BALANCE OF PAYMENTS REPORT

27 September 2023

Hungary's current account balance swung into surplus and will stay there. External debt ratio stagnated as a rapid rise in debt was counterbalanced by fast growth in nominal GDP.

In 2021 and 2022 soaring gas prices and energy import bills undermined the external position of Hungary, the C/A deficit rose from zero to 8% of GDP by 2022. In 2023 a drastic drop in gas prices and the fall in consumption and investments caused the C/A balance swing to a surplus of 1% of GDP by Q2. On the other hand, EU transfers dried up, and the NEO remained high, the net external financing capacity also improved sharply, from -10/12% of GDP to around zero. Gross external debt rose further, nevertheless fast nominal GDP growth counterbalanced it, and the previous main increasing trend in the major indicators of external debt has been replaced by stagnation.

Looking ahead, we revise our current account forecast from -1% of GDP to 0% in 2023, and from 0% to +1.5% in 2024 (consensus: -2.8% and -2.2%). We expect external debt trajectory to stagnate or to slightly ease from the current level of 65% of GDP.

Indicators of external balance: the C/A balance improved from -8% to +1% in Q2. (Charts 1–6.)

- Hungary's C/A balance improved further, from EUR -3 bn (NSA) a year ago, or from EUR -4 bn in H2 2022 (SA), and from EUR -1.5 bn in Q1 2023 (SA), to a surplus of EUR 0.7 bn (NSA) or 0.5 bn (SA) in Q2. Last year, the balance was -8% of GDP, now it was +1% in Q2. The data is marginally worse than the preliminary data (EUR +0.9 bn) or our nowcast (EUR +0.75 bn). The huge improvement of the C/A balance was driven by three main factors. First, as energy prices normalized, the energy bill also came down to more normal levels after the extreme figures in 2022: the quarterly energy balance improved from EUR -4.9 bn to EUR -2.9 bn in Q1, and to EUR -1.7 bn in Q2. The non-energy balance is also improving (from a quarterly EUR 0.5 bn to EUR 2 bn+), as exports growth remained robust, while decreasing consumption and the 15% fall in investments dragged down imports. The preliminary monthly C/A figure for July (EUR -0.14 bn NSA) also shows a surplus of 1% of GDP after seasonal adjustment.
- **EFC1:** Hungary's external financing capacity (the sum of the current account and the capital balances) also improved to +2.5% of GDP from the bottom of -7/-8% in H2 2022. It should be emphasized that in the past few years the EFC was usually significantly higher than the C/A balance, as capital balance used to reach a surplus of 2-3% of GDP due to EU cohesion fund inflows. By now, the surplus in the capital balance fell back to +0.5-1% of GDP as EU funds dried up.
- **EFC2** (EFC1 plus net errors and omissions), which we usually consider as the first best indicator[1] of external imbalances, has also improved, from -10%/-12% of GDP in 2022, and from -5.7% in Q1 to -0.7% in Q2. The NEO remained high at around 3% of GDP, which still increases the uncertainty around the interpretation of the external position. We can only repeat what we wrote in our previous reports: that the high NEO could be caused by hidden imports, problems related to following derivative positions (due to the increased price volatility on financial and commodity markets), or higher capital outflows under the radar. All in all, the EFC2 remained more negative than the C/A balance, as net external debt rose faster than the pace that would be consistent with the C/A and capital balance figures.

[1] We always emphasise that we consider EFC2 the first best indicator of external position, as it includes the transfer balance and the NEO (net errors and omissions); the EFC2 is not only consistent with the evolution of external liabilities (stock data are usually more reliable), but is also less affected by the frequent revisions between the C/A balance and the NEO lines.

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Energy balance: further decrease in Q2, in line with energy price normalization

- The energy intensity of the Hungarian economy is high by European standards (high share of energy-intense industry, low share of insulated houses), while local energy production is low, so Hungary's import dependence is huge. Net energy imports are high both in regional and European comparison.
- Trade statistics suggest that Hungary buys gas at a price that follows the TTF with some delay. Before the energy crisis, Hungary spent an annual amount of EUR 5-6 bn on energy in net terms, which rose to EUR 7 bn in 2021 and to EUR 17 bn in 2022, while it reached an annualized EUR 20 bn in Q3-Q4 2022 due to soaring gas and electricity prices. After energy prices more or less normalized, net energy import fell to an annualized EUR 10-10.5 bn (SA) in Q1, and to EUR 6.4 bn in Q2. With the current market prices of energy we expect an energy balance of EUR 8-8.5 bn in 2023 as a whole and also in 2024. (The Hungarian energy company hedged gas prices at higher gas price levels, however the effect of the hedge is not affecting the C/A balance, where gas imports are booked at market prices).

Capital flows: negative net FDI inflow due to M&A, debt absorption remained high (Charts 7 and 8)

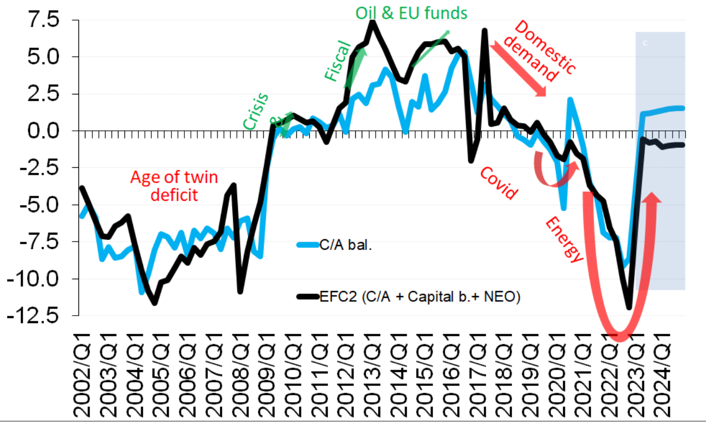
- After the net FDI outflow of EUR 2.6 bn in Q1, net FDI inflow remained negative (EUR -1.3 bn), so year-to-date net FDI inflow was negative. While the first half of the year is usually weak due to dividend payments, this figure is weaker than expected, partly due to strong M&A activity of Hungarian companies abroad and the purchase of local Vodafone subsidiary by the state and 4IG. Therefore the four-quarter average FDI moderated to +0.6% of GDP. Taking into account the recessionary global environment and that a potential purchase of Budapest Airport (the total price could be EUR 4-4.5 bn EUR, 51% of that could be paid by the government) is on the table, net FDI could remain week until 2024.
- Net incurrence of external debt was EUR 2 bn in Q2 and remained near EUR 12 bn or around 7% of GDP in the past four quarters, twice as much as in 2021, as last year the deterioration in the energy balance and this year's M&A activities have been covered largely by debt.

Indebtedness and reserves: rising nominal external debt level is counterbalanced by fast GDP growth (Charts 10-12).

- First, we emphasise that we use the BoP and external debt figures without SPVs. In our view, the figures that contain special-purpose vehicles are heavily distorted by entities that do not have too much to do with the Hungarian economy. Therefore we rely on data cleaned from SPVs, as these data are much more consistent with the Hungarian macro-trajectory, and give us reliable information on indebtedness and vulnerability. We also filter out intercompany loans, which we consider to be more FDI-like than debt.
- The gradual but steady decline in the indicators of external debt was a key factor in supporting Hungary's credit story, and its rating as well. After topping out in 2009-2010 at very high levels (120% of GDP), gross external debt (without SPVs and intercompany debt) fell to levels of around 53% of GDP, which could be considered low even in regional comparison. In 2020 the decrease in debt was reversed (just like in most CEE countries; see Chart 7), and gross and short-term debt followed upward trajectories, but levels are still not high in comparison with peers.
- **Gross external debt** without SPVs and intercompany lending rose by EUR 4 bn in Q2 and by EUR 26 in a year, to EUR 123 bn in nominal terms, driven mainly by the external debt of the government. Luckily the fast growth in nominal debt was mainly counterbalanced by the growth in GDP figures, therefore gross external debt to GDP stagnated just around 65% of GDP (and not around 70% as we wrote in our previous report, where we made a mistake).
- **Gross external FX debt** followed the same pattern in recent years: after hitting very high levels in 2009-2010 (90% of GDP), it fell sharply (to 30% by 2019) and has been on the rise since then (due to the government's intense Eurobond issuance and owing to the HUF's weakening). In Q1 it was at 42% of GDP, down from 44-46% in the past three quarters.
- **Net external debt** was stagnating around 10% of GDP for an extended period, but it also started to grow gradually from 2020, and by Q2 it reached 16% of GDP.
- **Short-term external debt stagnated at EUR 38 bn, and it eased to 20% of GDP.**
- **Hungary's FX reserves position could be considered as tight or just adequate,** as reserves rose to EUR 40 bn, while the reserve adequacy rules that we consider relevant (the short-term debt rule, and the IMF rule) run around EUR 37-38 bn. This level of FX reserves does not provide much room for manoeuvre for the national bank to intervene.

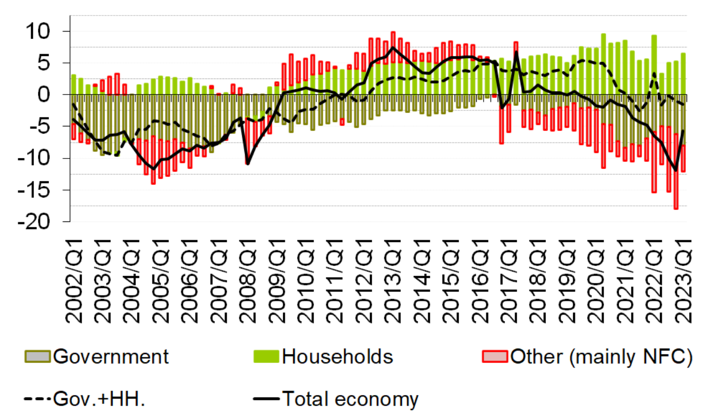
Looking ahead: Due to the further drop in energy prices, faster-than-expected export growth, and larger-than-expected drop in domestic demand, we revise our C/A balance forecast to 0% for 2023 (from -1% in the latest BoP report), and we expect +1.5% for 2024. These figures are better than the market consensus of -2.8% (2023) and -2.2% (2024). We think risks are balanced, as the weak global outlook moderates the probability of a drastic increase in energy prices, while domestic demand might remain weaker than in our baseline scenario. The net financing requirement (EFC2) could be 1.5-2 percentage points weaker in 2023 and in 2024, as the high NEO could lead to revisions, which might increase the C/A later, while we expect low EU fund absorption (around 1% of GDP this year, and 0.5% next year). We expect the gross-external-debt-to-GDP ratio to stagnate around the current level of 65% of GDP in 2023 and 2024.

Chart 1: Main indicators of external balance
(as % of GDP, SA)



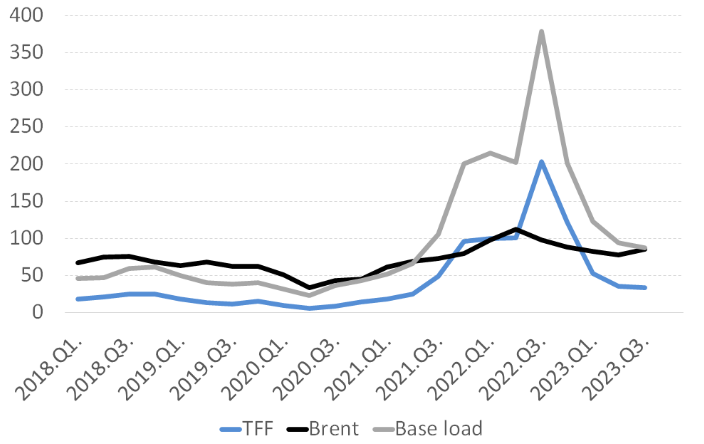
Sources: MNB, OTP Research

Chart 2: Net financing capacity of the main sectors and the whole economy (as % of GDP, SA)



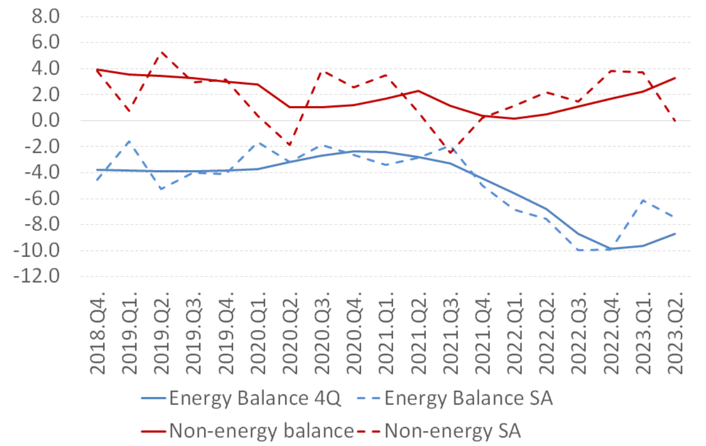
Sources: MNB, OTP Research

Chart 3: Energy prices (quarterly averages)
(TTF: MWh; Brent: USD/barrel; electricity: MWh)



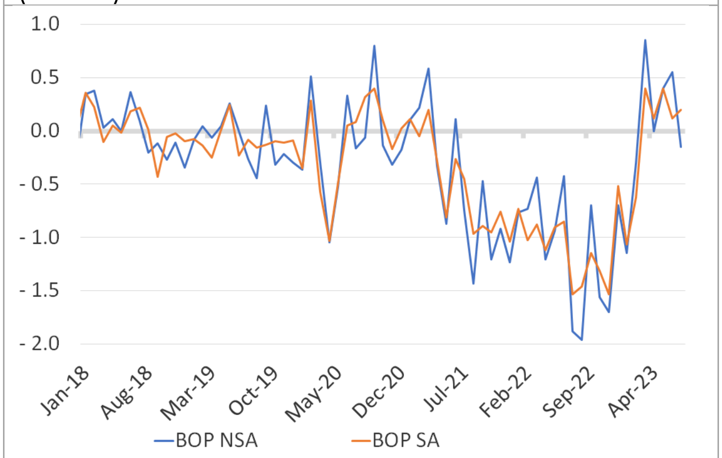
Sources: MNB, KSH (negative numbers represent outflow)

Chart 4: Energy and non-energy balance as % of GDP
(4Q averages; and quarterly SA figures; %)



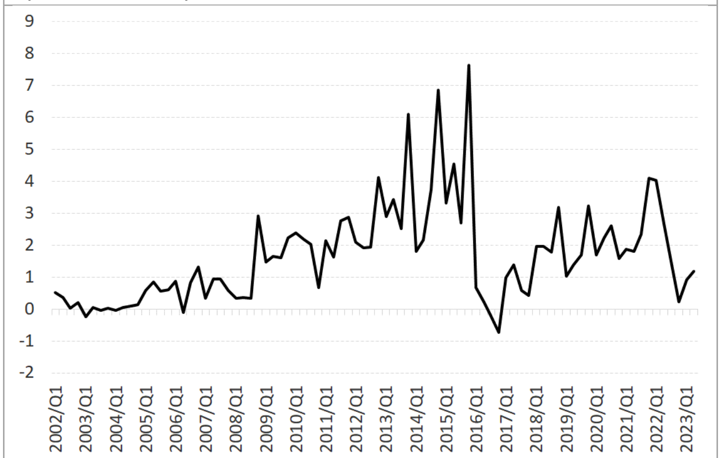
Sources: MNB, OTP Research (negative numbers represent outflow)

Chart 5: Monthly current account deficit
(EUR bn.)



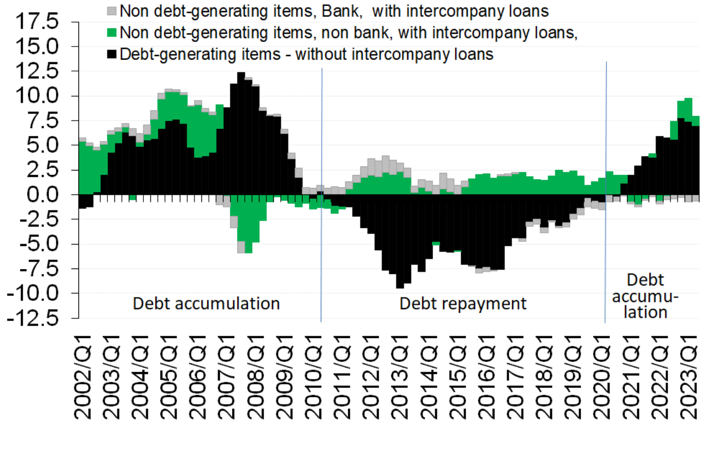
Sources: Eurostat, OTP Research

Chart 6: Capital balance
(as % of GDP, SA)



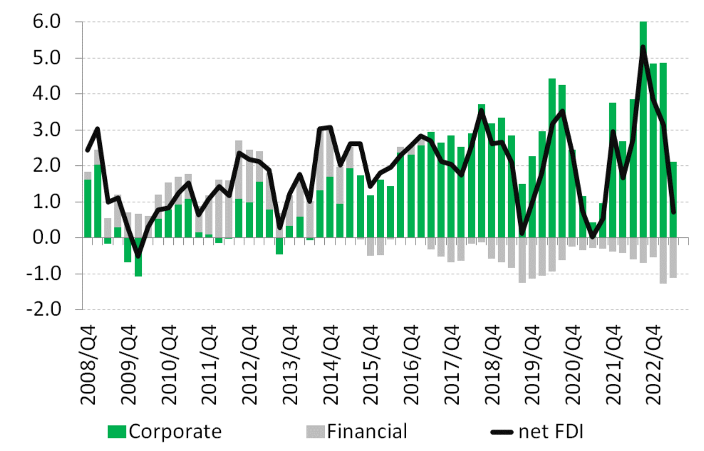
Sources: MNB, OTP Research (negative numbers represent outflow)

Chart 7: Structure of (net) capital flows
(as % of GDP, four-quarter average)



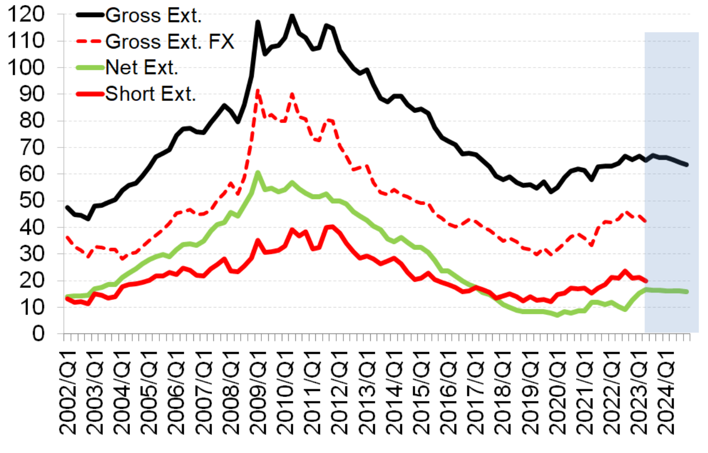
Sources: MNB, KSH (negative numbers represent outflow)

Chart 8: Net FDI inflow
(4Q sum; EUR bn)



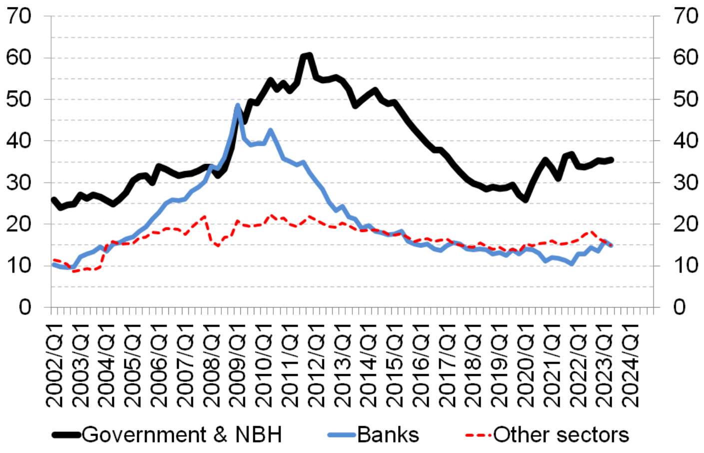
Sources: MNB, KSH (w/o intercompany debt)

Chart 9: Gross external debt (w/o intercompany debt, as % of GDP, data available till Q2 2022)



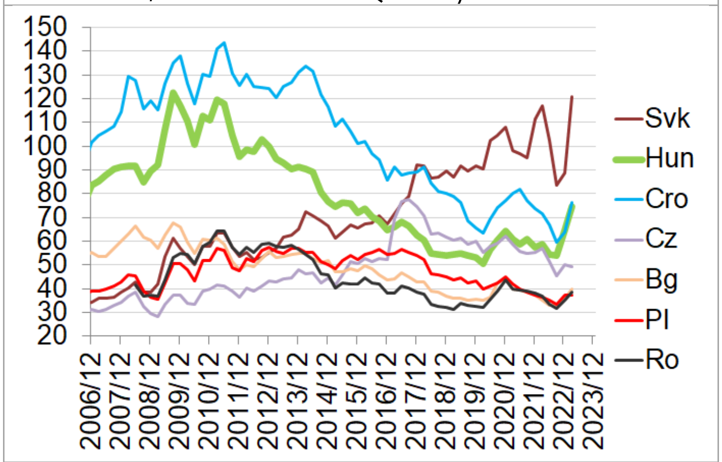
Sources: MNB, OTP Research

Chart 10: Gross external debt by sectors
(as % of GDP)



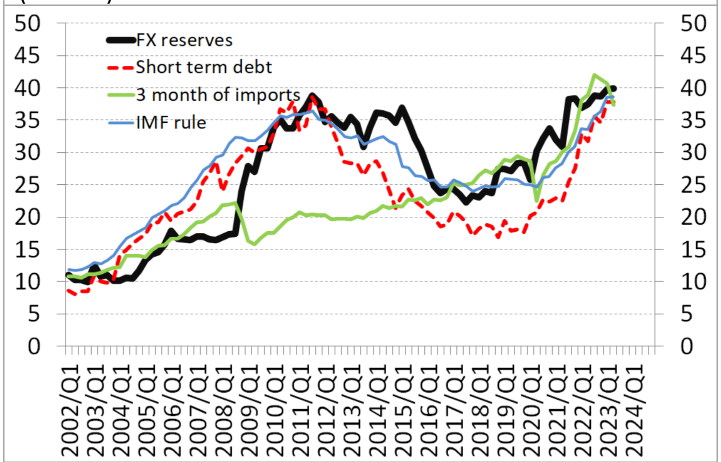
Source: MNB, OTP Research

Chart 11: Gross external debt (w/o intercompany debt, as % of GDP, data available till Q4 2022)



Sources: MNB, OTP Research

Chart 12: Reserves and reserve adequacy rules
(EUR bn)



Source: MNB, OTP Research

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