MACROECONOMIC AND FINANCIAL MARKET DEVELOPMENTS

BACKGROUND MATERIAL

TO THE ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING

OF 23 JULY 2024

JULY

2024

Time of publication: 2 p.m. on 7 August 2024

The background material 'Macroeconomic and financial market developments' is based on information available until 18 July 2024.

Article 3 (1) of the MNB Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines achieving and maintaining price stability as the primary objective of the Magyar Nemzeti Bank. The MNB's supreme decision-making body is the Monetary Council. The Council convenes as required by circumstances, but at least twice a month, according to a pre-announced schedule. At the second scheduled meeting each month, members consider issues relevant to decisions on central bank interest rates. Abridged minutes of the Council's rate-setting meetings are released regularly, before the next policy meeting takes place. As a summary of the analyses prepared by staff for the Monetary Council, the background material presents economic and financial market developments, as well as new information which has become available since the previous meeting.

The abridged minutes and the background materials to the minutes are available on the MNB's website at:
https://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

Table of contents

1. Macroeconomic developments 4
   1.1. Global macroeconomic environment 4
   1.2. Real economic trends in Hungary 6
      1.2.1. Economic growth 6
      1.2.2. Employment 7
   1.3. Inflation and wages 9
      1.3.1. Wages 9
      1.3.2. Inflation developments 9
   1.4. Fiscal and external balance trends 11
      1.4.1. Fiscal trends 11
      1.4.2. External balance developments 11
2. Financial markets 13
   2.1. International financial markets 13
   2.2. Developments in domestic money market indicators 15
3. Trends in lending 16

1. Macroeconomic developments

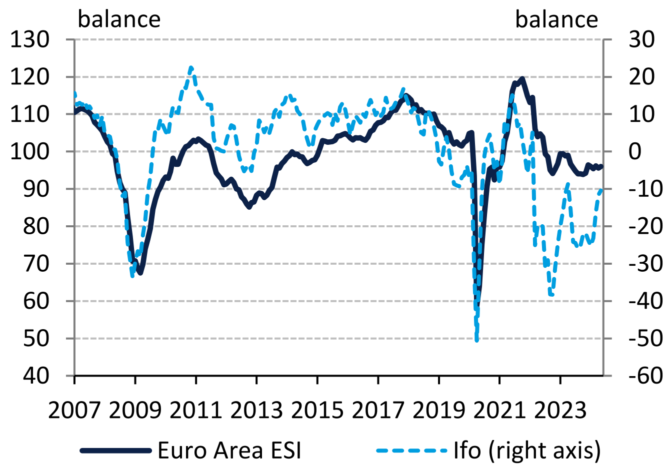
1.1. Global macroeconomic environment

In 2024 Q1, GDP growth was faster year-on-year in the United States and more moderate in the European Union, while in China it was slower than expected in Q2. International labour market developments remained favourable in June. The euro area's economic sentiment index deteriorated. At 3.0 percent, annualised inflation in the United States was 0.3 percentage points lower in June compared to the previous month. In China, consumer prices rose by 0.2 percent on an annual basis. Euro area inflation fell to 2.5 percent year-on-year, while core inflation was 2.9 percent.

In 2024 Q1, GDP growth was faster year-on-year in the United States and more moderate in the European Union, while in China it was slower than expected in Q2. GDP in the United States expanded by 2.9 percent on an annual basis in 2024 Q1. The 0.3 percent growth in the EU in the previous quarter was followed by a 0.5 percent expansion, while GDP in the euro area rose by 0.4 percent on a seasonally and calendar-adjusted basis. Based on first-quarter data for EU Member States, GDP grew in 20 countries on an annual basis. In China, growth in the second quarter was slower than expected (5.1 percent) at 4.7 percent.

In May, industrial production increased in the US and China, while retail sales volumes rose in the US, China and the euro area. Industrial production expanded by 5.6 percent in China and by 0.4 percent in the US in May. Industrial production in the euro area fell by 3.0 percent on an annual basis in April. Retail sales increased by 3.7 percent in China, 2.3 percent in the US and 0.3 percent in the euro area in May.

Chart 1 Business climate indices in Hungary’s export markets



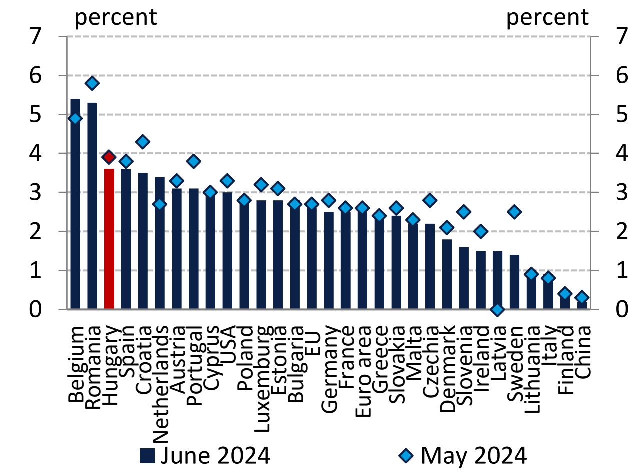
Source: European Commission, Ifo

In June, the Purchasing Managers’ Index for manufacturing increased in the United States, stagnated in China and fell in the euro area. Accordingly, the index exceeded the expansion threshold in the USA, and fell short of it in China and in the euro area. The euro area’s Economic Sentiment Indicator (ESI) worsened by 0.2 points in June (Chart 1).

International labour market developments remained favourable in June. In the United States, unemployment rate rose slightly to 4.1 percent in June from 4.0 percent in May, but this value still remains historically low. The number of US non-agricultural employees increased by 206,000 in June, slightly above expectations (190,000 persons), but the revised May and April totals published with the new data were 111,000 persons lower than in the previous month. The unemployment rate in the euro area was 6.4 percent in May, the same as in April.

Annualised inflation in the United States was 0.3 percentage points lower in June at 3.0 percent compared

Chart 2 Developments in the international inflation environment



Note: HICP inflation rates for EU Member States.

Source: Eurostat

to the previous month. In China, consumer prices rose by 0.2 percent on an annual basis in June. Eurozone inflation fell to 2.5 percent year-on-year, while core inflation was 2.9 percent in June. The inflation figure was in line with analysts' expectations, while core inflation was 0.1 percentage points above expectations.

In June, inflation fell in Romania, Slovakia and Czechia among the countries in the region, and rose in Poland. Prices rose by 5.3 percent in Romania, 2.9 percent in Poland, 2.4 percent in Slovakia and 2.2 percent in Czechia over a year, based on HICP data (Chart 2).

1.2. Real economic trends in Hungary

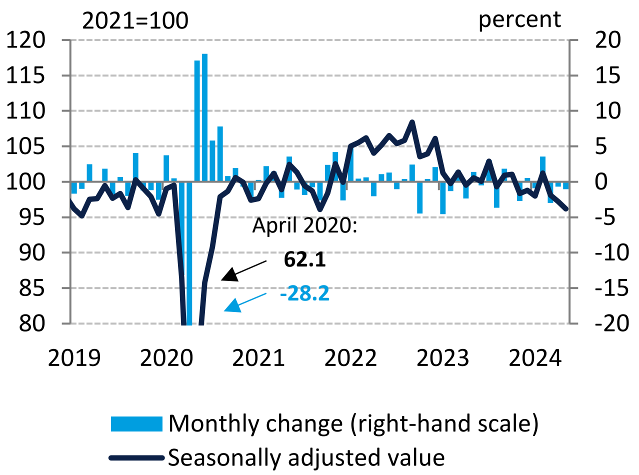
Gross domestic product grew by 1.1 percent in 2024 Q1 compared to the same period a year earlier, and by 0.8 percent from the previous quarter. In May, retail sales grew by 3.6 percent and construction output by 7.3 percent, while industrial production fell by 5.2 percent. Based on preliminary data for May, trade balance showed a surplus of EUR 1.1 billion. In May 2024, the number of employees in the 15-74 age group was 4,749,000. The unemployment rate stood at 4.3 percent in May.

1.2.1. Economic growth

Raw data indicate that in 2024 Q1, gross domestic product grew by 1.1 percent on an annual basis. Based on balanced data adjusted for seasonal and calendar effects, output rose by 1.7 percent year-on-year. The difference is explained by the fact that there were two working days less in the first quarter of this year than a year ago. Compared to the previous quarter, economic performance expanded by 0.8 percent.

The volume of industrial production fell by 5.2 percent in May 2024, compared to the same period last year (Chart 3). On a seasonally and working-day adjusted basis, output fell by 4.8 percent on an annual basis. Industrial output was 1.1 percent lower in May than in the previous month, according to seasonally and working-day adjusted data. Based on the HCSO's communication, most manufacturing sub-sectors contributed to the decrease in output in May. Among the most important sub-sectors, the manufacture of transport equipment, electrical equipment and computers, electronic and optical products declined, while the manufacture of food, beverages and tobacco increased.

Chart 3 Developments in industrial production



Note: From January 2024, seasonally adjusted value is based on the monthly averages of 2021.
Source: MNB calculation based on HCSO data

The volume of construction output grew by 7.3 percent year-on-year in May 2024. Construction of buildings and other construction work grew by 11.2 percent and 1.1 percent, respectively, year-on-year. Based on seasonally and calendar adjusted data, total construction output was less by 3.8 percent compared to April 2024. The volume of new contracts signed fell by 1.3 percent in May. In particular, the volume of contracts for the construction of buildings increased by 5.0 percent and for the construction of other structures it was lower by 9.0 percent on an annual basis. The volume of contracts in the construction sector at the end of May was up by 6.0 percent compared to the same period last year, with contracts for the construction of buildings up by 2.5 percent and those for other construction up by 9.3 percent, respectively.

In May 2024, the volume of retail sales increased by 3.6 percent year-on-year, continuing the growth that started in January. Retail trade excluding fuel sales rose by 4.4 percent on a calendar-adjusted basis. The annual volume of filling station sales decreased by 0.7 percent. On a monthly basis, retail sales increased slightly by 0.1 percent in May. Sales volumes were close to year-end 2022 levels, based on seasonally and calendar-adjusted data. Retail food trade rose by 6.3 percent on an annual basis in May. In addition, the sales of pharmaceuticals, medical products and perfumes (+8.1 percent), mail order (+3.2 percent) and furniture, hardware and ironmongery (+1.2 percent) also increased. Sales declined in books, computers (-2.3 percent) and mixed industrial goods (-3.0 percent).

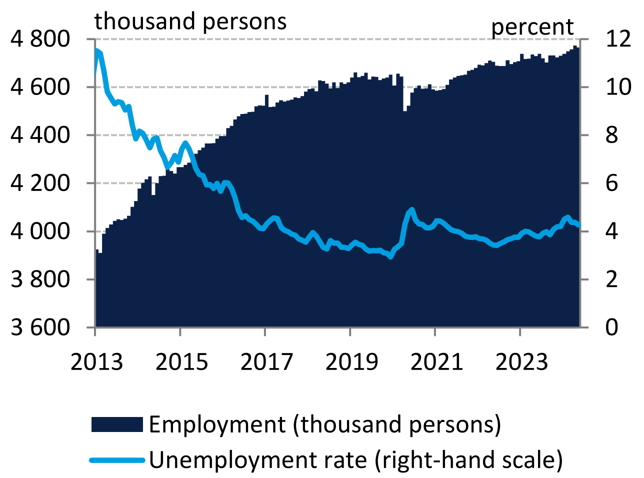
Based on preliminary data, trade balance showed a surplus of EUR 1.1 billion in May 2024. The balance deteriorated by EUR 603 million compared to the previous month and by EUR 73 million compared to the same period of the previous year. The balance adjusted for VAT residents decreased by EUR 68 million compared to a year earlier, thus showing a surplus of EUR 520 million. The 12-month rolling balance of external trade in goods fell by EUR 70 million from its historic peak in April and showed a surplus of EUR 13.2 billion in May. As in the previous month, the rolling balance adjusted for VAT residents achieved a surplus of EUR 5.5 billion. In May, the value of goods exports in euro fell by 8.8 percent on an annual basis, in line with the decline in industrial production. The nominal value of goods imports in euro terms shrank by 9.0 percent over a year. On a seasonally and calendar-adjusted basis, imports fell by 8.3 percent and exports by 8.4 percent year-on-year. Compared to April, exports fell by 2.7 percent and imports rose by 1.8 percent in May.

Based on the NAV's (National Tax and Customs Administration) online cash register data, inflation-adjusted turnover was 4.3 percent higher in May compared to the same period last year, putting turnover into positive territory since February. The nominal turnover of online cash registers increased by 8.5 percent year-on-year. In June, freight traffic (+22.3 percent) increased, while passenger road traffic (-27.8 percent) decreased. Electricity load increased by 2.8 percent. Cinema attendance increased by 52.6 percent and catering turnover by 12.0 percent. The number of Google searches for the term "unemployment benefit" rose in May.

1.2.2. Employment

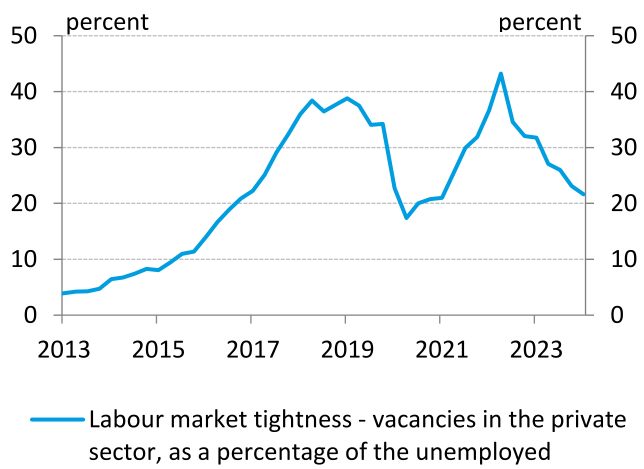
According to the Labour Force Survey data, the average number of employed persons aged 15-74 in May 2024 was 4,749,000, which, seasonally adjusted, is 7,000 lower than in April. In the period March–May 2024, the average number of employed persons was 4,745,000, which is 41,000 higher than in the same period of the previous year. In the same period, the average number of persons employed in the primary labour market increased by 42 thousand, the number of persons working at a business unit abroad rose by 7 thousand, while the number of persons in fostered

Chart 4 Number of persons employed and the unemployment rate



Note: Employment based on seasonally adjusted data.
Source: HCSO

Chart 5 Labour market tightness indicator



Note: Seasonally adjusted quarterly data.
Source: HCSO, MNB calculation

employment decreased by 8 thousand relative to the same period in the preceding year.

The number of unemployed persons amounted to 212 thousand in May, 26 thousand more than in the same period of the year before. Overall, the unemployment rate was 4.3 percent (Chart 4). In May, the seasonally adjusted unemployment rate rose by 2 thousand compared to April. According to raw data from the National Employment Service (NFSZ), there were 226,000 registered jobseekers in Hungary in May 2024 and 223,000 in June 2024. This represents a decline of 3 thousand and 1 thousand, respectively, relative to the same period of the previous year. Seasonally adjusted data show practically no change in the number of registered jobseekers in June 2024 compared to May, and this figure continues to be lower than in the months before the outbreak of the coronavirus pandemic.

The labour market has become less tight in recent months (Chart 5). There were 46,200 vacancies in the private sector in 2024 Q1, 21.6 percent fewer than in the same quarter of the previous year and 5.6 percent fewer compared to the previous quarter. Labour demand in both manufacturing and market services fell compared to the previous quarter. In manufacturing, there were 1.5 thousand fewer job vacancies than in 2023 Q4. In the market services sector, there were 28.2 thousand job vacancies in 2024 Q1, 2.5 thousand fewer than in the previous quarter. In the public sector, the number of job vacancies fell by 1.2 thousand compared to the previous quarter.

1.3. Inflation and wages

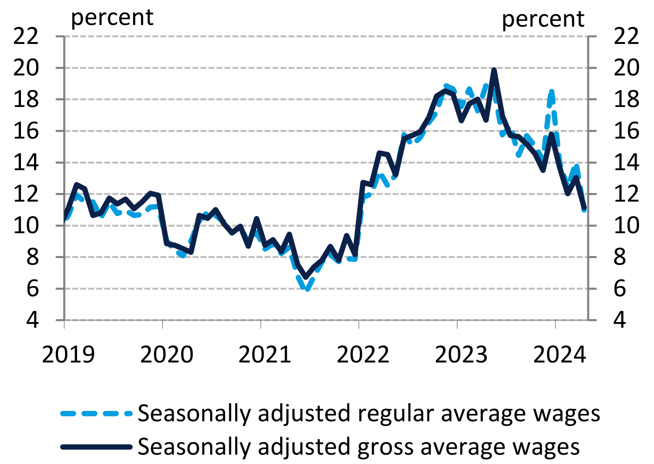
Consumer prices rose by 3.7 percent year-on-year in June 2024. Core inflation and core inflation excluding indirect tax effects rose slightly to 4.1 percent. Incoming data were below the median of analysts' expectations. In April 2024, average regular earnings (excluding bonuses) rose by 13.9 percent in annual terms in the national economy and by 11.7 percent in the private sector.

1.3.1. Wages

In April 2024, average gross earnings in the national economy rose by 13.5 percent and in the private sector by 11.6 percent compared to the same period of the previous year. Average regular earnings (excluding bonuses) rose by 13.9 percent in annual terms in the national economy and by 11.7 percent in the private sector. On a monthly basis, regular earnings fell by 1.1 percent, below last year's level but above the historical dynamics. Premium payments were 10.3 percent of regular earnings, the same as last year and close to the historical average.

Based on seasonally adjusted data, the dynamics of both gross average wages and regular average wages decelerated in the private sector when compared to the previous month (Chart 6). In the private sector, wage dynamics in market services exceeded the dynamics observed in manufacturing. In manufacturing, wages were 10.9 percent higher in April compared to the same period last year, based on raw data. With regard to market services, the Hungarian Central Statistical Office registered an increase of 11.6 percent. As for the sectors of the national economy, wages grew by 16.8 percent in construction, by 13.4 percent in tourism and by 12.6 percent in trade compared to the same period of the previous year.

Chart 6 Dynamics of average earnings in the private sector

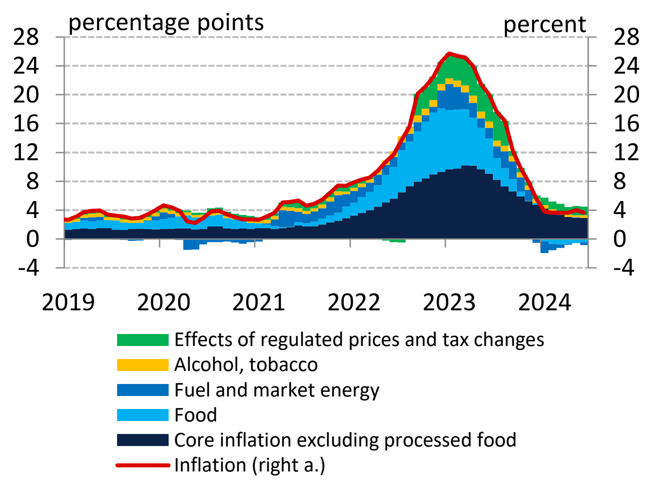


Source: MNB calculation based on HCSO data

1.3.2. Inflation developments

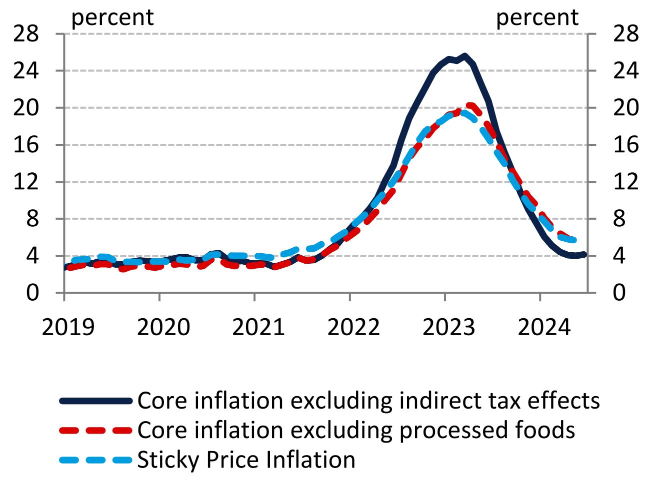
Consumer prices rose by 3.7 percent year-on-year in June 2024 (Chart 7). Core inflation and core inflation excluding indirect tax effects rose slightly to 4.1 percent. In monthly terms, the price of the representative consumer basket did not change, while in the case of core inflation an increase of 0.5 percent was observed. The annualised consumer price index decreased by 0.3 percentage points relative to the previous month. The fall in inflation was mainly due to lower fuel prices (-0.4 percentage points). The 0.1 percentage points increase in annual core inflation was driven by an increase in the price dynamics of processed food (+0.1 percentage points). The annual inflation rate for industrial goods stood at 1.7 percent as in the previous month, while the annual basis price index for market services was 9.7 percent. Unprocessed food prices fell by 1.9 percent, while processed food prices fell by 1.8 percent year-on-year. Fuel inflation eased to 3.2 percent on an annual basis, supported

Chart 7 Decomposition of inflation



Source: MNB calculation based on HCSO data

Chart 8 Measures of underlying inflation indicators



Source: MNB calculation based on HCSO data

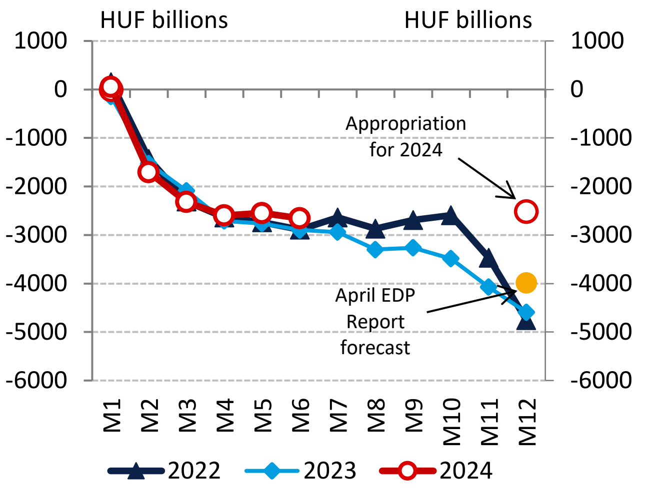
by base effects. The annual price index for goods and services with regulated prices was 4.3 percent. Incoming data were below the consensus of analysts' expectations. The median equalled 3.9 percent with expectations ranging from 3.6 to 4.1 percent.

The MNB's annualised indicators, which capture more persistent inflation trends, were unchanged in June. The inflation of sticky-price goods and core inflation excluding processed food also rose at an annual rate of 5.6 percent (Chart 8).

1.4. Fiscal and external balance trends

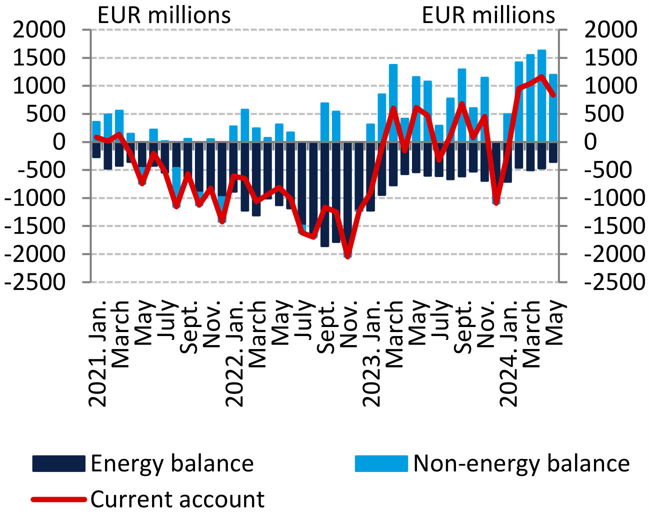
The general government's central sub-sector saw a deficit of HUF 108 billion in June, which reflects a HUF 25 billion improvement compared to the balance of June 2023. This implies that the deficit cumulated from the start of the year increased to HUF 2,656 billion by the end of June. In May 2024, the current account surplus amounted to EUR 838 million and net lending to EUR 928 million. The monthly current account balance declined, after a historical surplus in the previous three months, mainly due to a fall in the surplus on the goods balance.

Chart 9 The cumulative cash balance of the central government budget from the beginning of the year



Source: 2024 Budget Act, Hungarian State Treasury, HCSO

Chart 10 Developments in current account and energy balance



Note: The last monthly value of the energy balance is an estimate.

Source: MNB, HCSO

1.4.1. Fiscal trends

The **central sub-sector of general government** registered a deficit of HUF 108 billion in June, which represents a HUF 25 billion improvement compared to the balance of June last year. This implies that the deficit cumulated from the start of the year increased to HUF 2,656 billion by the end of June (Chart 9), HUF 240 billion lower than last year and 67 percent of the annual cash deficit target in the EDP Report.

In June, **central sub-sector revenues** increased by HUF 59 billion on an annual basis, with tax and contribution revenues up by HUF 141 billion and EU revenues down by HUF 72 billion. Labour taxes and contributions increased by 15 percent (HUF 130 billion), excise tax revenues by 14.4 percent (HUF 18 billion) and net VAT revenues by 1.6 percent (HUF 11 billion), while payments by enterprises decreased by 10 percent (HUF 27 billion) on an annual basis.

Budget expenditures in June were HUF 35 billion higher than in the same period of the previous year. The increase is mainly due to a HUF 75 billion increase in expenditure on medical and preventive care due to hospital debt settlement and health care wage increases, and an increase in pension expenditures of around HUF 47 billion. This was partly offset by a HUF 88 billion lower spending on public assets and a HUF 49 billion lower spending on public transport, utilities and public media services.

1.4.2. External balance developments

In May 2024, the current account surplus amounted to EUR 838 million and net lending to EUR 928 million (Chart 10). The monthly current account declined, after a historical surplus in the previous three months, mainly due to a narrowing of the surplus on the balance of goods. The decline in exports on an annual basis was mainly driven by a slowdown in industrial production and export sales in the subdued European economy. The fall in imports continued to be supported by low exports and a smaller energy imports bill. In May, the surplus on the balance of services was around the same as in May last year, while the deficit on the income balance was slightly lower than in the same period last year. The surplus on the transfer balance increased, with a rise in EU funds.

Financial account data show that net external debt increased slightly in May, while net direct investment rose

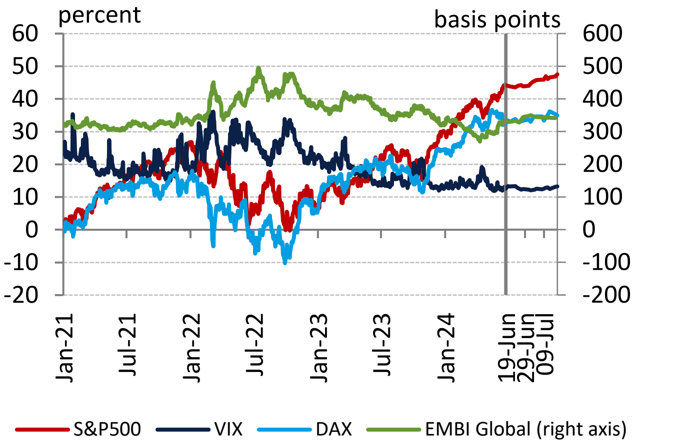
mildly. The EUR 0.2 billion increase in net FDI inflows was mainly driven by a rise in net inter-company loans, while reinvested earnings fell in May, in line with seasonality, due to dividends declared by foreign companies. The EUR 0.1 billion increase in net external debt resulting from transactions was linked to the banking system.

2. Financial markets

2.1. International financial markets

Since the last interest rate decision, global financial markets have been characterised by volatile sentiment. Market participants focused mainly on expectations regarding the interest rate policies of the world's leading central banks and the election results in the UK and France. Generally, both developed and emerging market stock market indices rose in the period, while developed market long-term yields were volatile.

Chart 11 Developed market equity indices, the VIX index and the EMBI Global Index

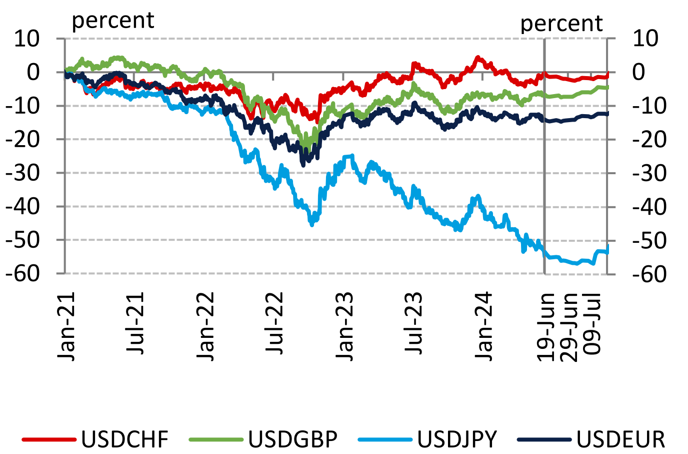


Note: Stock indices (S&P500 and DAX) normalised to the beginning of 2021.
Source: Bloomberg

Since the last interest rate decision, global financial markets have been characterised by volatile sentiment. Market participants focused mainly on expectations regarding the interest rate policies of the major central banks and the results of the UK and French elections, while the possible outcome of the US elections in the autumn also featured more prominently in news and analyses. Of the risk indicators, the VIX index, the key measure of US equity market volatility, increased by 0.4 percentage points. The EMBI index, which captures emerging market bond spreads, also rose (Chart 11).

Typically, both developed and emerging market stock exchange indices rose over the period. Only in China did the leading stock market indices fall amid positive sentiment. The main US stock market indices rose by 3.5-5.5 percent. European indices also increased, although to a lesser extent. Of the Asian indices, Japan's Nikkei was up by approx. 8 percent, while Chinese indices fell by 1.6 percent. The MSCI index, which tracks emerging market stock exchanges, rose by 4 percent.

Chart 12 Evolution of developed market foreign exchange rates compared to the first trading day of January 2021



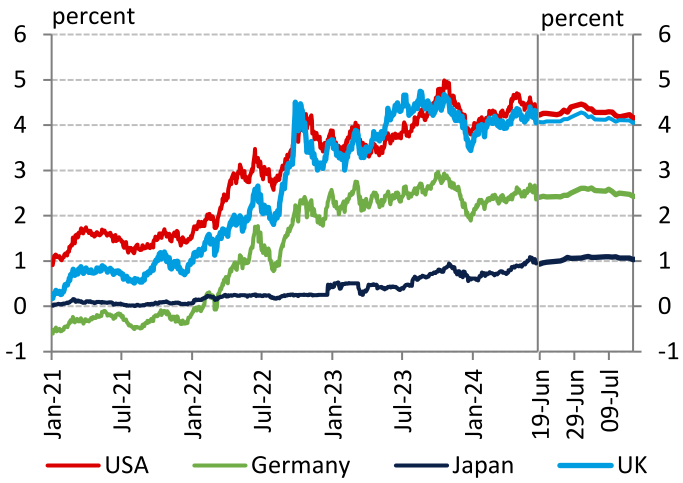
Note: Positive values indicate the strengthening of the variable (second) currency.
Source: Bloomberg

The dollar typically weakened against the major currencies: it weakened by 1.5 percent against the euro and by 2.2 percent against the British pound. Meanwhile, the exchange rate against the Japanese yen was almost unchanged, while the dollar strengthened by 0.4 percent against the Swiss franc (Chart 12).

Developed market long yields evolved mixed since the previous interest rate decision (Chart 13). The US 10-year yield fell by 10 basis points since the previous interest rate decision, while the German long yield rose by 1 basis point and the Japanese 10-year yield by 11 basis points. Ten-year government bond yields in the region fell by 15-45 basis points, with the largest decline in domestic yields.

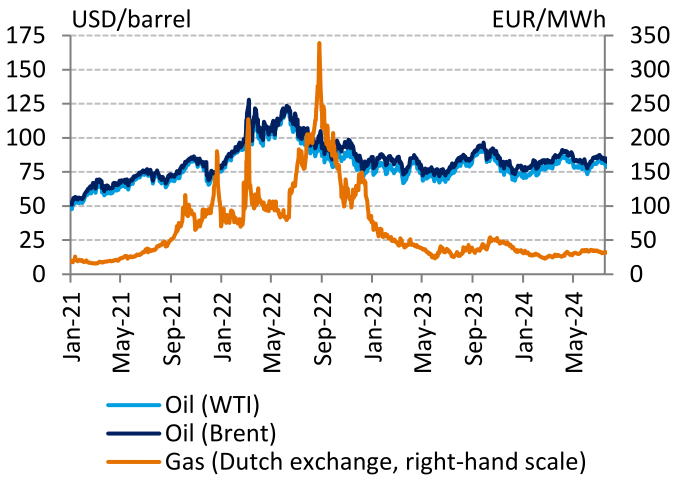
Commodity prices have moderated since the previous interest rate decision. The Bloomberg commodity price index fell by 2.5 percent during the period. The largest contributors to the decline were the fall in the cereals (11 percent) and livestock (9 percent) subindices. In the energy market, oil prices fell slightly, with Brent oil prices

Chart 13 Yields on developed market long-term bonds



Source: Bloomberg

Chart 14 Developments in oil and gas prices



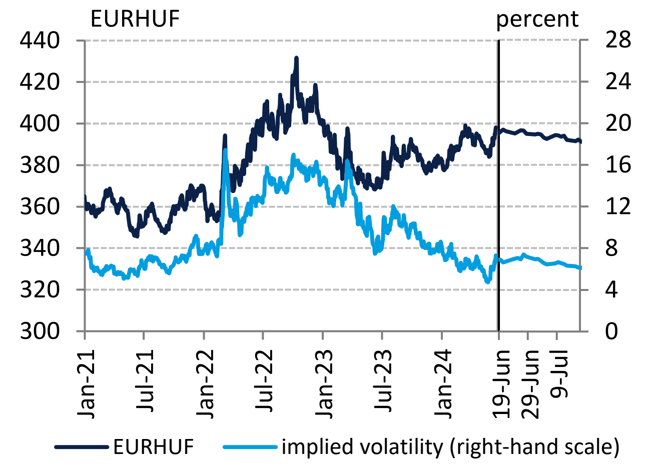
Source: Bloomberg

falling by 0.8 percent to close to USD 83.5, while WTI prices did not change significantly (Chart 14). Gas prices in Europe fell since the last interest rate decision and remain at moderate levels.

2.2. Developments in domestic money market indicators

The forint has been volatile against the euro since the June interest rate decision, but strengthened overall. The yield curve in the government bond market has shifted downwards. The 3-month BUBOR, which is relevant to monetary transmission, has fallen by 4 basis points to 6.83 percent since the previous interest rate decision.

Chart 15 EUR/HUF exchange rate and the implied volatility of exchange rate expectations

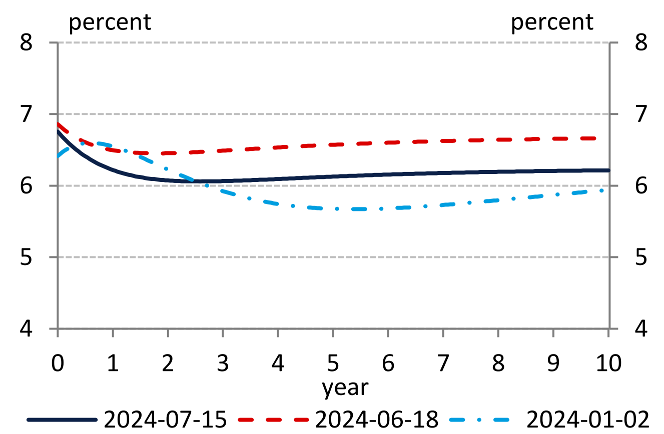


Source: Bloomberg

The forint has been volatile against the euro since the June interest rate decision, but strengthened overall (Chart 15). In the days following the June interest rate decision, the exchange rate approximated the 395 level, before strengthening below 393 in the improving international sentiment. The exchange rate weakened again following the release of domestic inflation data and the announcement of new tax measures. However, the weakening of the dollar in recent days led to a renewed strengthening of the exchange rate, with the EUR/HUF exchange rate reaching 391, which represents an overall gain of more than 1 percent over the period. Regional currencies were mixed over the period, with the Polish zloty strengthening by 1 percent and the Czech koruna weakening by more than 2 percent. The Romanian leu was stable against the euro.

The 3-month BUBOR, which is relevant to monetary transmission, has fallen by 4 basis points since the previous interest rate decision to 6.83 percent.

Chart 16 Shifts in the spot government yield curve



Source: Bloomberg

The government securities market's yield curve shifted downwards (Chart 16). The inter-year section of the yield curve moved up by 10–20 basis points, while the long-term section was up by 30–45 basis points.

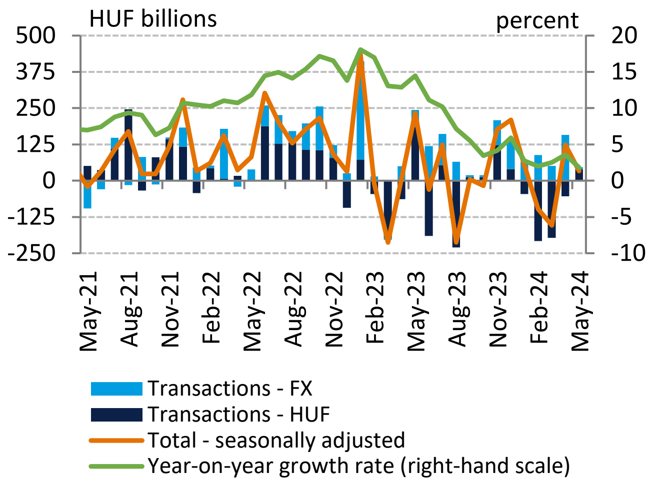
Since the previous interest rate decision, demand has been typically strong in both treasury bill auctions and government bond auctions. During the period under review, the average number of bids received by the Government Debt Management Agency in treasury bill auctions was almost 2.8 times higher than the pre-announced volume. In the government bond auction, the public debt management agency generally accepted bids above the announced volume, with an average coverage of more than four times.

Non-residents' holdings of forint government securities decreased. The stock held by non-residents decreased to HUF 6,559 billion, with the market share of forint government securities held by foreigners at 18 percent.

3. Trends in lending

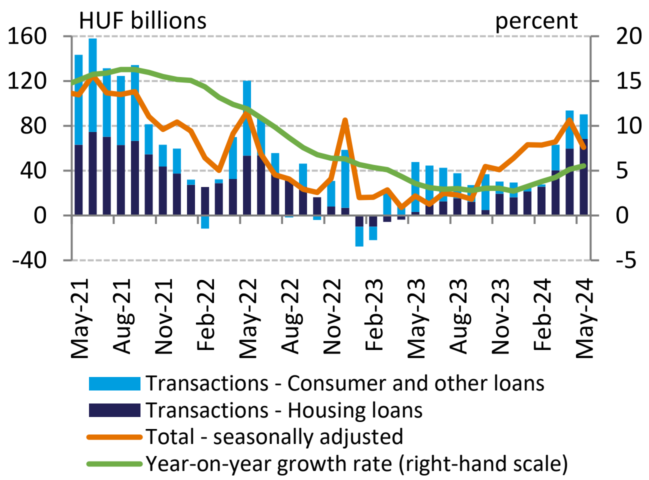
In May 2024, corporate and household lending expanded. The smoothed interest rate spread on corporate forint loans was down by 18 basis points from the previous month to 2.08 percentage points in May 2024.

Chart 17 Net borrowing by non-financial corporations



Source: MNB

Chart 18 Net borrowing by households



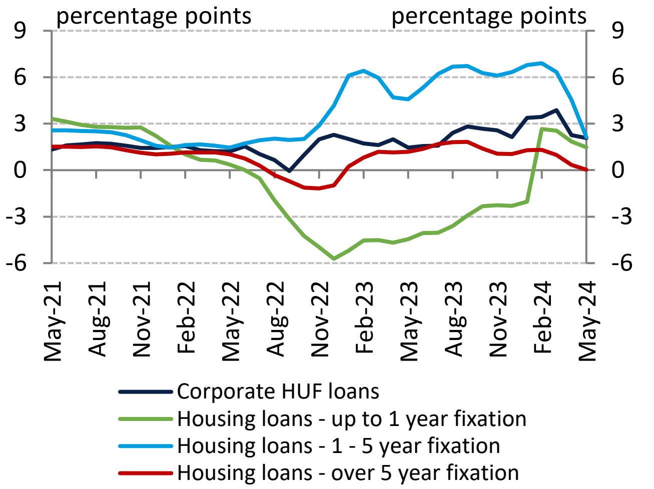
Source: MNB

Corporate loans increased by HUF 47 billion in May 2024, due to a HUF 39 billion increase in forint loans and a HUF 8 billion increase in foreign currency loans. The annual growth rate of loans slowed from 3.6 percent in April to 1.8 percent (Chart 17). Credit institutions contracted new non-overdraft loans in an amount of HUF 292 billion during the month, which is 3 percent higher than in the same period last year, which was an intensive contracting period of the Gábor Baross Reindustrialisation Loan Programme. The main contributors to new issuance were large individual transactions, which amounted to HUF 117 billion within the new loans issued.

In May, household lending increased by HUF 90 billion due to transactions, leading the annual growth rate of the stock to 5.5 percent, up by 0.4 percentage points from April (Chart 18). Due to the low base, the HUF 249 billion volume of new household loan contracts was 75 percent higher than in the same period last year, and the value of newly contracted housing loans rose by 162 percent year-on-year compared to the low level recorded last year, and 7 percent higher than in April. More than 1,100 contracts were signed in May related to the HPS Plus programme, available since January, worth HUF 29 billion.

The smoothed interest rate spread on corporate forint loans narrowed by 18 basis points from the previous month to 2.08 percentage points in May 2024 (Chart 19). For housing loans, the spread on products with fixed interest rates beyond 5 years fell by 32 basis points to 0.02 percentage points at the end of the review period, the last time a lower spread was observed in this product group was at the end of 2022.

Chart 19 Developments in corporate and household credit spreads



Note: In the case of household loans, APR-based smoothed spreads calculated using the average reference rate for the month in which the loan was issued. In the case of forint corporate loans and housing loans with variable interest or interest fixed for 1 year at the most, the 3-month BUBOR, while in the case of housing loans fixed for over one year the margin above the relevant IRS.
Source: MNB