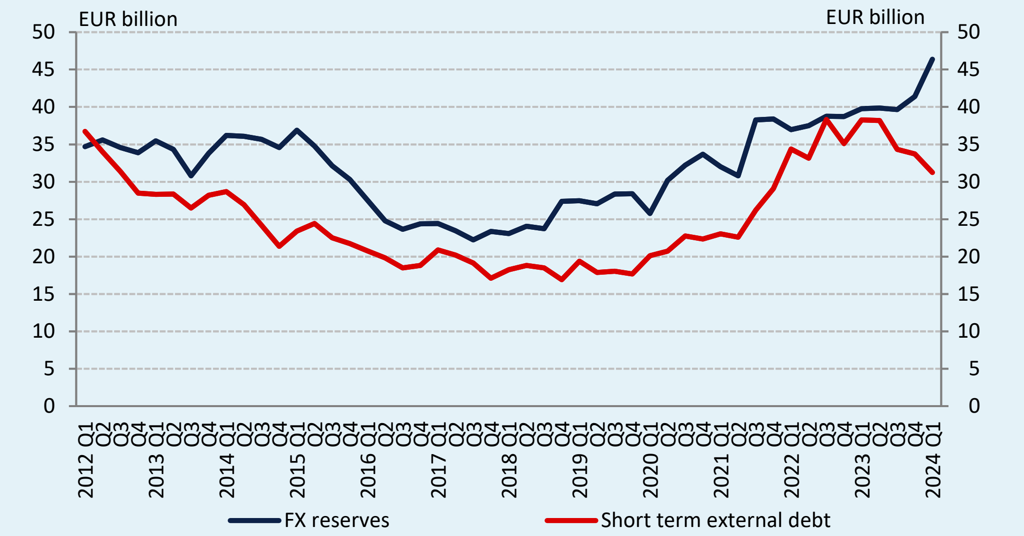
At the end of 2024 Q1, Hungary's gross external debt-to-GDP ratio stabilised at 64 percent. Following a rise at the end of 2022, the upward trend reversed in 2023 Q3, and since then the debt indicator fell by 5 percentage points, which for the most part reflected the decline in the general government's external debt. The indicator of the consolidated general government sector including the MNB dropped markedly, in line with the revaluation effects, while the increase in debt resulting from transactions (e.g. foreign currency bond issuance) had the effect of expanding the debt portfolio. The growth in the external liabilities of the banking sector was mainly related to short-term loans correcting after the year-end balance sheet adjustment. The gross external debt of companies as a percentage of GDP remained more or less unchanged.

International reserves stood at EUR 46.4 billion at the end of 2024 Q1, up significantly from EUR 41.4 billion at the end of 2023. Developments in international reserves were influenced by numerous factors, the most important of which were the following:

- The *net FX financing operations of the Government Debt Management Agency (GDMA)* increased the reserve level by a total of EUR 3.8 billion. According to the financing data released by the GDMA, gross foreign currency borrowing in the first quarter of the year was close to EUR 4.2 billion, while a dollar bond maturing in March entailed the repayment of about EUR 700 million. There was also a small amount of foreign currency borrowing.
- The net reserve-increasing effect of *EU funds* amounted to EUR 1.2 billion, which was primarily related to the inflow of agricultural funds and remaining amounts of 2014–2020 cohesion funds, along with some smaller advance amounts received from the Recovery and Resilience Facility (RRF).
- The reserve-reducing effect of the *Hungarian State Treasury's foreign currency transactions* amounted to nearly EUR 1.5 billion.
- Due to changes in the exchange rate, the *revaluation* of reserve items denominated in currencies other than the euro also increased the reserves.
- The *utilisation of the central bank's swap facility providing euro liquidity at the end of the quarter* and the balance of *international repo drawdowns* also increased the level of reserves compared to the end of 2023.

At the end of 2024 Q1, the MNB's international reserves exceeded the level of short-term external debt, which is monitored closely by investors, by a historic high of more than EUR 15 billion. At end-March 2024, international reserves and short-term external debt amounted to EUR 46.4 billion and EUR 31.2 billion, respectively. While the level of international reserves reached a historic high level during 2024 Q1, the reserve adequacy ratio, measured on the basis of short-term external debt, was also higher than ever since the start of the publication of short-term external debt data. The leeway above the Guidotti-Greenspan indicator, which is closely followed by both the central bank and investors, amounted to EUR 15.2 billion at the end of 2024 Q1 (Chart 15).

Chart 15: Short-term external debt of the Hungarian economy and its foreign exchange reserves

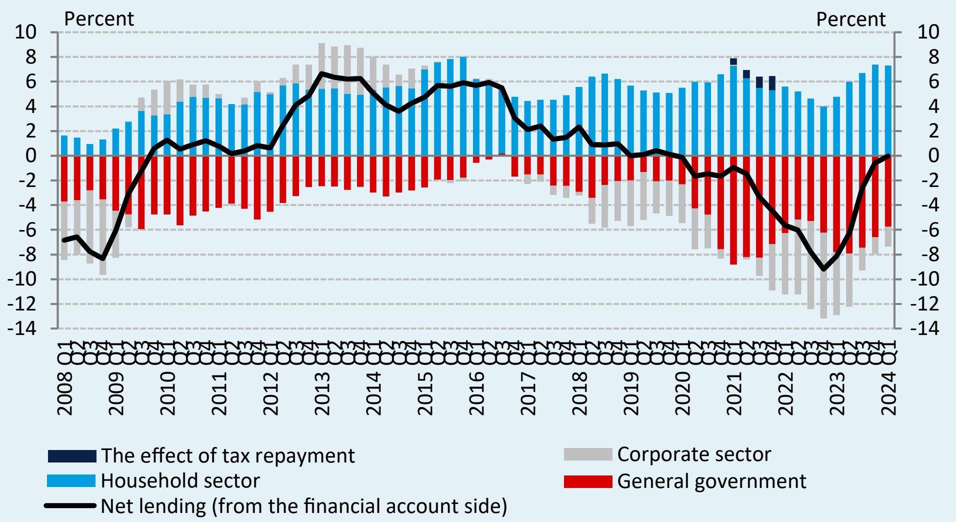


3 Sectors' savings approach

The net saving position of the economic sectors improved somewhat in 2024 Q1 in relation to the general government sector, while the net lending of the private sector decreased moderately. The net borrowing of the general government declined substantially, partly as a result of a drop in investment and partly as a consequence of rising tax revenues. The combined net financial savings of the household and the corporate sector decreased slightly, partly due to a pick-up in consumption and partly to falling corporate profits. Within household savings, the growth in government securities moderated, but the buoyant growth in mutual funds continued, while household holdings of bank deposits and cash also increased.

Sectoral saving flows suggest that the moderate decline in the private sector's net lending was accompanied by a decline of a larger degree than this in the fiscal deficit, resulting in a small improvement in the economy's net external position on the financing side, which is close to equilibrium (Chart 16). In the first quarter, the general government deficit narrowed to 5.7 percent of GDP, after falling by almost one percentage point in the first four quarters, partly due to subdued public investment and partly due to an increase in labour tax revenues. As a result of growing real incomes and a modest upturn in consumption, the net position of the household sector has stabilised at a high level of GDP, at 7.3 percent. At the same time, with investment activity remaining low and inventories shrinking, corporate profits as a share of GDP fell a bit, which was reflected in a modest overall increase in the sector's net borrowing. On the whole, as a result of a marginal deterioration in the private sector's position and a significant improvement in government net borrowing, the external financing requirement according to the various economic sectors' savings sank to a level close to equilibrium.

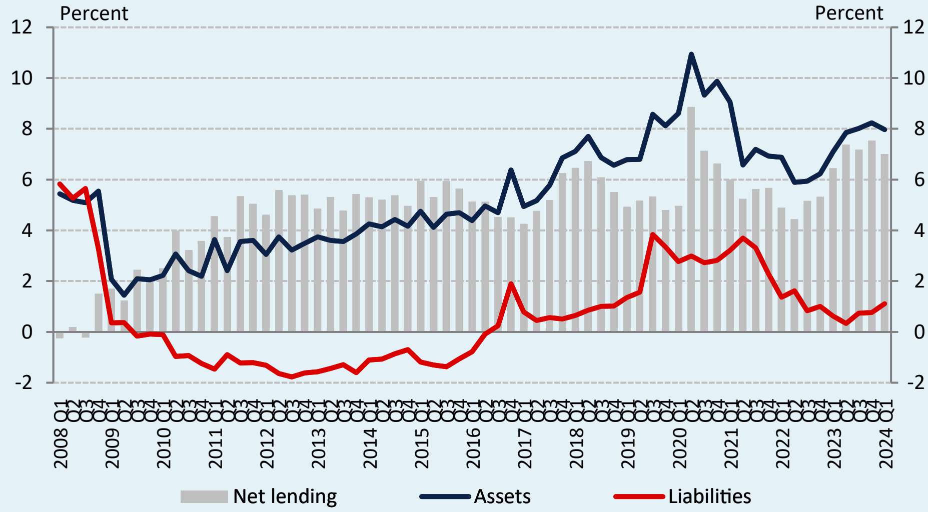
Chart 16: Net lending of specific sectors* (four-quarter values as a percentage of GDP)



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

According to the underlying trends, households' seasonally adjusted net financial savings decreased somewhat in 2024 Q1 versus the previous quarter, in parallel with a drop in financial assets and a modest decline in liabilities (Chart 17). Due to economic considerations, the MNB excludes one-off effects (such as earlier private pension fund savings, early repayment, real yield disbursement, indemnification of the depositors of liquidated mutual savings banks, forint conversion and settlement, personal income tax refunds) from the indicator based on underlying trends. One-off effects also influence the net indicator via the accumulation of financial assets and liabilities, and therefore the underlying trends are presented using net data along with the gross legs. According to the seasonally adjusted indicator, which is expressed as a percentage of GDP and captures the underlying trends, households' financial asset accumulation is still considered dynamic, driven by growing real wages and interest income, but as a consequence of the modest upturn in consumption, it decelerated somewhat in early 2024. Households' net borrowing as a percentage of GDP continued to increase, primarily in relation to a growth in demand for housing loans, while other borrowing remains somewhat subdued.

Chart 17: Households' net lending according to underlying trends

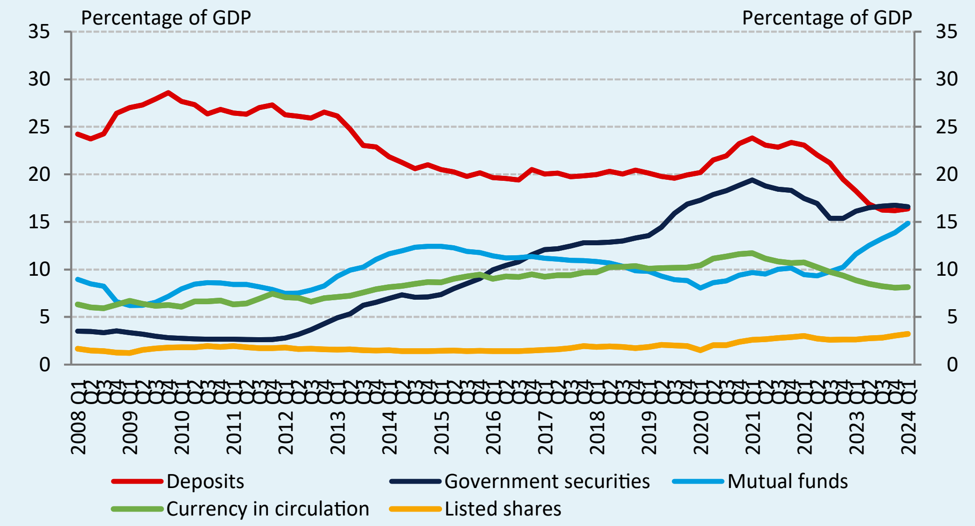


(seasonally and otherwise adjusted quarterly data, as a percentage of GDP)*
** Figures showing underlying trends, adjusted for pension fund savings, the early repayment scheme and the real yield disbursement, the indemnification of the depositors of liquidated mutual savings banks, the effect of forint conversion and settlement, and the PIT refund. Time series adjusted separately.*

Within the expanding financial asset accumulation, the share of investment funds continued to grow (Chart 18).

- In continuation of the trend observed in the last three months of 2023, overnight and other deposits increased by HUF 400 billion, resulting in stabilisation of the indicator as a percentage of GDP.
- Households' government securities holdings stabilised at over 16 percent of GDP, after increasing by more than HUF 150 billion due to transactions during the quarter. Within the government bond portfolio, redemptions of MÁP+ government securities continued to decelerate, as holdings of MÁP+ securities dropped by about HUF 40 billion in the first quarter. The stock of PMÁP securities declined by a substantial HUF 360 billion during the quarter under review, because the stock, which was declining partly because of interest payments, was renewed by private investors at a lower rate than before. In parallel with this, in the segment of variable interest rate securities, demand for BMÁP (PMÁP's alternative) showed a recovery after the previous quarter's decline, with holdings of this type rising more than HUF 70 billion due to transactions. The FixMÁP security, which pays a fixed interest rate every quarter, was launched in January and, as a result of surging demand, holdings had grown to more than HUF 270 billion by the end of the quarter. Similarly, sales of short-term fixed-income securities also picked up, with 1MÁP increasing by nearly HUF 170 billion. Driven by favourable yield conditions, quarterly transactions of BABA bonds nearly tripled year-on-year to about HUF 50 billion.
- During the first quarter, the stock of banknotes and coins held by households increased by more than HUF 180 billion, leaving household cash holdings at 8 percent of GDP.
- The buoyant, trend-like growth in the stock of mutual funds continued: after a moderate acceleration compared to previous quarters, the stock of investment funds increased by nearly HUF 600 billion as a result of transactions.

Chart 18: Developments in households' key financial assets



4 The short-term external debt of the economy diminished significantly

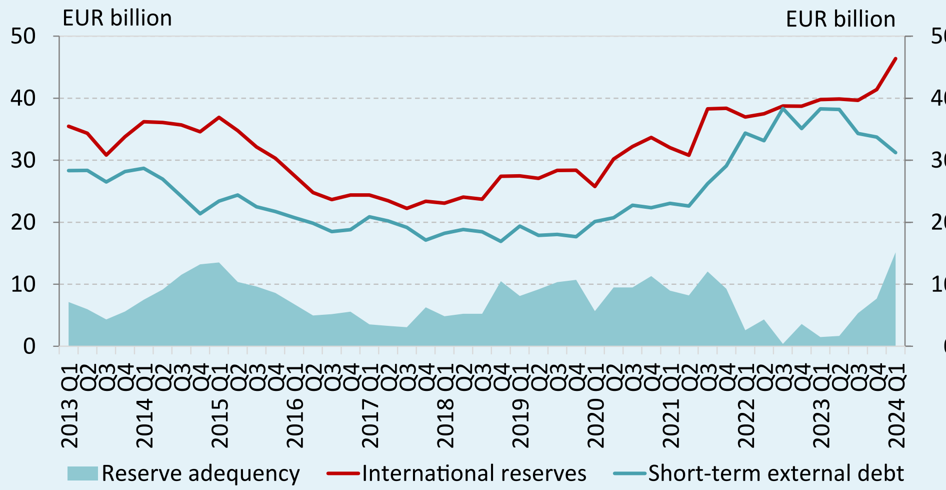
In the context of this special topic, we explore the recent improvement in reserve adequacy from the aspect of changes in short-term external debt. The significant decline in Hungary's short-term external debt since mid-2023 has been driven primarily by a normalisation of the macro environment, which has reduced the indicators for all three sectors. The external short-term corporate debt portfolio gradually normalised as the energy crisis subsided, and the central banks' use of special instruments, which is to be analysed together with banks' short-term external debt, declined, while the public sector index fell as a result of lower margins and amortising debt.

4.1 Lower short-term external debt indicates a decrease in vulnerability

Short-term external debt is an indicator that investors and international institutions focus on, as it provides information on a country's vulnerability. Short-term external debt is also an important indicator in its own right, as it provides insight into the sustainability of the foreign debt stock, the short-term refinancing needs and the associated risks. Investors and economists, however, also compare the indicator with the country's level of international reserves to form an idea of the vulnerability of the economy, because this may show whether the country could meet its external payment obligations for 1 year even if its external resources dried up. This is also the consideration underlying one of the most important reserve adequacy indicators: the Guidotti-Greenspan rule. This means that the larger the reserve adequacy leeway, the more resilient an economy is to external financing shocks (sudden stops); the extent of this leeway is therefore of particular interest to foreign investors. The recent increase in the reserve adequacy leeway has been driven by favourable shifts in both of these factors (Chart 18). On the one hand, at the beginning of 2024, the Government Debt Management Agency (GDMA) borrowed a significant amount of long-term funds in foreign currencies from abroad, which together with the restart of EU funds inflows, greatly contributed to the significant increase in foreign exchange reserves. On the other hand, the decrease in short-term external debt also continued. This factor is examined in more detail in our special topic.

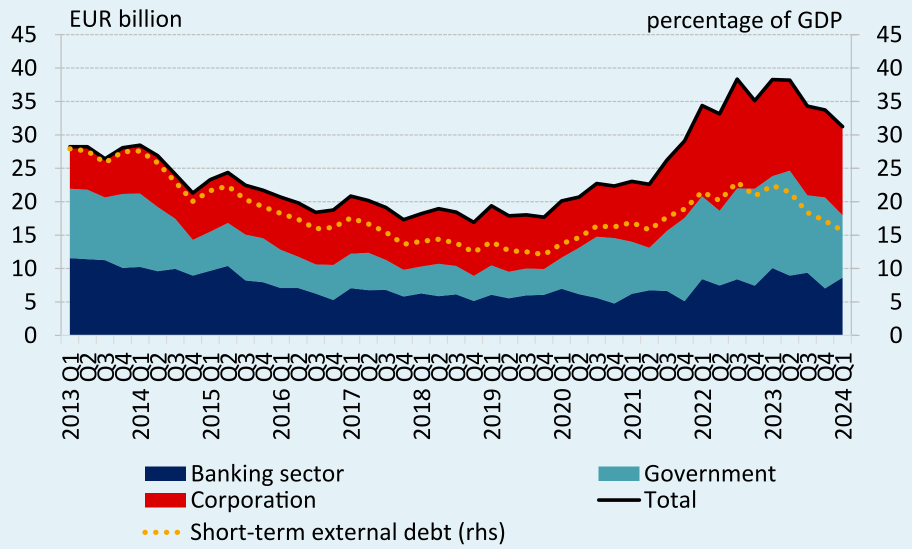
Hungary's short-term external debt has declined significantly since mid-2023. After the financial crisis, the indicator declined gradually up to 2018, in line with the economy's adjustment process and the resulting current account surplus as well as the associated drop in Hungary's external debt. However, the stock of external debt maturing within a year increased slowly at first and then accelerated from 2021 on, due to the impact of the crises (pandemic, energy crisis, Russian-Ukrainian war) that hit Hungary in several waves starting from 2020. Over the past year or so, however, we have witnessed a more marked decline, and the factors contributing to this are explored in more detail in this special topic.

Chart 19: Changes in short-term external debt and foreign exchange reserves



All three sectors played a role in the recent decline in short-term external debt (Chart 20). The indicator comprising the general government sector (including the public sector and the central bank, which will be discussed separately later) increased substantially at the end of 2022 after a steady decline in previous years, and then dropped back to its previous low level by the beginning of 2024. On the whole, however, only a small part of the national economy's indicator can be attributed to this sector in recent years. In parallel with a decrease in non-residents' speculative HUF position, however, there has also been a significant decline in the banking sector recently. The corporate sector also witnessed a gradual slowdown after the surge during the energy crisis. Overall, the recent decline in the economy's short-term external debt has been reflected in both the nominal debt ratio and the ratio expressed as a percentage of GDP, which is approaching pre-crisis levels.

Chart 20: Short-term external debt by sector

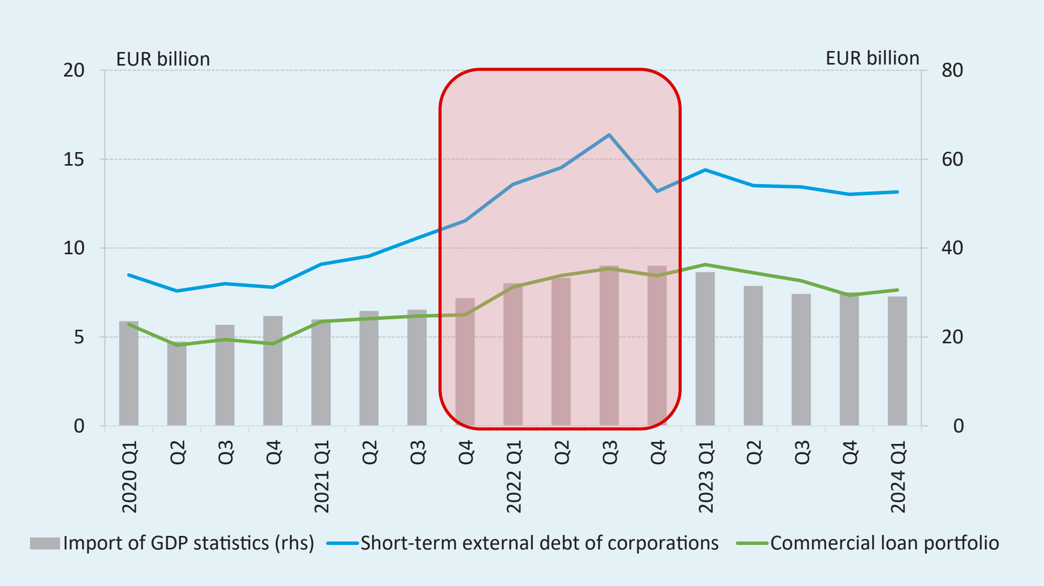


Note: The public sector's short-term external debt includes the central bank indicator as well.

4.2 Lower energy prices reduced corporate short external debt

The short-term external debt of non-financial corporations corrected as energy prices normalised. After years of stable growth, the short-term external debt of the corporate sector – the bulk of which is trade debt – rose by nearly EUR 5 billion in the span of one year from the end of 2021 to over EUR 16 billion, accounting for about one half of the increase in the short-term external debt of the economy as a whole (Chart 21). For the most part, the rapid rise in the sector's short-term external debt was driven by an increase in trade credit linked to rising import, commodity and energy prices. In addition, the portfolio on margin accounts for hedging purposes and other foreign borrowing presumably to finance the sudden surge in costs also increased during the period. With the easing of the energy crisis, the short-term external debt of corporates fell to close to EUR 13 billion by the end of 2023, primarily due to a decline in trade credit. This was mainly due to energy prices gradually returning to normal from the end of 2022, but the slowdown in exports in 2023 and the associated decline in import volumes may also have been a contributing factor.

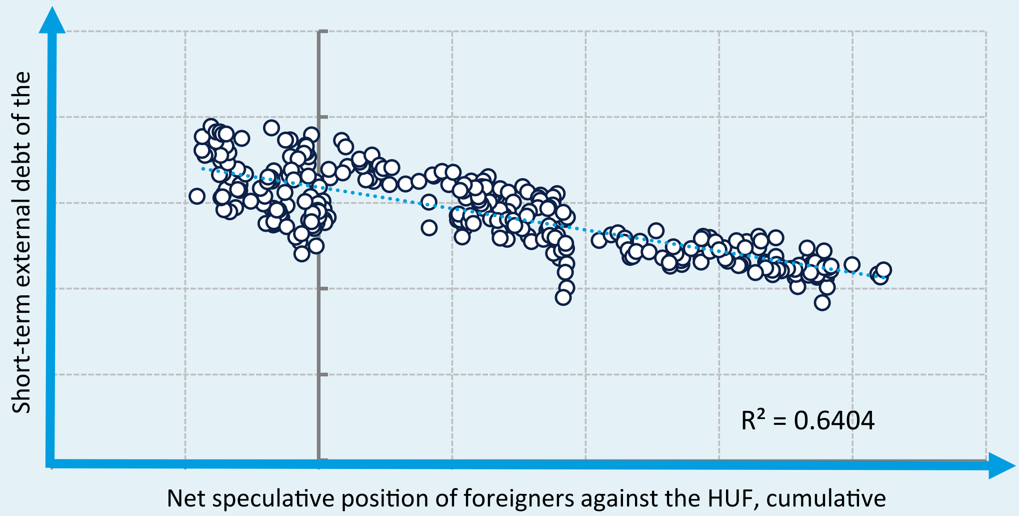
Chart 21: Short-term external debt of non-financial corporations and its determinants



4.3 As a result of normalising macro environment banks' short debt shrinked

The drop in banks' short-term external debt is linked to the normalisation of the macro environment. The importance of banks' short-term debt was also highlighted by the 2008–2009 crisis, as the banking system also contributed to the pre-crisis rise in short-term external debt. Short-term external bank debt then declined, reaching a local low in 2019 (with an annual average of EUR 6.3 billion), before rising and almost doubling by 2022. First the COVID-19 pandemic, then the energy crisis, the fragmentation of supply chains and the related inflation shock triggered spill-over effects not only in Hungary but also in Europe and around the world. These turbulences led to significant tensions in the economy as a whole and in almost all sub-markets and were reflected in a surge in interest rates and an increase in domestic risk premia and exchange rate volatility, as well as in the banking sector's increasing short-term external debt. In order to fight inflation and ensure financial market stability, Hungary needed a significant increase in the effective interest rate. The internationally attractive conditions amidst high domestic and global liquidity resulted in significant inflows of foreign capital, while the financing of rising external imbalances due to the energy price shock also necessitated foreign funds, a part of which appeared in banks' balance sheets as foreign debt. Likewise, with the record fast recovery of the external equilibrium during the past year and a half, the direction of the flows of foreign funds also reversed, with banks' short-term external debt declining in line with the gradual reduction in the speculative position of foreigners (Chart 22).

Chart 22: The relationship between the banking system's short-term external debt and non-residents' speculative position



Note: Daily data from 3 January 2023. Time series without end-of quarter data that are outliers because of short-term balance sheet adjustment.

Banking system participants have bridged temporary financial market volatility since 2020 partly with the help of central bank instruments made available to ensure financial market stability and have kept their short-term external debt at moderate levels even during periods of financial market turbulence.

4.4 Declining central bank short external debt

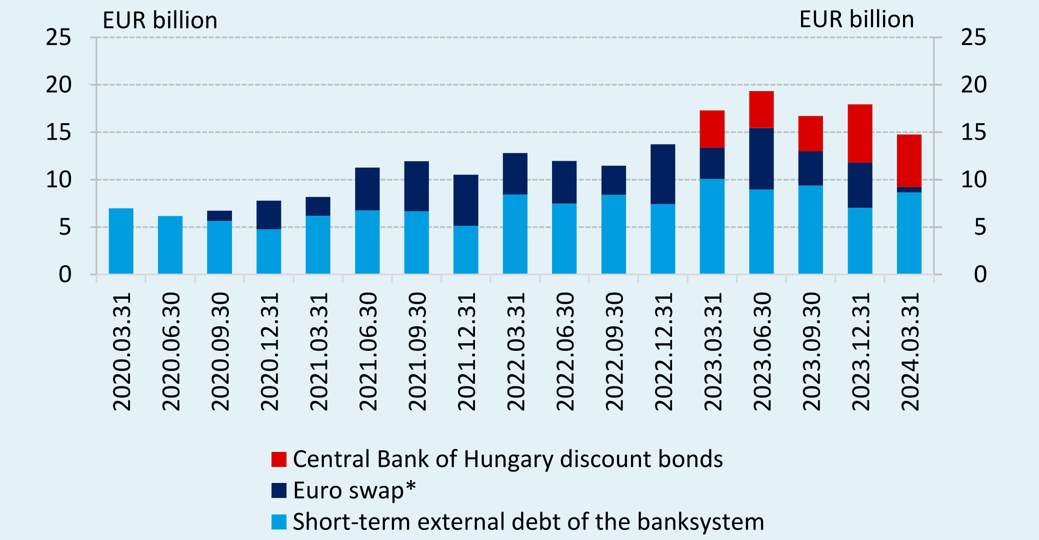
Central bank instruments introduced to strengthen the transmission mechanism and sustain financial market stability have reallocated short-term external debt. From early 2020, the central bank introduced instruments with the help of which it managed to stabilise the financial markets at the ends of quarters even during periods of international turbulence (pandemic, energy crisis, Russia-Ukraine war), with a particular focus on reducing the end-of- quarter volatility of swap market yields. The MNB conducts cross-currency swap tenders and discount bond auctions every quarter to provide liquidity in EUR over the end of the quarter and the beginning of the next one. With its active presence in the market, the MNB aims to strengthen the efficiency of monetary transmission by addressing financial market tensions in all relevant markets.

- From the autumn of 2020 onwards, the central bank provided quarterly foreign exchange liquidity for the banking sector, and this tool has been available on a continuous basis since July 2022 between the end of each calendar quarter. The foreign currency liquidity provided by the MNB to ease financial market tensions at the ends of quarters, supports the efficiency of monetary transmission during the quarter-end adjustments in banks' balance sheets, when foreign players temporarily place their HUF-deposits on the swap-market, thereby reducing the short-term debt of the banking sector. The instrument has reduced the volume of foreign currency-acquiring swaps with market players, which lowered volatility in the swap market that resulted in more stable HUF yield levels, which are necessary for financial market stability. The MNB may also use its instruments with international organisations (e.g. ECB Repo Line) to finance the foreign exchange swap provided; these, however, increase the MNB's short-term external debt. On the whole, therefore, central bank instruments rearrange the distribution of short-term external debt across sectors, while strengthening market stability.

- Also in order to sustain financial market stability and strengthen monetary transmission, the MNB launched its first discount bond tenders in December 2021, initially on a quarterly basis, and from February 2023 on a weekly basis. Some of the negotiable bonds are held by non-residents, which also results in a sectoral shift: the central bank's larger short-term external debt is accompanied by lower short-term external debt in the banking system, creating a more stable money market yield environment.

The central bank's short-term external debt declined significantly as financial market turbulence eased. The central bank instruments provided for the banking system to ease financial market tensions led to an increase in the MNB's short-term external debt during more volatile periods, while also mitigating turbulence by keeping the external debt of the banking system moderate at the ends of quarters. Thus, although the use of the instruments did not affect the size of short-term external debt at the level of the national economy as a whole, it did greatly alleviate tensions in the interbank market during turbulent periods via a rearrangement between sectors. As financial markets normalised, the banking system's use of the foreign exchange liquidity swap facility declined from 2023 H2, reducing the central bank's international repo drawdowns and, in turn, the external short-term debt.

Chart 23: Evolution of the liquidity management instruments provided by the MNB



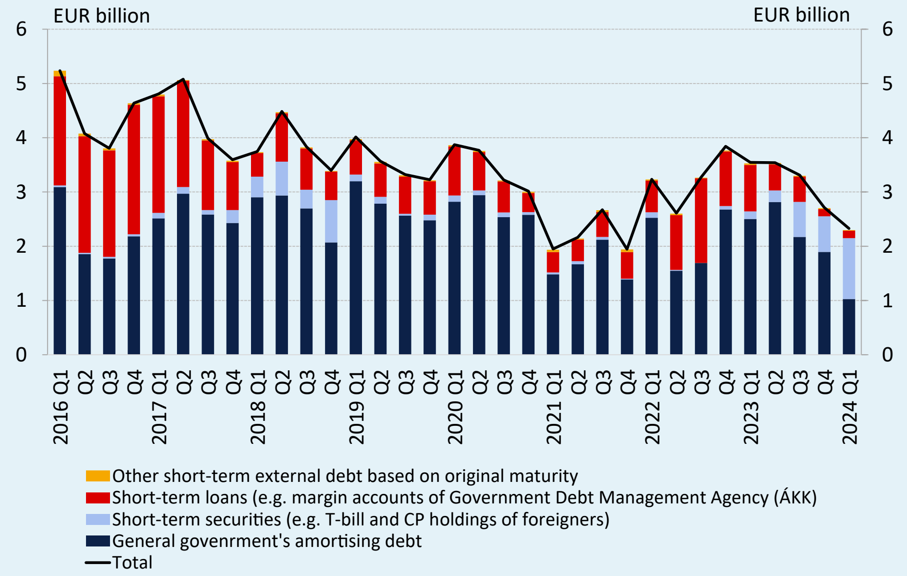
**The swap instrument for ensuring euro liquidity has been applied by the MNB since the autumn of 2020; initially at the end of each quarter, and since 2022, on a daily basis.*

4.5 The drop in the public short external debt was supported by several factors

Public short-term external debt has also moderated in recent quarters, as the margin stock dropped to a low level and amortising debt decreased. Short-term external public debt also increased during the turbulent periods in the autumn of 2022, but international developments explain only part of the increase in this indicator, while the trends in financing public debt also had such impacts. The sector's short-term external debt increased from the previous level of EUR 2 billion to nearly EUR 4 billion, driven initially by a larger stock of originally short-term external debt, including a larger GDMA margin stock caused by the strengthening of the USD. The sector's total short-term debt portfolio peaked at the end of 2022, and then remained at a high level, because the remaining time to maturity of two dollar bonds maturing in November 2023 and March 2024, became shorter than one year. However, the repayment of these bonds – partly financed from the record amount of long-term foreign funding raised in early 2024 – reduced not only the public sector's amortising debt, but, due to the loss of the related margin, also the sector's originally short-term external debt. Moreover, the sector's originally short-term external debt has also diminished since October 2022, partly as a result of the strengthening of the EUR against the USD. Since the autumn of 2023 however, the portfolio of the originally short-term external debt has been increasing again, in connection with securities issued under the ECP (Euro Commercial Paper) programme[3] in a total amount of USD 1 billion. Thus, overall, the decrease in the national economy's short-term external debt and the improvement in reserve adequacy were driven by the drop in the portfolio of amortising debt, and the shrinking of the margin as well.

[3] The aim of the issue, according to the GDMA, may be to cost-effectively expand the short-term liquidity management toolbox in the current high interest rate environment and to further diversify the investor base.

Chart 24: Components of general government short-term external debt



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

July 2024

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

H-1013 BUDAPEST, KRISZTINA KÖRÚT 55.