INFLATION REPORT

2024

JUNE

'... wise is the man who can put purpose to his desires.'

Miklós Zrínyi: The Life of Matthias Corvinus

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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. Low inflation ensures higher long-term economic growth and a more predictable economic environment, and moderates the cyclical fluctuations that impact both households and companies.

In the inflation targeting system in use since August 2005, the Bank has sought to attain price stability by ensuring an inflation rate near the 3-percent medium-term target. The Monetary Council, the supreme decision-making body of the Magyar Nemzeti Bank, performs a comprehensive review of expected developments in inflation every three months, in order to establish the monetary conditions consistent with achieving the inflation target. The Council's decision is the result of careful consideration of a wide range of factors, including an assessment of prospective economic developments, the inflation outlook, financial and capital market trends and risks to stability.

In order to provide the public with a clear insight into how monetary policy works and to enhance transparency, the Bank publishes the information available at the time of making its monetary policy decisions. The Report presents the inflation forecasts prepared by the Directorate Economic Forecast and Analysis, the Directorate Monetary Policy and Financial Market Analysis, the Directorate for Fiscal and Competitiveness Analysis and the Directorate Financial System Analysis, as well as the macroeconomic developments underlying these forecasts. The forecast is based on the assumption of endogenous monetary policy. In respect of economic variables exogenous to monetary policy, the forecasting rules used in previous issues of the Report are applied.

The analyses in this Report were prepared under the general direction of the acting Director Responsible for Economic and Fiscal Analyses and Statistics. The Report was prepared by staff at the MNB's Directorate Economic Forecast and Analysis, Directorate Monetary Policy and Financial Market Analysis, Directorate for Fiscal Analysis, Directorate Financial System Analysis and Directorate for International Monetary Policy Analysis and Training of Economic Sciences. The Report was approved for publication by Barnabás Virág, Deputy Governor responsible for Monetary Policy, Financial Stability and International Relations.

The Report incorporates valuable input from other areas of the MNB and the Monetary Council's comments.

The projections are based on information available for the period ending 13 June 2024.

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The Monetary Council's key findings related to the Inflation report

The primary objective of the Magyar Nemzeti Bank (MNB) is to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserves financial stability and supports the Government's economic policy, as well as its policy on environmental sustainability.

Economic performance of the European Union remains subdued; however, confidence indicators show some improvement. The ongoing Russia-Ukraine war and the generally tense geopolitical situation pose a significant risk to the external economic activity.

The EU economy expanded by 0.5 percent on an annual basis in 2024 Q1. The moderate growth is mainly driven by weak industrial activity and improving, albeit low consumer confidence. Economic performance in Germany, Hungary's main trading partner, fell by 0.2 percent year-on-year. In the same period, the US GDP grew slightly below expectations, by 3.0 percent year-on-year. The Chinese economy expanded at a rate of 5.3 percent above expectations in 2024 Q1, due mainly to the demand-stimulating measures of economic policy. The ongoing Russia-Ukraine war, the generally tense geopolitical situation and the expected developments in European industrial production pose risk in terms of external economic activity.

Continuous disinflation, which has been ongoing in the European Union since the inflation peak in October 2022, came to a halt at the end of last year.

The earlier rapid rate of disinflation is currently slowing down in the European Union. Euro area inflation rose to 2.6 percent in May. Inflation either remained unchanged or rose in 15 of the 27 EU members, while disinflation continued in the other countries. Within the region, based on the data of the national statistical offices, inflation rose in Poland (2.5 percent), while it fell in the Czech Republic and Romania (2.6 percent and 5.1 percent, respectively). In Slovakia, inflation rose to 2.7 percent, according to Eurostat. Inflation in the United States is currently hovering above 3 percent and stood at 3.3 percent in May.

Among the world's leading central banks, the European Central Bank (ECB) cut its policy rates by 25 basis points in June, while the Federal Reserve (Fed) may start reducing interest rates later. In the region, the Czech central bank continued to cut its key policy rate, while the Polish and Romanian central banks kept their base rates unchanged over the past quarter.

In the United States, the Fed maintained the target range of the federal funds rate at 5.25–5.50 percent. The chairman of the central bank remarked that their decisions are data-driven, and that they do not want to commit themselves to a particular interest rate path in advance. The central bank also announced that it will reduce its quantitative tightening target for government securities from USD 60 billion to USD 25 billion per month from June. The ECB cut its key policy rates by 25 basis points at its policy meeting in June. According to the central bank's press release, further interest rate decisions will be based on the inflation outlook in light of incoming economic and financial data, underlying inflation trends and the strength of monetary policy transmission. The central bank aims to reduce the PEPP portfolio by an average of EUR 7.5 billion per month in 2024 H2 and to close reinvestments completely by the end of 2024.

In the region, the Czech central bank cut interest rates by 50 basis points in May in continuation of the rate cuts started last December, reducing the policy rate to 5.25 percent. The central bank of Poland kept its policy rate unchanged at 5.75 percent and the central bank of Romania at 7.0 percent over the past quarter. The Magyar Nemzeti Bank cut the base rate by 75 basis points in March, by 50-50 in April and in May, bringing it down to 7.25 percent by the end of May.

Global investor sentiment in the previous quarter was influenced mainly by expectations about the interest rate policies of world's leading central banks, incoming macroeconomic data, the European Parliament elections and developments related to geopolitical conflicts.

Asset prices have been influenced mostly by expectations about the interest rate policies of central banks in advanced markets. Interest rates path based on market pricings rose in response to statements by decision makers at major central banks. Simultaneously, long bond yields in developed and emerging markets also rose. The US and German 10-year yields rose to over 4.3 and 2.5 percent, respectively, while regional yields rose by 10–30 basis points. Overall, the USD and EUR exchange rates also fluctuated against the major currencies, with the EUR/USD cross rate easing to near a 1.075 level.

Oil prices moderated, while European gas prices rose over the period. The conflict between Israel and Iran increased the price per barrel of oil temporarily before falling overall in the past quarter in response to easing geopolitical tensions and weakening demand. Rise in gas prices was mainly driven by uncertainties surrounding global supply.

In the first part of the previous quarter, the forint strengthened overall in the favourable international risk environment, while at the end of the period it weakened against the euro, mainly due to the deterioration of global and European investor sentiment. Government bond yields rose in the past quarter.

The forint exchange rate was volatile over the period. The favourable international environment allowed the domestic currency to strengthen against both the dollar and the euro in the first week of April. However, the upward shift of the expected interest rate path of the world's leadings central banks, the appreciation of the US dollar and an increase in geopolitical risks put emerging markets under pressure for a short period and also weakened the forint. From late April, the forint started to strengthen again, on the back of both an improved global sentiment and the Hungarian central bank's careful and patient interest rate cuts, which were well received by the market. However, the forint weakened in line with the regional currencies in late May in response to the deteriorating international, especially the European, sentiment.

The short and long ends of the government bond yield curve shifted upwards somewhat in response to rising domestic expectations for longer-term interest rates fuelled by expectations for a higher interest rate path in developed markets. Short-term interbank interest rates decreased at all maturities, following the reduction of the base rate in the submarkets.

Inflation in Hungary decreased into the central bank's tolerance band in early 2024. Rapid disinflation came to a halt in April. The inflation rate is expected to fluctuate within the tolerance band, close to its upper bound in the coming months. Annual average inflation is expected to range between 3.0–4.5 percent this year and between 2.5–3.5 percent in both 2025 and 2026.

Disinflation continued in 2024 Q1; however, similar to trends in Europe, the rate of inflation in Hungary also increased somewhat from April onwards. In May, consumer prices rose by 4.0 percent in annual terms. The increase in inflation was caused by rises in fuel prices and base effects. The monthly price increases in the case of core inflation were above the historical average, due to the backward-looking repricing of certain market services. Household inflation expectations rose slightly in May relative to April.

The short-term outlook for inflation has improved. More favourable than expected spring data and decreasing world oil prices together will result in a lower inflation path in 2024 compared to the March forecast. The inflation rate is expected to fluctuate within the tolerance band, close to its upper bound in the coming months, too. However, the decline in core inflation capturing underlying developments will stop in the second quarter and core inflation will rise close to 5.0 percent by the end of the year. According to the MNB's projection, annual inflation is expected to be between 3.0 and 4.5 percent this year on average. Inflation may be between 2.5 and 3.5 percent in 2025 and 2026. Anchoring inflation expectations, preserving financial market stability and disciplined monetary policy are crucial for the consumer price index to return to the central bank target in a sustained manner from next year.

Hungarian economic growth started in 2024 Q1, supported mainly by the strengthening of domestic demand. The Hungarian economy is expected to expand by 2.0–3.0 percent in 2024, 3.5–4.5 percent in 2025 and 3.0–4.0 percent in 2026.

The Hungarian economy expanded by 1.1 percent year-on-year, and by 0.8 percent quarter-on-quarter in 2024 Q1. The significant increase in real wages, the gradual easing of the precautionary motive, as well as the improvement in consumer confidence were all reflected in growing household consumption in the first quarter. The general decline in investment decelerated the pace of economic growth by 1.5 percentage points. The pace of decline slowed down in the sectors producing for domestic and export markets; however, investments related to the state and the households fell more significantly. Exports and imports declined by 5.3 percent and 9.2 percent, respectively, thus, net exports made a positive contribution to growth with generally subdued import demand. With employment at high levels, labour market tightness has eased in recent quarters. The unemployment rate stood at 4.4 percent in April.

In 2024, the gradual expansion in Hungary's GDP will be mainly supported by the strengthening of domestic demand. In addition to the easing of the precautionary motive, the expansionary effect of strong real wage growth on consumption will become increasingly pronounced in the rest of the year. Investment may still slow down economic growth in 2024. Public investment may decrease this year, while residential investment may increase. The corporate sector has taken a wait-and-see approach to investment; however, with the persistent improvement in demand, deferred investment will be gradually brought back on stream in 2025. Exports will be affected by opposing trends. Subdued European economic activity is holding back domestic exports, but ongoing and newly announced, significant capacity-enhancing foreign direct investment projects will continue to stimulate exports in the coming years. With the pick-up in the production of new export capacities built recently, balanced economic growth is expected from 2025, and Hungary's export market share is likely to increase. Hungary's GDP is expected to grow by 2.0–3.0 percent in 2024, by 3.5–4.5 percent in 2025 and by 3.0–4.0 percent in 2026.

Household lending picked up in 2024 Q1, while demand in corporate lending remained subdued.

The annual growth rate of corporate loans in the financial intermediary system as a whole moderated by 2.6 percentage points relative to the previous quarter, and stood at 3.2 percent at the end of 2024 Q1. The annual dynamics of lending to micro, small and medium-sized enterprises, which captures the underlying lending trends better, was 2.5 percent. The total amount of newly contracted corporate, non-current account loans was down significantly, by around 25 percent year-on-year in the first quarter. At the same time, based on responses to the Lending Survey, a quarter of the banks saw a decline in demand for corporate loans in 2024 Q1. Nevertheless, 14 percent of respondents in net terms expect demand to increase in the second and third quarters of the year. Given the still uncertain growth outlook, the annual growth rate of corporate lending might reach 5 percent at the end of 2024, while from the beginning of 2025 the rate of expansion might stabilise at around 8–9 percent.

The annual growth rate of lending to households rose by 1.3 percentage points relative to the previous quarter and reached 3.6 percent in 2024 Q1. The total amount of housing loans contracted by credit institutions in 2024 Q1 was 130 percent higher than the low base seen a year earlier, while personal loan issuance was 48 percent higher. The increase in new loan contracts was also supported by changes in family allowances at the beginning of the year and a voluntary APR ceiling announced in October 2023. Based on the responses to the Lending Survey, banks reported rising demand for both housing loans and consumer loans in the first quarter, and they expect further growth in demand in both segments. The annual growth rate of lending to households may reach close to 8 percent at the end of 2024, and is expected to range between 9 and 10 percent from the beginning of 2025.

The current account surplus is expected to rise further.

The current account balance rose significantly even by historical standards in 2023. The favourable trend in external balance persevered in 2024, with the current account surplus of over EUR 1 billion in April marking another historic high. In the coming years, the current account surplus may be even larger than the Bank's previous expectation. The expected increase in the surplus in 2024 as a whole primarily reflects a further improvement in the terms of trade, declining investment activity characterised by a high import share and inventory accumulation. Over the longer term, with earlier manufacturing investment projects turning productive, the country's increasing export market share will support the improvement in the external balance. The current account surplus is projected to continue to increase over the forecast horizon, reaching 1.5–2.7 percent of GDP in 2024, and rising to 3–4 percent of GDP in 2025–26.

The government deficit-to-GDP ratio may be between 4.5 and 5.0 percent in 2024, between 3.5 and 4.5 percent in 2025 and between 2.8 and 3.8 percent in 2026, depending on macroeconomic developments and the extent of fiscal control. The primary balance is expected to improve to reach near equilibrium levels this year. Decline in deficit is supported by stabilising global energy prices and falling inflation; however, it is slowed by a shortfall in tax revenues compared with the appropriation set out in the Budget Act, and high government interest expenditure. The government debt-to-GDP ratio declines steadily, which will require the set deficit targets to be achieved in a disciplined manner.

Based on the Monetary Council's risk assessment, the baseline projection is surrounded by two-way risks to inflation and growth.

The Monetary Council highlighted three alternative risk scenarios around the baseline projection in the June Inflation Report. In the scenario which assumes a deceleration in global economic activity, both economic growth and inflation may be lower compared to the baseline. The alternative scenario presuming a divergence between the Fed's and the ECB's monetary policy is consistent with a higher inflation path and lower growth path. The scenario assuming faster wage growth and a quicker recovery in consumption is in line with a higher growth path and inflation path compared to the baseline scenario. In addition to the highlighted scenarios, the Monetary Council discussed alternative scenarios including projections assuming higher energy prices and faster improvement in productivity and energy efficiency. Geopolitical conflicts, including mainly the Russia-Ukraine war, the situation in the Middle East and the fragmentation of the multilateral trading system, continue to carry a significant risk.

SUMMARY TABLE OF THE BASELINE SCENARIO

(Data show annual changes and the forecast is based on endogenous monetary policy.)

	2023	2024	2025	2026
	Actual		Forecast	
Inflation (annual average)				
Core inflation	18.2	4.1 - 5.3	2.7 - 3.5	2.7 - 3.3
Core inflation excluding indirect tax effects	18.1	4.1 - 5.3	2.7 - 3.5	2.7 - 3.3
Inflation	17.6	3.0 - 4.5	2.5 - 3.5	2.5 - 3.5
Economic growth				
Household final consumption expenditure	-2.2	3.3 - 3.7	2.7 - 3.7	2.7 - 3.7
Government final consumption expenditure[1]	1.3	(-0.1) - 0.7	(-0.3) - 0.9	(-0.1) - 1.1
Gross fixed capital formation	-7.4	(-1.5) - 0.5	3.1 - 6.3	0.7 - 3.6
Domestic absorption	-5.6	0.5 - 1.3	2.6 - 3.8	1.8 - 3.0
Exports	0.9	0.6 - 1.4	6.1 - 7.9	4.6 - 6.4
Imports	-4.3	(-1.5) - (-0.7)	5.4 - 7.4	3.1 - 5.1
GDP	-0.9	2.0 - 3.0	3.5 - 4.5	3.0 - 4.0
Labour productivity[2]	-1.1	2.1 - 2.6	3.4 - 4.7	2.8 - 4.2
External balance[3]				
Current account balance	0.2	1.5 - 2.7	2.2 - 3.6	3.0 - 4.6
Net lending	1.2	3.1 - 4.3	4.1 - 5.5	4.8 - 6.4
Government balance[3]				
ESA balance	-6.7	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Labour market				
Whole-economy gross average earnings[4]	14.3	12.4 - 13.0	7.1 - 8.3	7.7 - 9.0
Whole-economy employment	0.6	0.1 - 0.3	(-0.3) - 0.4	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	11.0 - 11.6	7.5 - 8.6	6.9 - 8.1
Private sector employment	1.0	0.1 - 0.3	0.0 - 0.5	0.0 - 0.5
Unemployment rate	4.1	4.2 - 4.3	3.5 - 4.0	3.2 - 4.1
Private sector nominal unit labour cost	17.5	8.8 - 9.7	2.9 - 4.5	3.1 - 4.9
Household real income[5]	2.0	3.4 - 4.0	2.1 - 3.3	2.1 - 3.3

[1] Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.

[2] Whole economy, based on national accounts data.

[3] As a percentage of GDP.

[4] For full-time employees.

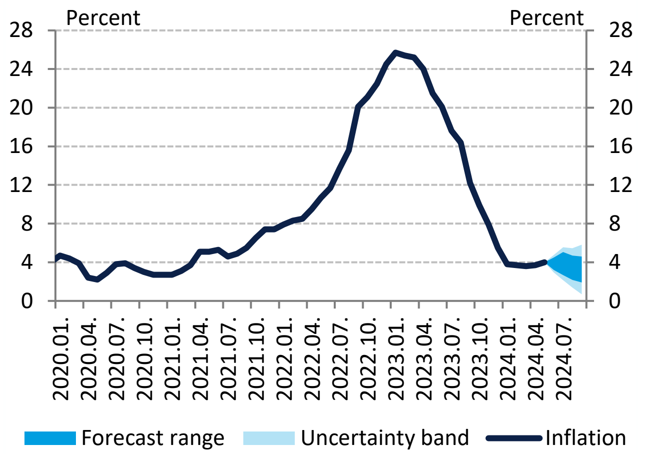
[5] MNB estimate.

1 Inflation and real economy outlook

1.1 Inflation forecast

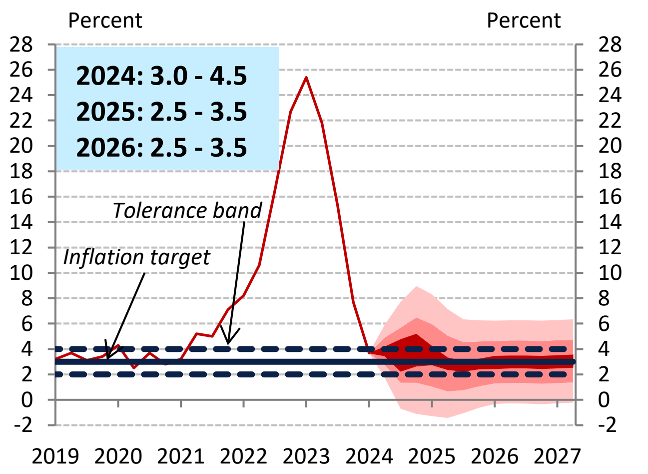
Consumer prices rose by 4.0 percent year-on-year in May. In our forecast, inflation remains within the central bank's tolerance band, close to the upper bound, in the coming months. Core inflation, which captures underlying processes, will stop declining in the second quarter and then rise to nearly 5.0 percent by the end of the year. The consumer price index is expected to permanently return to the central bank's inflation target in 2025. Inflation may range between 3.0 and 4.5 percent this year and between 2.5 and 3.5 percent in 2025 and 2026 on an annual average. Annual core inflation adjusted for taxes is projected to be 4.1–5.3 percent in 2024, 2.7–3.5 percent in 2025 and 2.7–3.3 percent in 2026.

Chart 1-1: Monthly evolution of the near-term inflation forecast



Note: Annual change. The uncertainty band shows the uncertainty around the forecast range with regards to the root mean squared error of previous years' near-term forecasts.
Source: HCSO, MNB

Chart 1-2: Fan chart of the inflation forecast



Note: Based on seasonally unadjusted data.
Source: HCSO, MNB

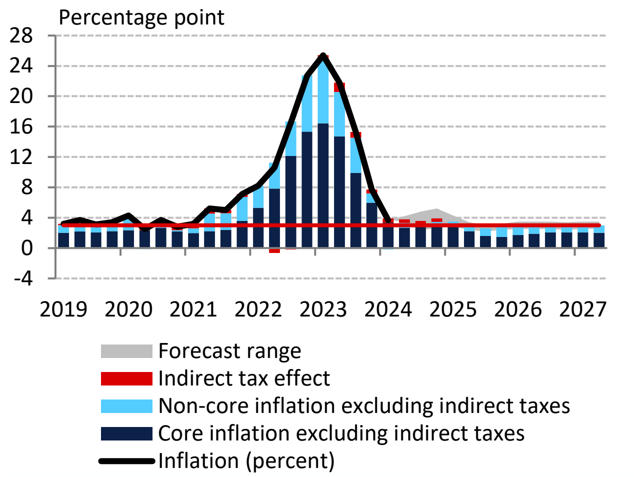
According to our forecast, inflation will remain within the central bank's tolerance band, close to the upper bound, in the coming months (Chart 1-1). Core inflation, which captures underlying processes, will stop declining in the second quarter and then rise to nearly 5.0 percent by the end of the year.

The consumer price index is expected to permanently return to the central bank's inflation target in 2025. Compared to the March prognosis, both the lower and upper bounds of the forecast band for inflation this year have been lowered by 0.5 percentage point, while the projections for 2025 and 2026 remain unchanged. This year's lower inflation path is underpinned by the decline in fuel prices which started in the second half of April and incoming data. **Inflation may range between 3.0 and 4.5 percent in 2024 and between 2.5 and 3.5 percent in both 2025 and 2026** (Chart 1-2).

We forecast that core inflation adjusted for taxes, which captures underlying processes, may range between 4.1 and 5.3 percent in 2024, between 2.7 and 3.5 percent in 2025 and between 2.7 and 3.3 percent in 2026. Global oil prices in US dollar terms fell substantially from April to May, while our assumption for the rest of the year was unchanged from the March forecast. The global price of Brent crude is now around USD 80/barrel, following a level of around USD 90/barrel in April. After the extreme values of seen in recent years, European gas and electricity prices are ranging at a lower levels in 2024. In February 2024, the global gas price fell below EUR 30/MWh and is currently at around EUR 35/MWh, due to uncertainties about global supply.

The subdued changes in food prices in recent months have been supported by year-on-year declines in global food commodity prices, as well as government measures generating stronger competition. As regards unprocessed food products, annual inflation in this product group is projected at around 0.3 percent this year, 3.3 percent next year and 4.3 percent in 2026. Global food commodity prices

Chart 1-3: Decomposition of the inflation forecast



Note: The decomposition is based on the midpoint for the forecast range.
Source: HCSO, MNB

Table 1-1: Details of the inflation forecast

		2024	2025	2026
Core inflation excluding indirect tax effects		4.1 - 5.3	2.7 - 3.5	2.7 - 3.3
Core inflation		4.1 - 5.3	2.7 - 3.5	2.7 - 3.3
Non-core inflation	Unprocessed food	0.3	3.3	4.3
	Fuel and market energy	0.1	2.6	2.6
	Regulated prices	3.0	1.9	2.2
	Alcohol and tobacco	4.5	3.5	3.4
Inflation		**3.0 - 4.5**	**2.5 - 3.5**	**2.5 - 3.5**

Note: Percent. Based on seasonally unadjusted data. The table is based on the midpoint of the forecast range.
Source: MNB

continue to fall on a year-on-year basis, suggesting that food inflation will remain subdued.

Annual inflation in the vehicle fuel and market energy product group is expected to be around 0.1 percent this year and 2.6 percent next year and in 2026 (Table 1-1). This year's modest price increase is supported by the decline in global oil prices and domestic fuel prices that started in mid-April. Inflation for goods and services with regulated prices is forecast to average around 3.0 percent in 2024. Our analysis is based on the technical assumption that measures affecting retail energy prices remain unchanged over the entire forecast horizon

Box 1-1: Assumptions applied in our forecast

As Hungary is a small, open economy, our forecasts for the most important macroeconomic variables are fundamentally influenced by trends in external factors. A brief presentation of the changes in external assumptions helps make the forecast more transparent (Table 1-2).

Table 1-2: Main external assumptions of our forecast

Technical assumptions	2024		2025		2026		Change		
	Previous	Current	Previous	Current	Previous	Current	2024	2025	2026
EUR/USD	1.09	1.08	1.09	1.08	1.09	1.08	-0.6%	-0.6%	-0.6%
Oil (USD/barrel)	82.5	81.1	77.8	77.0	76.9	75.7	-1.7%	-1.0%	-1.5%
Oil (EUR/barrel)	75.7	74.9	71.3	71.0	70.5	69.8	-1.1%	-0.4%	-1.0%
Gas (EUR/MWh)	28.8	33.4	30.0	37.9	29.2	37.6	16.0%	26.2%	28.9%
Euro area inflation (%)	2.3	2.5	2.0	2.2	1.9	1.9	0.2 pp.	0.2 pp.	0.0 pp.
Euro area real GDP (%)	0.6	0.9	1.5	1.4	1.6	1.6	0.3 pp.	- 0.1 pp.	0.0 pp.
GDP growth of Hungary's main export partners* (%)	1.1 - 1.9	1.2 - 1.8	1.9 - 2.7	1.9 - 2.7	1.3 - 2.2	1.3 - 2.2	0.0 pp.	0.0 pp.	0.0 pp.

Source: Bloomberg, Consensus Economics, MNB, ECB

Overall, there were no significant changes in expectations for GDP growth in Hungary's main trading partners for 2024. As anticipated, economic output in the European Union expanded by 0.5 percent in the first quarter. Growth was supported by the fact that household consumption rose slightly in most Member States, in an environment characterised by substantially lower inflation. GDP growth slowed moderately on an annual basis in the US. The US economy expanded at an annual rate of 2.9 percent and a quarterly rate of 0.3 percent. China's annual growth exceeded expectations in 2024 Q1, reflecting a rate of 5.3 percent which was higher versus the fourth quarter of last year, while Chinese GDP expanded by 1.6 percent on a quarterly basis. Risks to external economic activity include a slowdown in disinflation, higher-than-expected interest rate paths, the unfavourable outlook for industrial production in Europe, the ongoing war between Russia and Ukraine and the generally tense geopolitical situation. Global industrial production remained subdued, and global trade also stagnated in 2024 Q1. Global economic activity continued to be supported by tight labour markets in advanced economies. Business cycle indicators show that consumer confidence in EU economies improved somewhat, but remains at low levels. Business sentiment stagnated in services and deteriorated somewhat in industry. Compared to the March forecast, this year's outlook for global and European growth has not changed, and thus our assumptions for external demand also remain unchanged.

In contrast to its March forecast, the ECB expects a higher inflation path in 2024 and 2025, along with higher growth this year and lower growth next year. The ECB projects that GDP growth in the euro area will be 0.3 percentage point higher in 2024 compared to its previous forecast. The ECB forecasts growth of 0.9 percent this year, while the forecast for 2025 is 0.1 percentage point lower than in March and thus growth next year may amount to 1.4 percent. According to the ECB's June forecast, inflation in the euro area is expected to be 0.2 percentage point higher this year and next year as well, at 2.5 percent in 2024 and 2.2 percent in 2025.

The price of Brent crude oil rose prior to the second half of April, before falling sharply. The conflict between Israel and Iran temporarily pushed up the price of oil per barrel, which then subsequently fell as geopolitical tensions eased and demand weakened. The global price of Brent crude is currently hovering at around USD 80 per barrel. In early June, the OPEC+ countries extended their plans to curb oil production until the end of 2025. However, upward price pressure from restricted oil supply is being offset by concerns about weak global demand, while geopolitical conflicts may also continue to pose significant risks. The difference between the price of Brent and that of Russian Ural crude persisted during the past period.

Domestic petrol and diesel prices have fallen significantly in recent weeks. Russian Ural crude continues to reach Hungary via pipeline. Brent is the benchmark for gasoline and diesel prices, meaning that its price in USD and the USD/HUF exchange rate have a significant impact on fuel prices. In line with international trends, the market price of petrol and diesel increased in Hungary before the second half of April; since then, however, both fuel prices have fallen significantly.

After the extreme values seen in recent years, European gas and electricity prices are ranging at lower levels in 2024. Trends in domestic and European gas purchase prices follow the Dutch TTF gas price, which reached its historic peak at over EUR 300 in August 2022. The sustained fall in gas prices that started in December 2022 then caused world gas prices to drop to below EUR 30/MWh by February 2024. Contributing factors included the high filling rates of European gas storage facilities, the increase in LNG capacity, a mild winter, low residential consumption and reduced demand for gas as European industry struggles with economic downturn. Gas prices have risen since February, due to global supply uncertainties and interruptions in gas supplies from Norway to Europe and are currently at levels of around EUR 35/MWh. Changes in gas prices also affect electricity prices through gas-fired power plants. In line with the increase in gas prices seen in recent weeks, electricity prices have also risen in the past weeks. The 7-day moving average of the German Phelix electricity price is around EUR 80, still substantially lower than the 2023 average of nearly EUR 100.

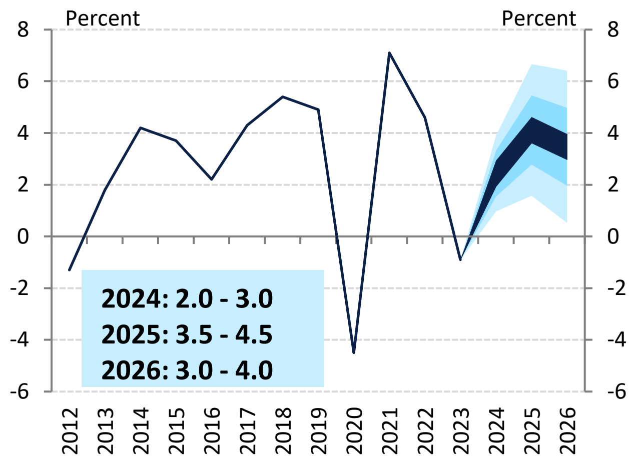
The budget deficit-to-GDP ratio is projected to be between 4.5–5.0 percent in 2024, 3.5–4.5 percent in 2025 and 2.8-3.8 percent in 2026, depending on macroeconomic trends and the tightness of fiscal control. A decline in the deficit is supported by stabilising global energy prices and falling inflation, but is slowed by a shortfall in tax revenues and high government interest expenditures. The government debt-to-GDP ratio is projected to drop consistently, but this will also require the deficit targets to be met.

While the 2021–2027 Cohesion Funds are being drawn down on an ongoing basis, Hungary still has no access to the RRF. Hungary has access to a total of EUR 12.2 billion in the 2021–2027 Cohesion envelope. However, access to the Recovery and Resilience Facility and the cohesion funds representing a combined total amount of close to EUR 20 billion is linked to the implementation of the 27 super milestones stipulated by the Commission. Budget data early this year reveal that EU payments are lower than expected on the basis of the appropriations; as a result, advance payments are also lower.

1.2 Real economy forecast

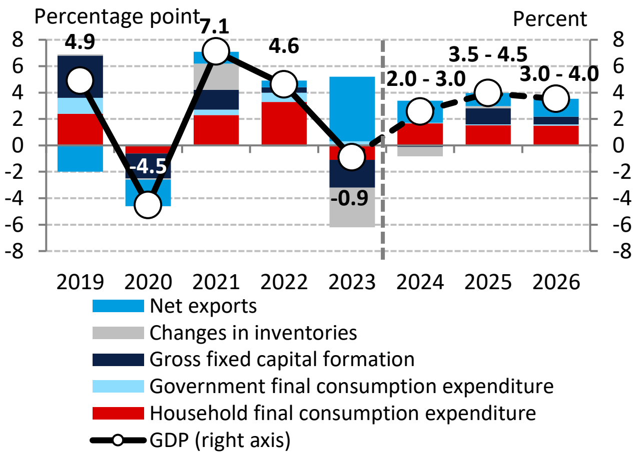
After growing by 1.1 percent in 2024 Q1, the economy is expected to expand gradually over the rest of the year. Domestic GDP growth is forecast to be between 2.0 and 3.0 percent for the year as a whole. Rising real wages and gradual improvement in consumer confidence were reflected in household consumption early in the year, which supported economic performance. During the first quarter, investment fell to a larger degree than previously expected. Services facilitated the economic recovery, while falling industrial output was a negative factor in this regard. Looking ahead, market services are likely to be the main growth driver in 2024, whereas business confidence indicators and slimmer order books suggest that industrial industry performance will likely be subdued during the year. We expect household consumption and net exports to be the main contributors to a gradual rise in GDP this year, while investment gaining momentum and favourable external demand should lead to balanced growth from 2025 onwards. The economy is forecast to return to its long-term growth track in 2025, with GDP growth of 3.5–4.5 percent in 2025 and 3.0–4.0 percent in 2026.

Chart 1-4: Fan chart of the GDP forecast



Note: Based on unadjusted data.
Source: HCSO, MNB

Chart 1-5: Expenditure side decomposition and forecast of GDP



Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions. Source: HCSO, MNB

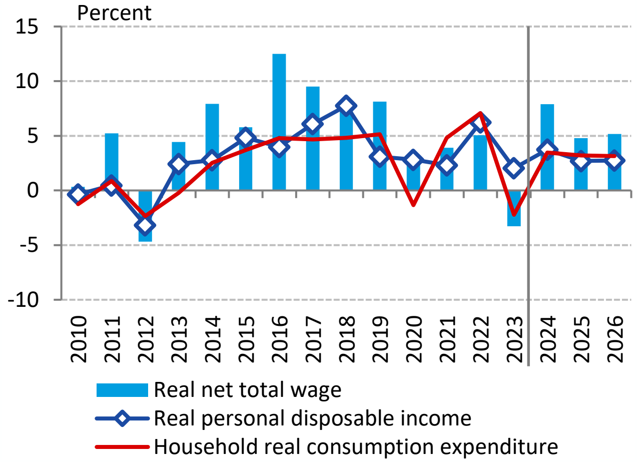
Domestic GDP grew by 1.1 percent year-on-year in 2024 Q1. Adjusted for seasonal and calendar effects, economic output expanded at a rate of 1.7 percent year-on-year and 0.8 percent quarter-on-quarter. The incoming data were in line with our expectations in the March Inflation Report. Among the main economic sectors, services were the primary contributor to economic growth, while subdued industrial output held back growth by 0.9 percentage point. Expenditure side items exhibited two different trends. Rising real wages and improving consumer confidence were reflected in household consumption, which expanded by 3.6 percent year-on-year in the first quarter. Gross fixed capital formation fell by 6.9 percent year-on-year, slowing down economic growth by 1.5 percentage points. Change in inventories held back growth by 2.3 percentage points. The contribution of net exports to growth was 3.1 percentage points, as imports (–9.2 percent) fell more than exports (–5.3 percent).

GDP is likely to grow gradually this year. Positive real wage dynamics and rising household income will support continued growth in demand for services. Business confidence indicators and slim order books suggest that industrial production is likely to remain subdued, and this item is expected to support economic growth again from the end of the year. Based on the number of contracts, construction industry output is expected to remain subdued this year, despite the growth registered in the first quarter.

We forecast that the Hungarian economy will expand by 2.0–3.0 percent this year, supported mainly by domestic demand. With economic performance picking up from mid-2024, we forecast **GDP** to return its long-term growth path in 2025, **with GDP growth expected to continue at 3.5-4.5 percent in 2025 and at 3.0–4.0 percent in 2026** (Charts 1-4 and 1-5).

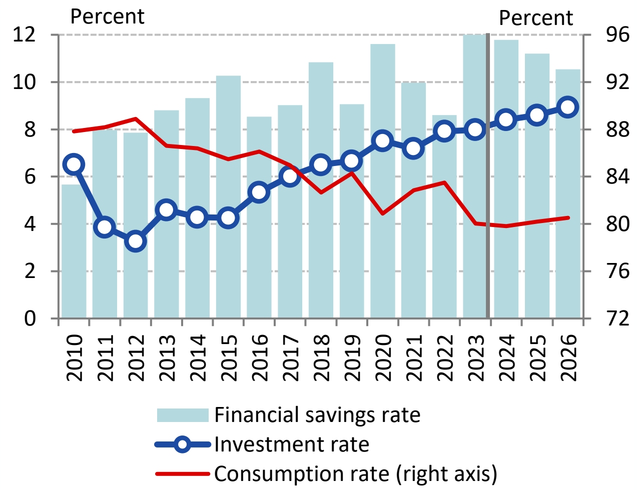
Favourable wage and income trends in 2024 may result in household consumption underpinning economic growth.

Chart 1-6: Annual changes in net total wage, personal disposable income and household consumption expenditure in real terms



Source: HCSO, MNB

Chart 1-7: Evolution of households' consumption, investment and financial savings rates as a percentage of disposable income



Source: HCSO, MNB

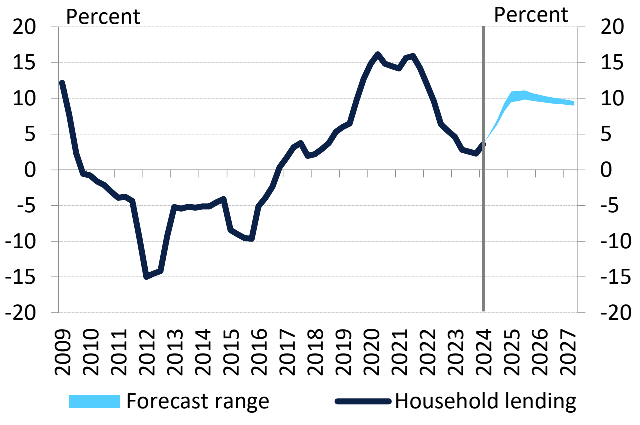
Household demand will be boosted by accelerating household credit growth from early 2024, improving credit conditions and gradually strengthening consumer confidence (Chart 1-8). Housing loans contracted by credit institutions in 2024 Q1 rose at a rate of 130 percent year-on-year, and personal loan issuance was 43 percent higher. Inflation and wage trends point to an increase in households' real income this year, which should also support household consumption growth. Consumption is projected to grow at a rate between 3.3 and 3.7 percent this year and between 2.7 and 3.7 percent in 2025 and 2026 (Chart 1-6).

We expect a gradual decline in the savings rate over the forecast horizon, in line with higher household investment and consumption rates. In response to the uncertain economic environment and high inflation, households accumulated substantial savings in 2023 and at the same time their consumption rate fell. As wages are rising, savings should start to shrink from this year, leading to an increase in household investment and consumption (Chart 1-7).

After a moderate decline this year, investment is forecast to expand in 2025 and 2026. Gross fixed capital formation contracted by 6.9 percent in the first quarter, falling significantly short of our expectations. The structure of investment shows duality this year looking ahead. Looking ahead, increasingly favorable lending dynamics and gradually recovering domestic demand are expected to lead to a moderate expansion in the household and corporate sector investments this year, but this is offset by a decline in public investment. Change in investment is expected to amount to (–1.5)–0.5 percent in 2024, 3.1–6.3 percent in 2025 and 0.7–3.6 percent in 2026. The nominal investment rate may stabilise at around 25–26 percent over the forecast horizon, while the real investment rate at 2015 prices is likely to be lower, at around 22–23 percent (Table 1-3).

As credit growth gains momentum, corporate investment is expected to expand from the second half of the year. According to the MNB's business survey, investment expectations in the corporate segment have been stagnating over the past months. Corporate credit growth in early 2024 was below our earlier expectation, mainly due to the negative impact of large transactions on corporate credit dynamics. Around 25 percent of the banks saw a decline in demand for corporate loans in 2024 Q1 and a net 14 percent of the responding institutions expect demand to increase in 2024 Q2 and Q3. We estimate that corporate credit growth is likely to accelerate going forward, reaching

Chart 1-8: Forecast for lending to households



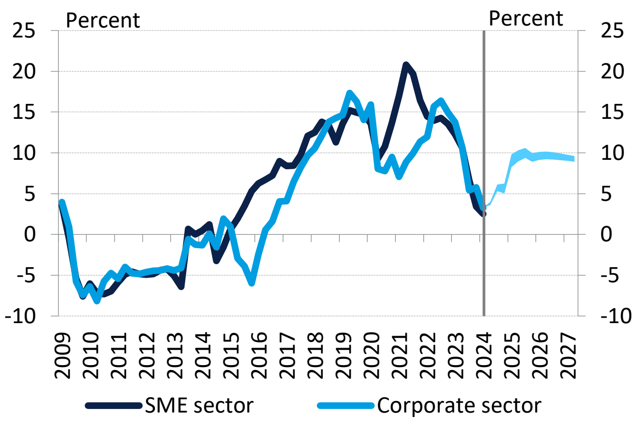
Note: Transaction-based, year-on-year data. 2019 Q3 data adjusted for transactions of lombard loans.
Source: MNB

Table 1-3: Evolution of gross fixed capital formation and investment rate

	2023	2024	2025	2026
Gross fixed capital formation	-7.4	-0.5	4.7	2.2
Government investments	-8.2	-8.0	-2.6	-5.2
Private investments	-7.3	1.3	6.3	3.7
Investment rate	26.3	25.6	25.9	25.8

Note: The values represent the middle of the forecast range. Year-on-year growth for gross fixed capital formation and investment rate as a percent of GDP. Source: MNB

Chart 1-9: Annual changes in lending to non-financial corporations and SMEs



Note: Transaction-based, year-on-year data. The SME sector does not include the self-employed. The growth rate of the overall corporate sector is based on the total amount of outstanding credit to the entire financial intermediary system. Source: MNB

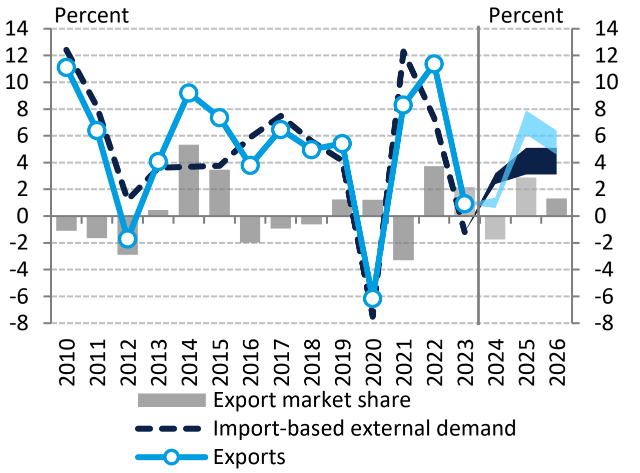
5 percent at the end of 2024 and stabilising at 8–9 percent between the beginning of 2025 and the end of the forecast horizon (Chart 1-9). Overall, business investment is expected to grow only at a moderate pace this year, while we expect a substantial expansion supported by the implementation of previously announced large industrial capital projects from next year onwards.

Household investment is expected to increase over the forecast horizon. Housing loan disbursements were already 212 percent higher in April 2024 than one year earlier, boosting household investment. We forecast household investment to grow by 2.0 percent in 2024, 3.0 percent in 2025 and 5.0 percent in 2026.

Domestic exports stand to grow substantially from next year, in line with trends in economic activity in Europe. Exports fell by 5.3 percent on an annual basis in 2024 Q1. Risks to external economic activity this year continue to include slower disinflation, higher-than-expected interest rate paths, an unfavourable outlook for industrial production in Europe, the ongoing war between Russia and Ukraine and the overall tense geopolitical situation. Looking forward, indicators point to a further decline in exports in the first half of the year. The slowdown in exports is essentially a cyclical phenomenon: the main reasons are unfavourable trends in economic activity in Europe and the resulting weakening external demand. However, domestic export market competitiveness has not suffered damage, and therefore exports are likely to be an important factor in GDP growth again in the medium term. Expansion in domestic exports will be supported by greenfield FDI investments in the manufacturing sector, primarily related to battery and car manufacturing, and thus export growth may become more dynamic again as of 2025. In line with this, Hungary's external market share is expected to decline temporarily this year before rising again from next year; as a result, balanced growth is expected to materialise, and the economy may return its long-term growth path (Chart 1-10).

We expect imports to fall in 2024. Imports declined by 9.2 percent on an annual basis in the first quarter, falling slightly short of our previous expectations. This decline is due mainly to lower exports and investment. The fall in imports exceeding that in domestic items and exports is likely due to the lower import intensity of the individual consumption-side items. However, this will not lead to a sustained decrease in imports, and imports are expected to expand significantly from next year as exports and investment pick up.

Chart 1-10: Changes in export market share

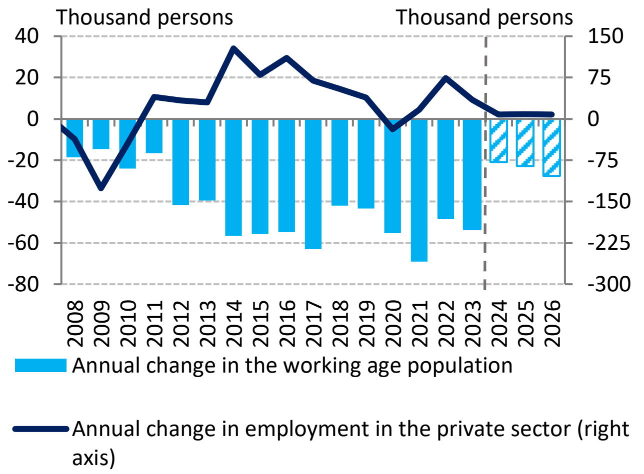


Note: Export market share based on the average of the forecast range.
Source: HCSO, MNB

1.3 Labour market forecast

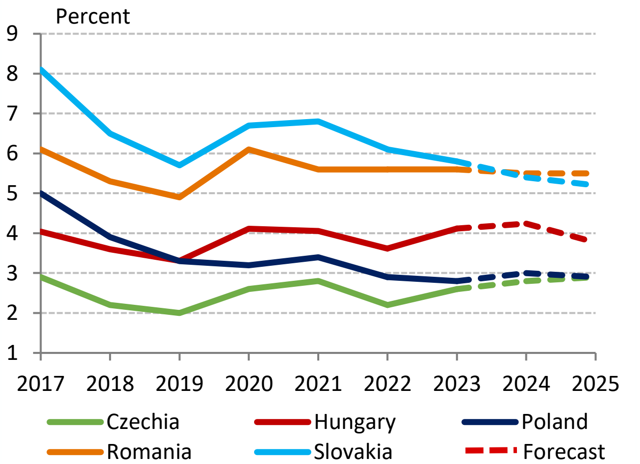
Employment continued to grow in the first months of 2024 and remains at historically high levels. However, given the moderation in labour demand seen in recent quarters and the slowly recovering economy, we expect only a moderate rise in employment this year. The unemployment rate may range between 4.2 and 4.3 percent this year and between 3.5 and 4.0 percent in 2025. Wage growth in 2024 is driven mainly by the rise in the minimum wage at the end of last year, the easing labour market tightness and the pace of moderation in inflation expectations. Average wages in the private sector are expected to increase by 11.0–11.6 percent this year and 7.5–8.6 percent next year.

Chart 1-11: Annual change in the working age population and the number of persons employed in the private sector



Note: The number of persons employed refers to those aged 15-74, but the projection for the working age population refers to those aged 15-64. The number of employed persons is based on the midpoint of the forecast range.
Source: Eurostat, HCSO, MNB

Chart 1-12: Change in the unemployment rate



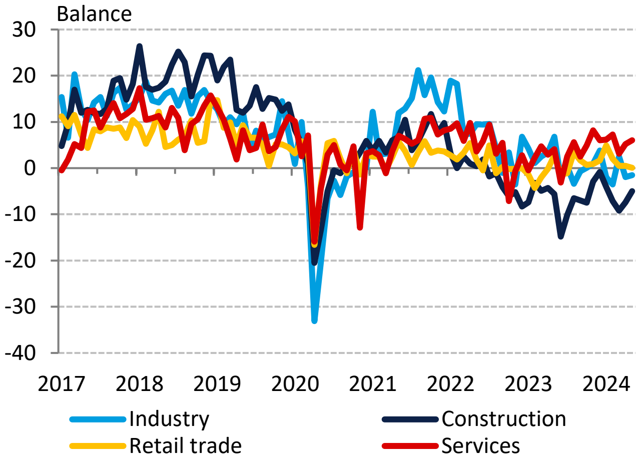
Note: Data on Hungary based on the midpoint of the forecast range.
Source: Eurostat, European Commission, HCSO, MNB

Employment in the national economy is expected to rise slightly further this year from its historically high level. In some sectors, coverage for labour demand arising as a result of the economy gaining momentum is partially at companies' disposal, because in the recent period they reacted to the slowdown of the economy not with layoffs, but with a reduction in the number of working hours and with labour hoarding. Employment is therefore expected to grow slowly as economic performance picks up, which is also impacted by demographic trends putting an increasingly effective constraint on further substantial growth in employment (Chart 1-11). According to our current forecast, employment in the private sector is expected to change between 0.1 and 0.3 percent in 2024 and to increase by 0.0–0.5 percent in 2025 and 2026.

The unemployment rate may fall for the rest of the year and next year. The unemployment rate stood at 4.6 percent in 2024 Q1, reflecting a year-on-year increase of 0.6 percentage point (30,000 persons). According on the seasonally adjusted monthly data based on the HCSO's model estimate, unemployment tended to stagnate in the early months of the year. We expect the unemployment rate to decrease for the rest of the year as economic performance gradually recovers. Our current forecast for the unemployment rate is in the range of 4.2–4.3 percent this year. The rate may be between 3.5 and 4.0 percent in 2025 and between 3.2 and 4.1 percent in 2026 (Chart 1-13).

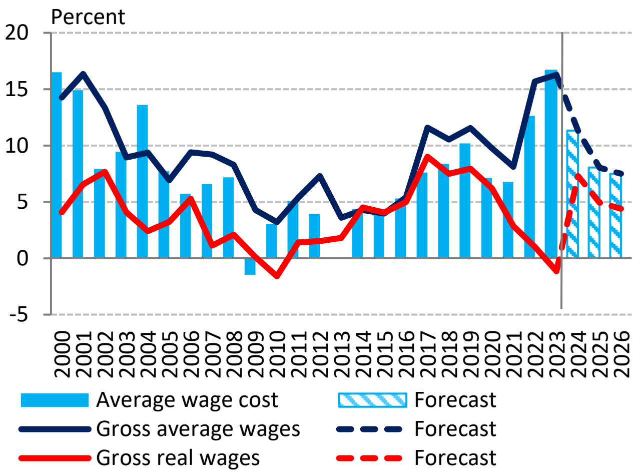
Labour market tightness is easing, and labour demand is moderating. The tightness of the labour market has eased in recent quarters. The number of job vacancies has been falling across a wide range of sectors of the economy on an annual basis, with the largest declines in manufacturing, information and communication, and transportation and storage in the first quarter of the year. According to the latest ESI survey, most companies in construction and manufacturing expect a reduction of their workforce in the coming months. In services, the majority of firms expect their employment to increase in the next three months, while in retail, the ratios of companies facing a decrease or increase in their workforce are balanced (Chart 1-13).

Chart 1-13: Employment expectations in the ESI business survey



Note: The balance is positive (negative), if the majority of companies plans to hire (lay off). Seasonally adjusted data.
Source: European Commission

Chart 1-14: Annual changes in gross average wages and average labour cost in the private sector



Note: Based on the midpoint of the forecast range.
Source: HCSO, MNB

In 2024, nominal wage growth will be more moderate than last year; however, real wages are expected to increase substantially this year. Real wages have been rising since September 2023, following a significant reduction in inflation in the course of 2023. Labour market tightness has eased, and inflation expectations are cooling gradually. Nevertheless, the underlying wage trends are still solid. In December 2023, the minimum wage and the guaranteed minimum wage increased by 15 percent and 10 percent, respectively. Wages in the private sector may rise by 11.0-11.6 percent this year. Our forecast for 2025 and 2026 is 7.5–8.6 percent and 6.9–8.1 percent, respectively. Real wages in the private sector may rise by 7.0–7.6 percent in 2024, 4.4–5.4 percent in 2025 and 3.8–5.0 percent in 2026 (Chart 1-14).

Table 1-4: Changes in projections compared to the previous Inflation Report

	2023	2024		2025		2026	
	Actual	Previous	Current	Previous	Current	Previous	Current
Inflation (annual average)							
Core inflation	18.2	4.0 - 5.6	4.1 - 5.3	2.8 - 3.4	2.7 - 3.5	2.7 - 3.3	2.7 - 3.3
Core inflation excluding indirect tax effects	18.1	4.0 - 5.6	4.1 - 5.3	2.8 - 3.4	2.7 - 3.5	2.7 - 3.3	2.7 - 3.3
Inflation	17.6	3.5 - 5.0	3.0 - 4.5	2.5 - 3.5	2.5 - 3.5	2.5 - 3.5	2.5 - 3.5
Economic growth							
Household final consumption expenditure	-2.2	2.8 - 3.5	3.3 - 3.7	2.6 - 3.6	2.7 - 3.7	2.7 - 3.7	2.7 - 3.7
Final consumption of government[1]	1.3	0.9 - 2.0	(-0.1) - 0.7	0.4 - 1.6	(-0.3) - 0.9	0.7 - 1.8	(-0.1) - 1.1
Gross fixed capital formation	-7.4	0.8 - 3.8	(-1.5) - 0.5	1.8 - 4.7	3.1 - 6.3	0.7 - 3.6	0.7 - 3.6
Domestic absorption	-5.6	2.1 - 3.1	0.5 - 1.3	2.0 - 3.2	2.6 - 3.8	1.8 - 3.0	1.8 - 3.0
Exports	0.9	1.3 - 2.7	0.6 - 1.4	6.1 - 7.9	6.1 - 7.9	4.6 - 6.4	4.6 - 6.4
Imports	-4.3	1.5 - 2.9	(-1.5) - (-0.7)	4.3 - 6.3	5.4 - 7.4	3.1 - 5.1	3.1 - 5.1
GDP	-0.9	2.0 - 3.0	2.0 - 3.0	3.5 - 4.5	3.5 - 4.5	3.0 - 4.0	3.0 - 4.0
Labour productivity[2]	-1.1	2.4 - 3.2	2.1 - 2.6	3.4 - 4.7	3.4 - 4.7	2.8 - 4.2	2.8 - 4.2
External balance[3]							
Current account balance	0.2	0.0 - 1.2	1.5 - 2.7	1.2 - 2.6	2.2 - 3.6	2.1 - 3.7	3.0 - 4.6
Net lending	1.2	1.9 - 3.1	3.1 - 4.3	3.1 - 4.5	4.1 - 5.5	4.0 - 5.6	4.8 - 6.4
Government balance[3]							
ESA balance	-6.7	(-5.0) - (-4.5)	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)	(-3.8) - (-2.8)
Labour market							
Whole-economy gross average earnings[4]	14.3	11.4 - 12.3	12.4 - 13.0	7.0 - 8.2	7.1 - 8.3	7.4 - 8.7	7.7 - 9.0
Whole-economy employment	0.6	(-0.3) - 0.1	0.1 - 0.3	(-0.3) - 0.4	(-0.3) - 0.4	(-0.2) - 0.6	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	10.0 - 11.0	11.0 - 11.6	7.1 - 8.2	7.5 - 8.6	6.5 - 7.6	6.9 - 8.1
Private sector employment	1.0	(-0.1) - 0.3	0.1 - 0.3	0.0 - 0.5	0.0 - 0.5	0.0 - 0.5	0.0 - 0.5
Unemployment rate	4.1	4.2 - 4.3	4.2 - 4.3	3.5 - 4.0	3.5 - 4.0	3.2 - 4.1	3.2 - 4.1
Private sector nominal unit labour cost	17.5	8.2 - 9.4	8.8 - 9.7	2.7 - 4.3	2.9 - 4.5	2.7 - 4.5	3.1 - 4.9
Household real income[5]	2.0	2.8 - 3.7	3.4 - 4.0	2.0 - 3.2	2.1 - 3.3	2.1 - 3.3	2.1 - 3.3

[1] Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.
[2] Whole economy, based on national accounts data.
[3] As a percentage of GDP.
[4] For full-time employees.
[5] MNB estimate.

Table 1-5: MNB baseline forecast compared to other forecasts

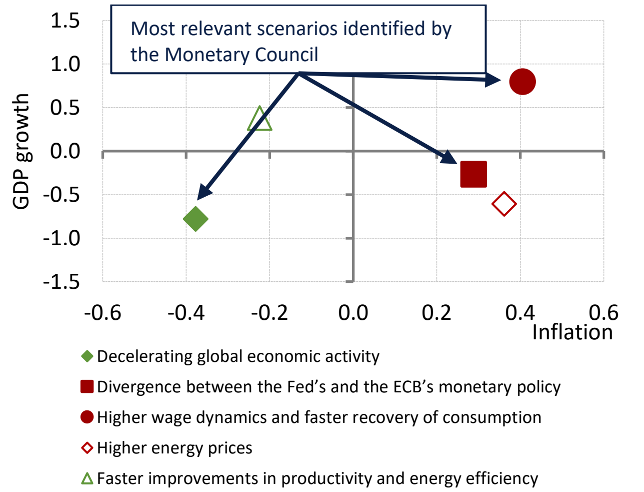
	2024	2025	2026
Consumer Price Index (annual average growth rate, %)			
MNB (June 2024)	3.0 - 4.5	2.5 - 3.5	2.5 - 3.5
Consensus Economics (May 2024)[1]	2.8 - 4.1 - 5.2	2.0 - 3.6 - 5.0	
European Commission (May 2024)[2]	4.1	3.7	
IMF (April 2024)	3.7	3.5	2.9
OECD (May 2024)	4.0	3.9	
Reuters survey (June 2024)[1]	3.6 - 4.2 - 5.2	3.4 - 3.8 - 4.4	2.1 - 3.1 - 3.4
GDP (annual growth rate, %)			
MNB (June 2024)	2.0 - 3.0	3.5 - 4.5	3.0 - 4.0
Consensus Economics (May 2024)[1]	1.1 - 2.3 - 2.9	2.0 - 3.3 - 4.6	
European Commission (May 2024)[2]	2.4	3.5	
IMF (April 2024)	2.2	3.3	2.8
OECD (May 2024)	2.1	2.8	
Reuters survey (June 2024)[1]	2.0 - 2.4 - 2.9	3.0 - 3.5 - 3.9	2.5 - 3.5 - 4.4
Current account balance[3]			
MNB (June 2024)	1.5 - 2.7	2.2 - 3.6	3.0 - 4.6
European Commission (May 2024)[2]	0.0	-1.4	
IMF (April 2024)	-0.2	-0.3	-0.3
OECD (May 2024)	0.8	0.5	
Budget balance (ESA 2010 method)[3]			
MNB (June 2024)	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Consensus Economics (May 2024)[1]	(-5.6) - (-4.9) - (-4.1)	(-5.0) - (-4.0) - (-3.1)	
European Commission (May 2024)[2]	-5.4	-4.5	
IMF (April 2024)	-5.2	-4.3	-3.2
OECD (May 2024)	-4.5	-3.7	
Reuters survey (June 2024)[1]	(-5.5) - (-5.0) - (-4.5)	(-5.0) - (-4.1) - (-3.2)	(-4.5) - (-3.7) - (-2.8)
MNB (June 2024)	1.2 - 1.8	1.9 - 2.7	1.3 - 2.2
ECB (June 2024)	0.9	1.4	1.6
Consensus Economics (May 2024)[1]	1.3	1.8	
European Commission (May 2024)[2]	1.3	1.9	
IMF (April 2024)[2]	1.2	1.9	1.9
OECD (May 2024)[2]	1.3	2.0	

[1] For Reuters and Consensus Economics surveys, in addition to the average value of the analysed replies, we also indicate the lowest and the highest values to illustrate the distribution of the data.
[2] Values calculated by the MNB; the projections of the named institutions for the relevant countries are adjusted with the weighting system of the MNB, which is also used for the calculation of the bank's own external demand indices. Certain institutions do not prepare forecast for all partner countries.
[3] As a percentage of GDP.
Source: Consensus Economics, ECB, European Commission, IMF, OECD, Reuters poll, MNB

2 Effects of alternative scenarios on our forecast

The Monetary Council highlighted three alternative risk scenarios around the baseline projection of the June Inflation Report. In the scenario that assumes decelerating global economic activity, both economic growth and inflation may be lower compared to the baseline. The alternative scenario which considers a divergence between the Fed's and the ECB's monetary policy is consistent with a trajectory of higher inflation and lower growth. The scenario assuming higher wage dynamics and a faster recovery in consumption is consistent with a higher growth and inflation path compared to the baseline scenario. In addition to the highlighted scenarios, the Monetary Council discussed alternative scenarios including paths featuring higher energy prices, as well as faster improvements in productivity and energy efficiency. In terms of risks, geopolitical conflicts continue to represent a significant risk, primarily due to the Russian-Ukrainian war, the situation in the Middle East and fragmentation of the multilateral trading system.

Chart 2-1: Risk map: effect of alternative scenarios on the baseline forecast



Note: The risk map presents the average difference between the inflation and growth path of the alternative scenarios and the baseline forecast over the monetary policy horizon. The red markers represent tighter and the green markers represent looser monetary policy than in the baseline forecast.
Source: MNB

Decelerating global economic activity

Economic performance picked up in China and the European Union in 2024 Q1, while the United States continues to show stable growth, despite a moderate slowdown in the first quarter. This means that the divergence between the growth trajectory of the EU and the USA, which has been present since 2023 Q1, was maintained. At the same time, retail sales in all three regions are showing signs of recovery. Most of Hungary's key export partners were only able to achieve modest growth in the first quarter, while the economy of Hungary's main trading partner, Germany, shrank by 0.2 percent in 2024 Q1, compared to the same period last year.

In recent months, economic indicators in the euro area have developed in line with expectations. In China, the Purchasing Managers' Index (PMI) for manufacturing improved, while it dropped in the United States and the euro area. Based on forward-looking indicators, Hungary's main export partners are experiencing a slow, fragile improvement. In Germany, the PMI was higher than expected based on the preliminary data from May. However, while business activity in the German private sector shows growth not seen in a year, the PMI for manufacturing remained below the expansion threshold.

Market analysts expect moderate growth in the euro area in 2024. Based on Bloomberg analysts' median expectations for growth prospects, the global economy may expand by 2.9 percent, with growth of 2.4 percent in the USA, 4.9 percent in China, and 1.0 percent in the EU in 2024.

Hungary's export performance is strongly influenced by demand for electric cars. Compared to last year's average, the market share of electric cars decreased in the EU in

2024 Q1 within new car registrations. The impact of this was reflected in the production and export data of the Hungarian manufacturing industry. The further expansion of the share of electric cars is hindered by several factors (e.g. the slow development of charging infrastructure and the withdrawal of state subsidies).

If the **risk scenario of decelerating weakening global economic activity** occurs, global growth and, in line with this, EU growth will be more moderate than in the baseline scenario. The slowdown in the global economy continues to weigh on the growth prospects of the German export sector. We assume that the growth gap between the EU and other globally dominant regions will continue to increase, which would negatively impact Hungary's growth prospects, as Hungary is most strongly linked to European economic trends. The slowing demand for electric cars poses a further risk. The subdued performance of Hungary's external markets hampers domestic export performance via a decline in external demand, thus contributing to a slowdown in GDP growth. In addition, a lower inflation path, due to lower external inflation, is envisaged compared to the baseline scenario.

Divergence between the Fed's and the ECB's monetary policy

The monetary policy of the world's leading central banks shows a divergence. In May 2023, market expectations showed an average difference of just 0.4 percentage point between the Fed and the ECB regarding the expected interest rate by the end of 2024, while this difference amounted to around 1.6 percentage points in June 2024. The Fed did not change its interest rate conditions at its rate-setting meetings during the last quarter, but the ECB started to cut interest rates in June. Looking ahead, the Fed's interest rate may remain at its current level longer than previously expected, while the ECB may continue the interest rate reduction that started in June 2024.

Inflation reached a turning point in 2023 in both the US and the euro area. Still, inflation in the USA has remained above 3 percent since 2023 Q2, which may result in a tighter interest rate path from the Fed. In addition, the slowdown in the recovery of budget balances pose a monetary policy challenge in both economies, as well as the somewhat looser but historically tight labour market.

At the press conference following the **Federal Reserve** decision in June, Jerome Powell said that the better-than-expected May CPI figure was a positive development, but decision-makers were still unsure about inflation approaching the central bank's target in a sustainable manner. After the rapid decrease in inflation experienced in the second half of last year, disinflation stalled in the first quarter of this year, which means that reaching the goal may take longer than expected. Based on the current median forecast of the Federal Open Market Committee, an interest rate cut of 25 basis points is expected this year. At the same time, based on market expectations, the Fed's first interest rate cut of 25 basis points is also due in November.

European Central Bank decision-makers decided on a 25-basis point reduction in the policy rates at the June interest rate meeting. According to the statement, the Governing Council continues to apply a data-dependent, meeting-by-meeting approach, without committing to a predetermined interest rate path. The decision-makers decide on the appropriate level of monetary conditions and its persistence based on incoming data. Interest rate decisions are made on the basis of the inflation outlook, underlying inflation and the strength of monetary transmission. Based on market pricing, further easing is expected in 2024.

If the alternative path that takes into account a stronger divergence between the Fed’s and ECB’s monetary policy is realised, US monetary policy may remain tight longer compared to the base path, while the ECB may ease further after the June step during the course of this year. Due to the divergence, capital flows turn towards the USA, resulting in a stronger dollar and capital outflows from emerging markets. This is equivalent to an increase in the risk premium in the Central Eastern European region, and thus in Hungary as well. In this environment, risk aversion towards emerging markets, including Hungary, would rise more persistently and strongly, which may be exacerbated by uncertainty stemming from ongoing geopolitical tensions. As a result, inflation may rise and growth may decelerate.

Higher wage dynamics and a faster recovery of consumption

In 2024 Q1, double-digit real wage growth was registered in Hungary. Gross average earnings rose by more than 14 percent on average in the period between January and March, and thus in conjunction with inflation dropping to the central bank’s tolerance band, real wages grew at a rate of more than 10 percent.

The favourable wage growth has only been moderately reflected in the development of retail trade. Based on calendar-adjusted data, retail sales increased by more than 4 percent in March.

In 2024 Q1, the financial assets of households increased significantly, expanding by HUF 4,000 billion. In recent years, high inflation has eroded not only the income of households, but also their financial assets to a large extent. As a response, households substantially increased their savings during this period. When inflation decreased, the volume of financial assets rose, meaning that the recovery of savings may be followed by an expansion in consumption.

The easing of precautionary motives and favourable wage developments may lead to a faster-than-expected recovery of domestic consumption. Consumer confidence is crucial for consumption and saving decisions. Even though GKI's consumer confidence index is still below the long-term average, it has shown a trend-like increase since September 2022, which, combined with the recent favourable trends, suggests a faster recovery in consumption.

If the alternative path is realised, real wage growth may remain at a high level for a longer period, which would result in a sharp increase in domestic consumption, in addition to the faster-than-expected easing of precautionary motives. The faster recovery in consumption is consistent with a higher growth and inflation path compared to the baseline scenario.

Further risks

In addition to the highlighted scenarios, the Monetary Council considered two other alternative paths.

The alternative path based on **higher energy prices** implies global supply problems and a protracted wartime environment, which would lead to rising commodity prices and a less favourable external position for Hungary compared to the baseline scenario. The realisation of risks pointing in the direction of commodity market turmoil and persistently higher prices puts upward pressure on global inflation. In this alternative scenario, the external inflation environment would thus be higher than expected, causing a ripple effect in domestic prices. As the Hungarian economy is a commodity importer, both external and internal balance developments would develop unfavourably, which also raises the risk premium. The scenario is consistent with a higher inflation and lower growth trajectory compared to the base scenario.

In the alternative path with a faster improvement in productivity and energy efficiency, improved competitiveness will further stimulate growth in the domestic economy, mainly on the supply side, through the shift to an intensive growth model. Productivity may be improved at a higher degree than assumed in the baseline scenario if more of the 330 steps to improve competitiveness are carried out, and energy efficiency improvements are enhanced by implementing the 144 points of the discussion paper 'Sustainable Balance and Convergence', thus accelerating a green transition. Completion of the targeted measures would significantly improve productivity, leading to a lower cyclical position in the domestic economy. This is consistent with a lower inflation path and higher economic output.

3 Macroeconomic overview

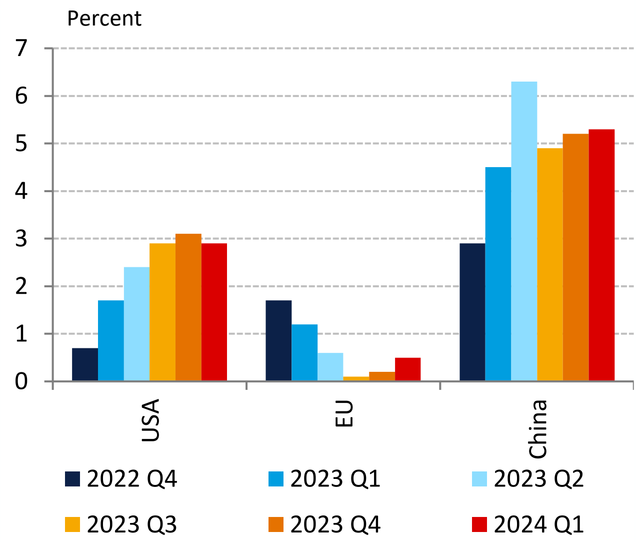
3.1 Evaluation of international macroeconomic developments

During the first quarter of the year, output in the European Union economy expanded moderately, in line with expectations, while the labour market remained tight. Growth in the US economy decelerated slightly, while Chinese economic growth exceeded preliminary expectations. From the aspect of external economic activity, the generally tense geopolitical situation and the subdued European growth prospects still pose significant risks. In the United States, the Federal Reserve left the target range for the federal funds rate unchanged in May and in June. The Fed also continued the balance sheet tightening it commenced in June 2022 and announced that starting from June the central bank would reduce the target value of quantitative tightening for government securities from USD 60 billion to USD 25 billion per month. The ECB kept key interest rates unchanged in April and then reduced its rates by 25 basis points in June. The central bank confirmed in June that it would begin reducing the PEPP portfolio in 2024 H2, with reinvestments scheduled to be fully completed by the end of 2024. In the region, the Czech central bank cut its policy rate by 50 basis points to 5.25 percent in May. The Polish and Romanian central banks left their interest rates unchanged in the last quarter.

3.1.1 International economic trends

EU economic output expanded moderately in 2024 Q1 (Chart 3-1), with the performance of the European economies generally in line with the preliminary expectations. In 2024 Q1, the EU expanded by 0.5 percent, while the euro area economies grew by 0.4 percent year-on-year, based on seasonally and calendar-adjusted data. Output in Germany, Hungary's main trading partner, fell by 0.2 percent on an annual basis in 2024 Q1. Among the countries in the region, GDP expanded in the Czech Republic (+0.2 percent), Poland (+1.3 percent) and Slovakia (+2.7 percent) in year-on-year terms. GDP contracted in three of the 27 countries in the European Union on a quarterly basis.

Chart 3-1: GDP growth in leading global economies



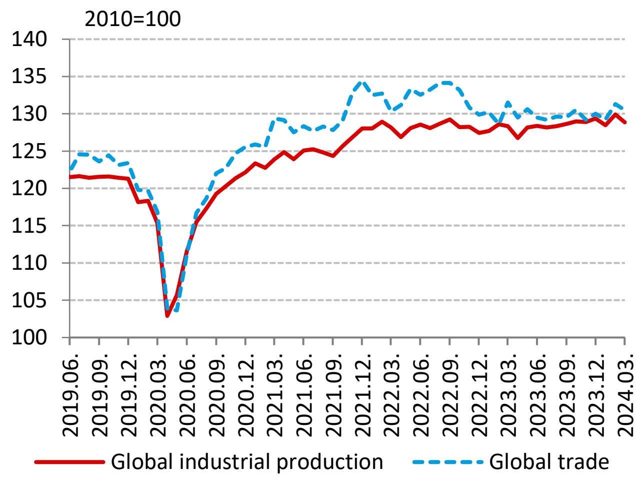
Note: Annual growth. In the case of the EU, the calculation is based on seasonally and working day adjusted data.
Source: Trading Economics, FRED, Eurostat

Annual GDP growth in the US decelerated slightly. The US economy grew at an annual rate of 2.9 percent, while on a quarterly basis it grew by 0.3 percent. Growth was supported by further strong expansion in household consumption and by investment.

China's annual growth exceeded expectations in 2024 Q1, with a rate of 5.3 percent, which was higher than in the final quarter of last year, while on a quarterly basis output expanded by 1.6 percent. Retail sales slowed, but industrial production continued to show stable year-on-year growth.

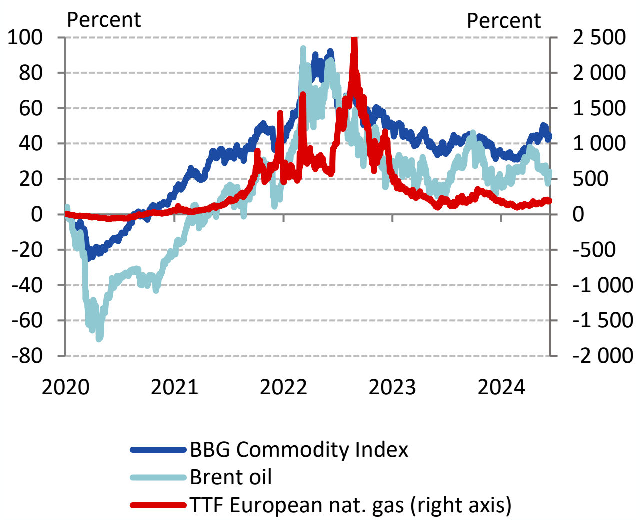
From the aspect of external economic activity, there continue to be significant risks, due to stalling disinflation and higher-than-expected interest rate paths, and the unfavourable outlook for industrial production in Europe, as well as the generally tense geopolitical situation and the war between Russia and Ukraine. In 2024 Q1, global industrial production remained subdued, and world trade also stagnated (Chart 3-2). The world market price of oil did

Chart 3-2: Development of global industrial production and global trade



Note: Based on seasonally adjusted data.
Source: CPB

Chart 3-3: Commodity prices



Source: Bloomberg

not change significantly compared to December, while the price of natural gas rose somewhat from a low level (Chart 3-3). Global economic activity has been supported by the still tight labour market in developed economies. There has been no substantial change in the global and European growth outlook for this year compared to the December forecast. Business confidence indices show that consumer confidence in EU economies somewhat improved, but remains at low levels. At the same time, business sentiment stagnated in services and deteriorated moderately in industry.

3.1.2 International monetary policy, inflation and financial market trends

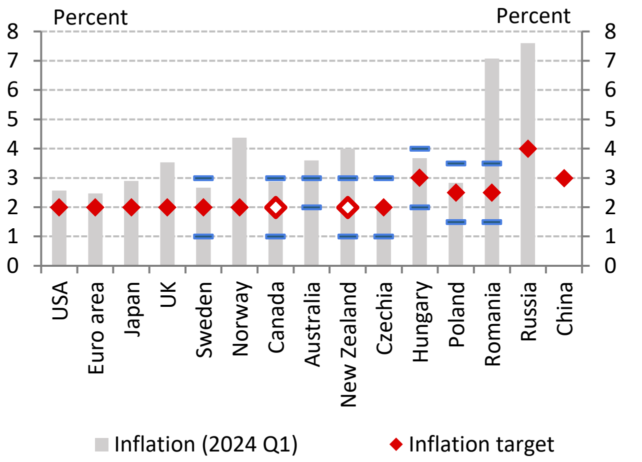
Global inflation continued to decline during the past quarter and approached the central bank's target in several countries (Chart 3-4). Nonetheless, the world economy is generally characterised by high rates of inflation in services, which is hampering disinflation.

In the United States, CPI inflation fell from 3.5 percent in March to 3.4 percent in April and then to 3.3 percent in May. Core inflation decreased from 3.8 percent in March to 3.6 percent in April and then to 3.4 percent in May. The PCE inflation index rose from 2.5 percent in February to 2.7 percent in March, before remaining at 2.7 percent in April. In terms of the structure of inflation, services – in particular housing services – continue to make the highest contribution.

In the United States, the Federal Reserve maintained the target range of the federal funds rate at 5.25–5.50 percent in May and in June. Fed Chairman Jerome Powell said that the policy-makers would make their decisions in a data-driven manner and did not want to pre-commit to any interest rate path. The Fed announced that starting from June it would reduce the target value of quantitative tightening for government securities from USD 60 billion to USD 25 billion per month, while the target value for mortgage-backed securities remained unchanged at USD 35 billion. The Fed's balance sheet total continued to shrink, falling to USD 7,310 billion by the beginning of June 2024, amounting to 25.8 percent of GDP (Chart 3-5).

Inflation in the euro area was at 2.4 percent in March and in April, before rising to 2.6 percent in May, according to preliminary data. Core inflation fell from 2.9 percent in March to 2.7 percent in April, and then rose to 2.9 percent in May, according to preliminary data. Compared to the March forecast, the ECB's June projection features higher inflation for 2024 and 2025. According to the June forecast,

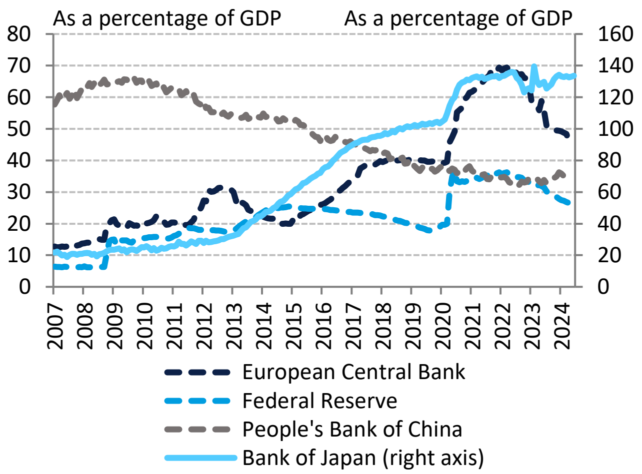
Chart 3-4: Inflation targets of central banks and actual inflation



Note: The blue lines represent the inflation control range in Australia, Canada and New Zealand, while in other countries they mark a permissible fluctuation band. In Canada and New Zealand the mid-point of the target band is accentual, which is marked by empty diamond.

Source: OECD, FRED, National Institute of Statistics Romania, Statistics Sweden, Federal State Statistics Service

Chart 3-5: Balance sheet totals of globally important central banks



Source: Databases of central banks, Eurostat, FRED

annual inflation may reach 2.5 percent in 2024, 2.2 percent in 2025 and 1.9 percent in 2026.

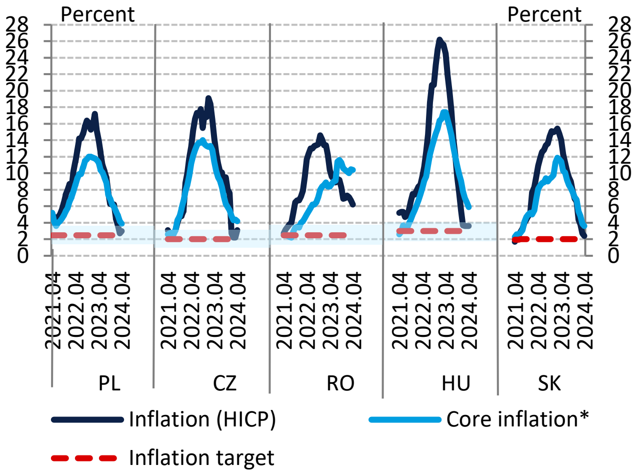
The ECB left its policy rates unchanged with its April interest rate decision, and then cut rates by 25 basis points in June. According to the announcement of the central bank, the Governing Council continues to use a data-dependent, meeting-by-meeting approach. Based on the incoming data, the policy-makers decide on the appropriate level and length of restrictiveness. The Governing Council makes its interest rate decisions depending on the inflation outlook, the underlying inflation processes and the strength of monetary transmission. In June, the central bank confirmed that it would reduce the PEPP portfolio by EUR 7.5 billion per month on average in 2024 H2. The ECB intends to fully stop the reinvestments at the end of 2024. The ECB's balance sheet total stood at EUR 6,541 billion at the beginning of June 2024, or 45.8 percent of GDP (Chart 3-5).

At its April interest rate meeting, the Bank of Japan made no changes to its policy rate, which remains between 0 and 0.1 percent. Ahead of the interest rate decision, Bank of Japan Governor Kazuo Ueda said that central bank would consider further restriction of monetary stimulus if inflation continues to accelerate, signalling the possibility of another interest rate hike. Inflation fell from 2.8 percent in February to 2.7 percent in March and then to 2.5 percent in April. The balance sheet total of the central bank stood at 133.6 percent of GDP at the beginning of June (Figure 3-5).

China's central bank maintained its medium-term lending facility at 2.5 percent. In addition, it left its one-year and five-year benchmark lending rates unchanged at 3.45 and 3.95 percent, respectively, for top-rated customers. Inflation advanced from 0.1 percent in March to 0.3 percent in April and then stayed at 0.3 percent in May. At the beginning of April, the central bank's balance sheet total amounted to 34.3 percent of GDP (Chart 3-5).

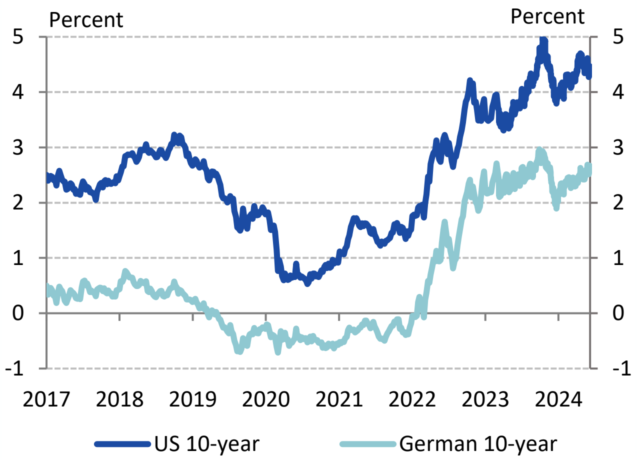
Poland's central bank kept its policy rate unchanged at 5.75 percent at its rate-setting meetings held in April, May and June. Looking ahead, the central bank will decide on further measures based on incoming data on inflation and economic activity. Adam Glapinski, Chairman of the Polish central bank, said at a press conference that there was no room for an interest rate cut this year. Inflation rose from 2.0 percent in March to 2.4 percent in April and then to 2.5 percent in May according to preliminary data. The Harmonised Index of Consumer Prices was 3.0 percent in April (Chart 3-6).

Chart 3-6: Inflation and core inflation in the region



Note: Annual change, percent. *In the case of core inflation, we use the Eurostat definition (inflation excluding energy, food, alcohol and tobacco). The blue area indicates the tolerance band around the inflation targets.
Source: Eurostat

Chart 3-7: US and German 10y-government bond yields



Source: Bloomberg

The Czech central bank cut its policy rate by 50 basis points to 5.25 percent in May. Central bank Governor Aleš Michl told a press conference after the decision that the decision-makers would evaluate the incoming data at each interest rate meeting and decide on any interest rate cuts accordingly. Inflation rose from 2.0 in March to 2.9 in April, and then decreased to 2.6 percent in May. The Harmonised Index of Consumer Prices stood at 3.1 percent in April (Chart 3-6).

The policy rate of the Romanian central bank also remained unchanged, at 7.0 percent. Mugur Isărescu, Governor of the Romanian Central Bank, said at the press conference held on the occasion of the May inflation report that it was not certain that the central bank would start cutting interest rates at the next two interest rate meetings in July and August. Inflation fell from 6.6 percent in March to 5.9 percent in April and then to 5.1 percent in May. The Harmonised Index of Consumer Prices was 6.2 percent in April (Chart 3-6).

Overall, investor sentiment did not change significantly in the past quarter; at the same time, geopolitical conflicts may continue to pose significant risks, for both the energy sector and global value chains. During the past period, asset price developments were mostly influenced by expectations about the interest rate policies of advanced market central banks. The interest rate path as a whole priced in by market participants moved upwards in response to statements by policy-makers at the major central banks.

Developed market long bond yields rose, with the US 10-year yield advancing by 20 basis points to 4.5 percent and the German 10-year yield increasing by 32 basis points to over 2.5 percent (Chart 3-7). The Japanese 10-year yield rose by 31 basis points to 1.0 percent compared to the previous quarter. Emerging market bond yields also moved higher, with the Polish 10-year yield in the region rising by 30 basis points, the Czech 10-year yield by 32 basis points and the Romanian 10-year yield by 38 basis points. The MSCI index of emerging economies rose by 2.4 percent. Compared to the US dollar, the euro weakened by 0.4 percent in the past quarter, while the British pound and the Swiss franc strengthened by 0.5-0.9 percent. After the previous quarter, the Japanese yen weakened again to a greater extent, depreciating by 3.8 percent versus the US dollar.

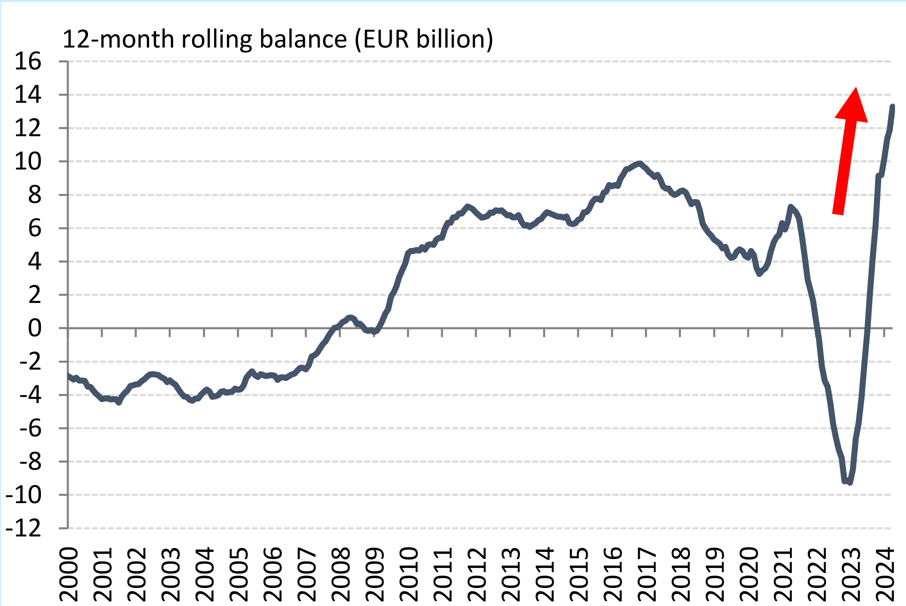
Based on market prices, the Fed's interest rate may remain at its current level, while the ECB started reducing its interest rates in June. The Fed did not change interest rates at the meetings held the last quarter, while the ECB cut its policy rates by 25 basis points in June. Based on market prices, the Fed is expected to start its interest rate reduction cycle in the autumn, while the ECB may resume with cuts in the autumn.

Box 3-1: Factors behind the historically high foreign trade surplus

During the first months of this year, the balance of foreign trade in goods recorded the highest surplus measured since the beginning of data reporting (Chart 3-8). Starting from 2023 Q2, a surplus exceeding EUR one billion was measured in several months, and then this figure rose to a historically high level in 2024 Q1, as the value of exports exceeded the value of imports by nearly EUR 3.8 billion in the first three months of the year. The significant accumulated surplus is clearly demonstrated by the fact that the 12-month rolling balance, looking back one year, almost reached EUR 12 billion, another historic high.

The trade surplus caused the current account balance to return to the positive domain. As a result of the significant surplus of goods, the domestic current account balance turned positive in 2023 after an increase of more than 8 percentage points and showed a surplus of 0.2 percent of GDP for the entire year. Since Hungary is a small, open economy, it is important to examine the factors behind the development of the foreign trade balance.

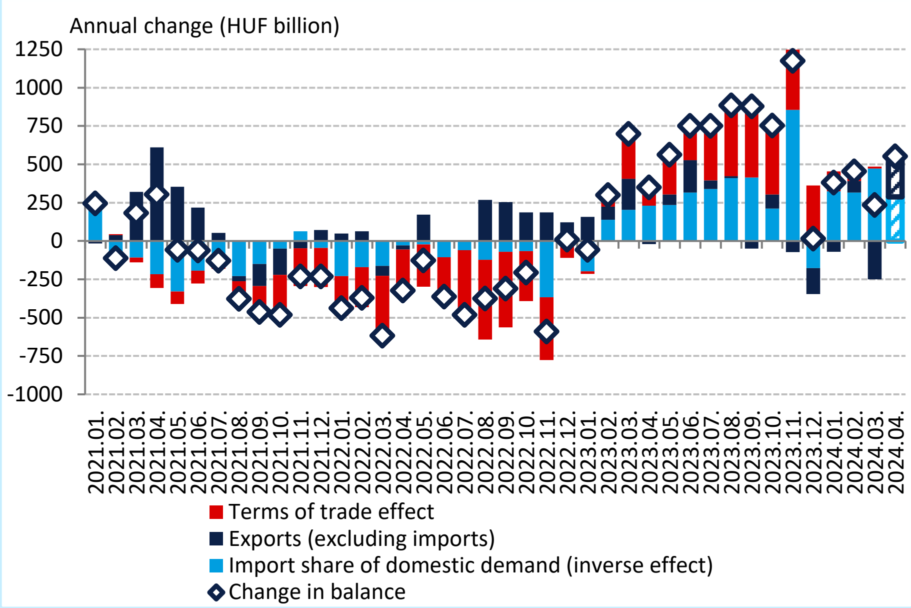
Chart 3-8: Changes in the balance of foreign trade in goods



Note: For each month, the chart shows the foreign trade balance in goods of the month and the preceding 11 months.
Source: HCSO

The outstanding goods surplus was realised in conjunction with a decline in imports. The improvement in the balance since the beginning of last year was primarily caused by the favourable terms of trade and the decline of internal demand items through their import content (Chart 3-9). Thanks to the lower energy prices, the terms of trade improved by 6.7 percent overall last year, significantly facilitated by a major correction in energy prices, which in itself resulted in a 4.0-percent improvement in the balance. The volume of goods exports increased by 3.0 percent last year, before falling by 2.1 percent in the first two months of this year, while the volume of goods imports decreased by 2.5 percent last year and has fallen by 8.9 percent so far this year. The development of exports is primarily driven by demand in Hungary's export markets, while imports were moderated by last year's decline in residential consumption and investments.

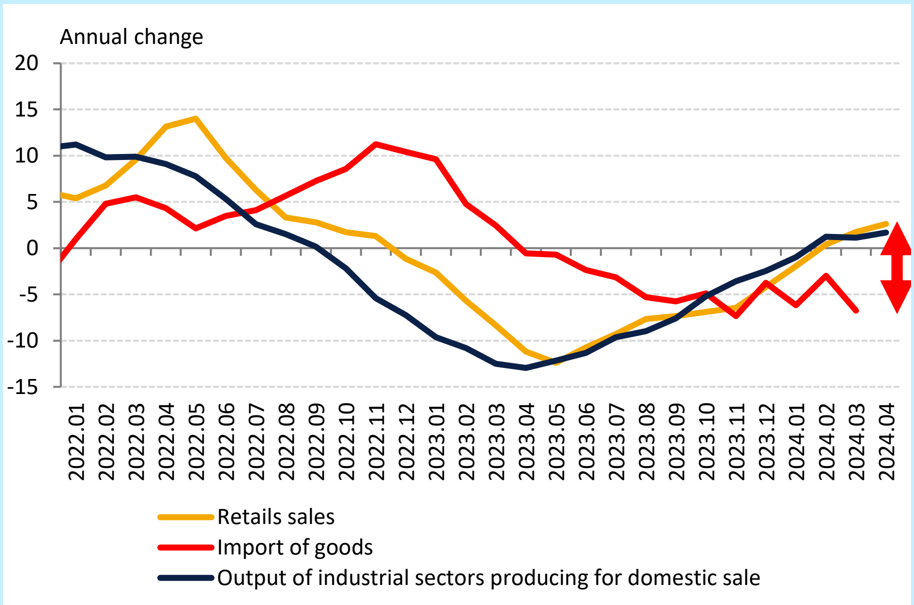
Chart 3-9: Decomposition of annual changes in the trade balance in goods



Note: Estimated values are shown for April, as only preliminary data are available for this month.
Source: HCSO

The moderate recovery in consumption has not yet been reflected in the development of goods imports (Chart 3-10). In conjunction with falling inflation, real wages increased again from September 2023, and retail sales have shown a gradual improvement since the second half of the year. At the same time, household consumption also expanded slightly in the last quarter. Falling energy prices also facilitated the recovery in internal demand, as a result of which the output of industrial subsectors serving the domestic market increased in the first months of the year.

Chart 3-10: Annual change in retail sales, industrial sectors serving the domestic market and goods imports



Note: Based on seasonally and calendar adjusted data. Three-month moving average. Detailed data on the volume of imports for April are not yet available.
Source: HCSO

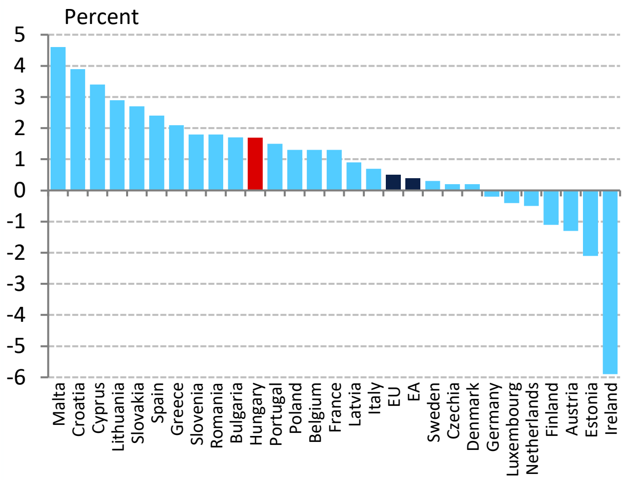
Through its high import content, the decline in investments in 2023 and 2024 Q1 may have contributed significantly to the decrease in imports. Last year, investments fell by 7.4 percent as a whole, with the drop in investment activity accelerating to a decline of 6.9 percent in 2024 Q1 compared to the same prior-year period. Due to the high import impact of investments, this may have substantially contributed to the low level of imports.

From the next year, both exports and imports are expected to increase. In the case of energy prices, no further significant reduction is anticipated, and accordingly their balance-improving effect may be more moderate in the future. As external economic activity gains momentum, industrial production and goods exports will also recover, and thus exports may increase again from the beginning of next year. At the same time, with the further improvement of consumer confidence, the gradual easing of caution and the expected rebound in investments, goods import may expand again.

3.2 Analysis of the production and expenditure sides of GDP

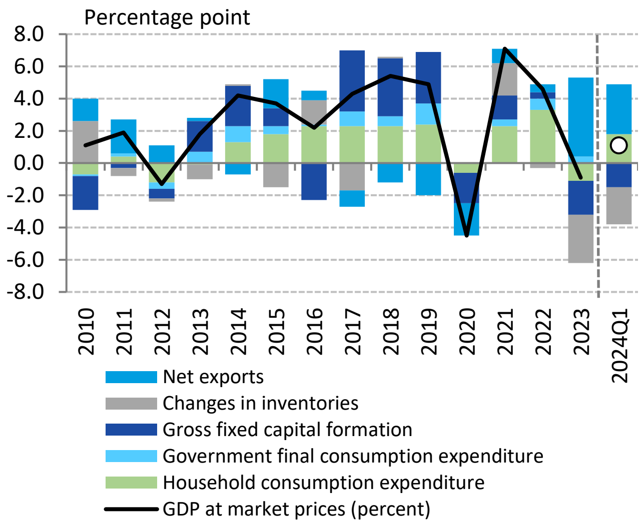
Gross domestic product expanded by 1.1 percent in 2024 Q1 compared to the same period of the previous year and by 0.8 percent versus the previous quarter. On the consumption side, household consumption expenditure (+1.8 percentage point) and net exports (+3.1 percentage point) contributed to economic growth in 2024 Q1, while the development of gross fixed capital formation (–1.5 percent) restrained growth. The contribution of the change in inventories was substantially negative, trimming GDP growth by 2.3 percentage points. On the production side, of the main national economy sectors, services (+1.7 percentage point) supported economic growth in 2024 Q1, while industry (-0.9 percentage point) held back growth.

Chart 3-11: Annual GDP change in EU countries in 2024 Q1



Note: Seasonally and calendar-adjusted data.
Source: Eurostat

Chart 3-12: Annual change in decomposition of expenditure-side GDP



Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions. Changes in inventories includes acquisitions less disposals of valuables.
Source: HCSO, MNB

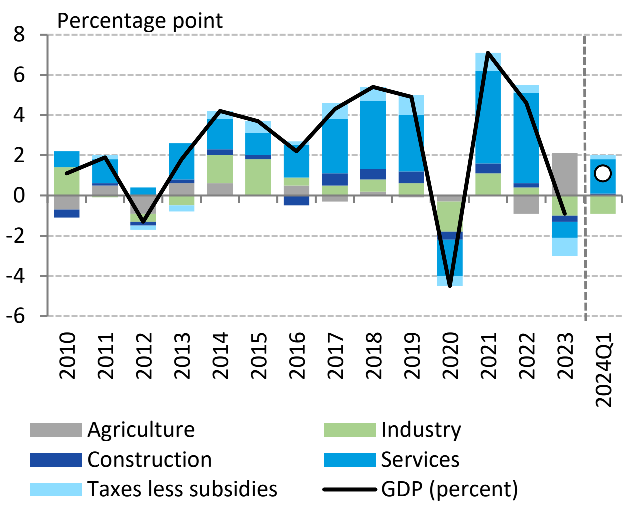
Gross domestic product expanded by 1.1 percent in 2024 Q1 compared to the same period of the previous year and by 0.8 percent versus the previous quarter. In the first quarter of this year, Hungary's economy expanded by 1.7 percent on an annual basis, according to the seasonally and calendar-adjusted data used in international comparisons. Since the GDP of the euro area and the EU increased by 0.5 percent and 0.4 percent, respectively in 2024 Q1 (Chart 3-11), Hungary's growth margin remained positive.

In 2024 Q1, household consumption expenditure increased by 3.6 percent compared to the same period of the previous year, supporting growth by 1.8 percentage points (Chart 3-12). With the exception of semi-durable goods (–0.4 percent), consumption increased in every product group: the volume of non-durable goods increased by 4.4 percent, of services by 2.4 percent, and that of durable goods by 1.8 percent. Community consumption fell by 2.7 percent on an annual basis.

Gross fixed capital formation decreased by 6.9 percent compared to the same prior-year period. The four-quarter rolling average of the investment rate was somewhat lower than in the previous quarter, at 25.8 percent. Investment in construction fell by 7.6 percent and investment in machinery and equipment dropped by 11.9 percent on an annual basis in the first quarter of the year. The decline in investments by companies producing for foreign and domestic markets slowed in the last quarter, while public investment rose. The contribution of the change in inventories was substantially negative, reducing GDP growth by 2.3 percentage points. The volume of imports decreased to a greater extent (–9.2 percent) than that of exports (–5.3 percent).

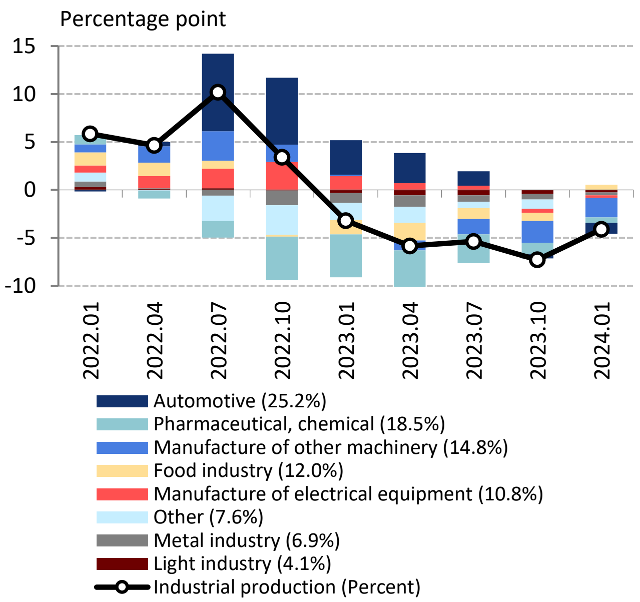
Exports of goods fell by 6.2 percent and exports of services fell by 0.8 percent compared to the same period of the previous year. The balance of foreign trade in goods showed a historically high surplus of EUR 3.8 billion in the first quarter. The terms of trade improved by 1.9 percent year-on-year, mainly driven by the correction in the price of mineral fuels. In April 2024, the trade surplus in goods was

Chart 3-13: Annual change in decomposition of production-side GDP



Source: HCSO

Chart 3-14: Sectoral breakdown of annual change in domestic industrial production



Note: The 2023 weight of the sectors in industrial production is given in brackets. Without water and waste management industry. Total industrial production does not include the performance of enterprises with less than five employees.
Source: HCSO, MNB

EUR 1.8 billion, with exports 8.8 percent higher in euro terms and imports 3.5 percent lower than in the same period of the previous year. The trade balance in goods improved by EUR 197 million compared to the previous month, and by EUR 1.4 billion year-on-year.

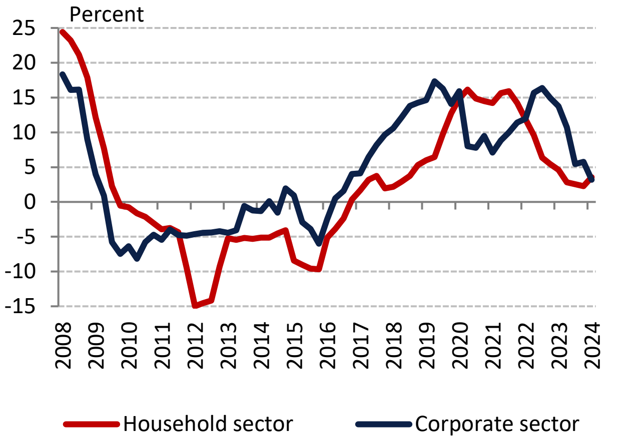
On the production side, the value added of industry fell by 4.2 percent, and within this the value added of manufacturing dropped by 4.8 percent, compared to the same period of the previous year (Chart 3-13). In the first quarter, vehicle production, which is the largest of the manufacturing sectors, contracted by 5.1 percent and the manufacture of electrical equipment fell by 5.7 percent, while food industry grew by 4.5 percent on average year-on-year (Chart 3-13). Due to favourable calendar effects, industrial production dynamics turned positive again in April 2024, while the underlying trends remained weak. The volume of industrial production increased by 6.4 percent on an annual basis, but based on seasonally and calendar-adjusted data, production fell by 2.1 percent compared to the same period last year.

Value added in the construction sector was 3.0 percent higher than in the same period of the previous year. Construction of buildings increased by 0.5 percent and other construction by 6.0 percent in the first quarter year-on-year. The volume of construction contracts was 6.3 percent lower than in the same period of the previous year, while the volume of new contracts increased by 36.7 percent. In March 2024, construction output fell by 6.3 percent year-on-year.

Value added in agriculture was 0.4 percent higher than in the same period of the previous year. With this, agriculture did not make a significant growth contribution to the national economy.

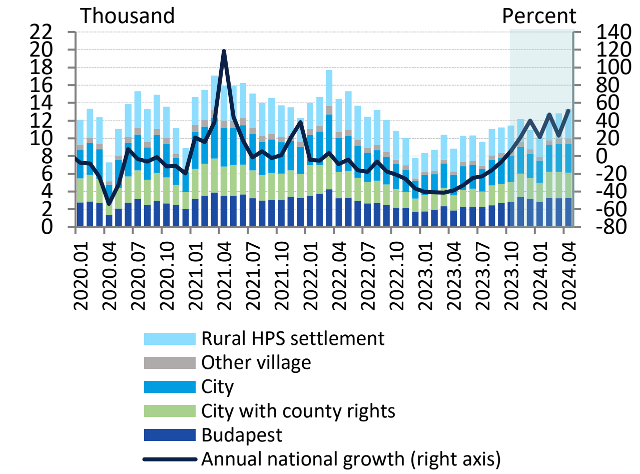
Overall value added in services increased by 2.7 percent in 2024 Q1. The expansion was wide-ranging, and the highest increase was recorded by the HCSO in the information, communication sector (+9.8 percent). In addition, the added value of arts, recreation and miscellaneous increased by 7.3 percent, that of hotels and hospitality by 5.2 percent, and that of transportation and storage by 4.2 percent. The added value of the trade and vehicle repair sector, which represents a large weight, fell by 3.0 percent. In April 2024, the volume of retail sales increased by 3.2 percent year-on-year, thus continuing the growth that began in January. The turnover of NTCA online cash registers increased by 5.6 percent in nominal terms, while inflation-adjusted turnover increased by 1.9 percent year-on-year in April, according to seasonally and calendar-adjusted data. This figure differs from retail trade in that it includes turnover

Chart 3-15: Annual change in lending to non-financial corporates and households



Note: Data for the corporate and household sector are based on transactions with the total financial intermediary system.
Source: MNB

Chart 3-16: Number of housing market transactions by settlement type



Note: Only taking into account 50-percent and 100-percent private acquisitions. From July 2022 to September 2023, data from the NTCA fee database are adjusted based on the estimation of the level of processing by type of settlement. Based on transactions and estimated market share of real estate agents in the months shown.
Source: Housing market intermediary database, MNB, NTCA

from hotels and restaurants, taxi services and some accommodation services, among other activities.

Banks saw a pick-up in demand for loans in the household segment in 2024 Q1, while corporate loans were characterised by a wait-and-see attitude. The annual growth rate of household loans in the total financial intermediary system accelerated by 1.3 percentage points quarter-on-quarter, amounting to 3.6 percent at the end of March, while corporate loans grew by 3.2 percent year-on-year, following a deceleration of 2.6 percentage points (Chart 3-15). New contracts in the household segment in 2024 Q1 rose 71 percent versus the low base value of the same prior-year quarter, while the number of contracts concluded in the corporate segment fell by 25 percent. Based on the responses to the lending survey, the banks saw a pick-up in demand in the household sector in the first quarter, while one quarter of the banks perceived a decrease in demand in the corporate segment. Looking ahead to 2024 Q2 and Q3, however, demand is likely to pick up in both segments: in net terms, 50 percent, 46 percent and 14 percent of banks expect an increase in demand for housing loans, consumer loans and corporate loans, respectively.

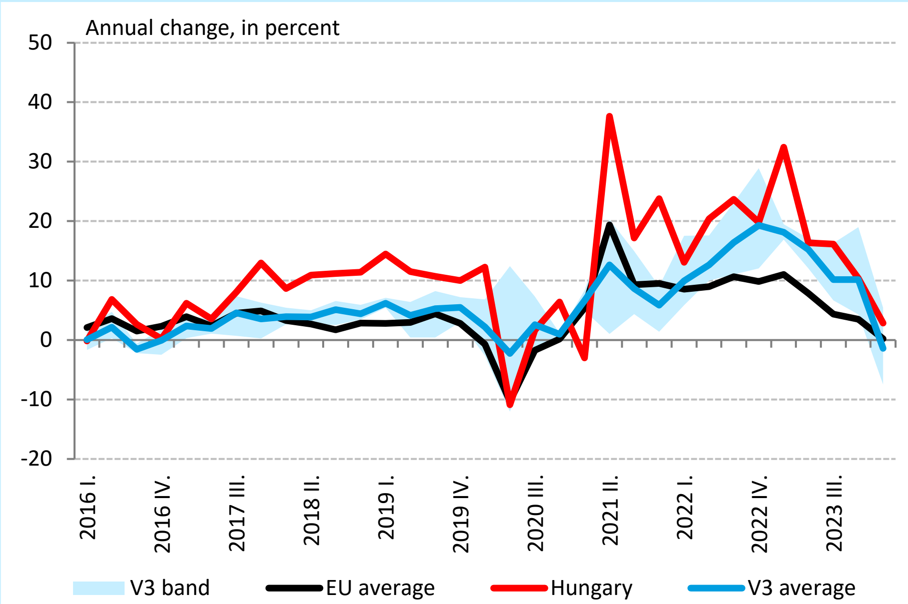
Turnover in the housing market picked up and thus reached the long-term average again (Chart 3-16). In 2024 Q1, the number of private individuals' housing market transactions reached 35,700 nationwide, exceeding the extremely low number of transactions recorded in the same period of the previous year by 30 percent, returning to the long-term Q1 average for the years 2011–2023. In the first quarter, the number of housing market transactions increased by 55 percent in Budapest, by 41 percent in cities with county rights, by 21 percent in other cities and by 10 percent in settlements eligible for the rural HPS on an annual basis. According to the MNB's house price index, nominal house prices rose by 5.8 percent in 2023 Q4 nationwide, versus the same prior-year period, including increases of 3.4 percent in the capital, 5.7 percent on average in rural cities and 7.5 percent in villages. According to the preliminary data, annual house price appreciation may have accelerated to 7.2 percent nationwide in 2024 Q1.

Box 3-2: Profits in the past quarters: domestic and international developments

In recent years, one of the important factors in the growth of inflation was the rising profitability of companies. As a consequence, profit-driven inflation has come into the focus of economic analyses (see Box 3-1 of the June 2022 Inflation Report). Profit-driven inflation is the phenomenon where companies increase prices more than the increase in costs would justify in order to be profitable. In addition to the disruption of the economy's supply-demand balance, the process can also be triggered by the weakness of market competition or a rise in inflation expectations.

The growth rate of gross operating profit and mixed income, a statistical indicator of the national economy that captures the change of corporate profits, was significantly lower in the first quarter than in recent years. From 2021 onwards, a higher increase in profits than in previous years was generally observed both in the countries of the region and in the European Union as a whole (Chart 3-17). In recent quarters, in an environment characterised by disinflation and shrinking demand, companies reported a decelerating increase in profits. In the first quarter, the operating profit of companies operating in Hungary increased by 2.8 percent, while the average of the Visegrád countries decreased somewhat, and the same indicator stagnated in the EU.

Chart 3-17: Gross operating profit and mixed income

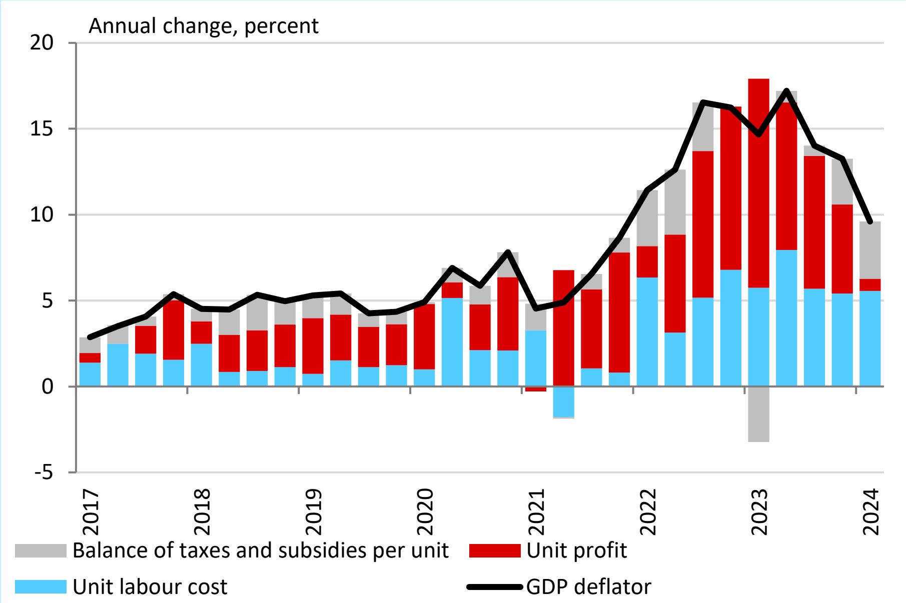


Note: Based on nominal, quarterly raw data.

Source: HCSO, Eurostat

Since 2023 Q1, the contribution of profits to the GDP deflator has decreased substantially. The price level of GDP increased by 9.6 percent in 2024 Q1, mainly driven by labour costs and the balance of taxes and subsidies (Chart 3-18). The contribution of profit per unit to the GDP deflator was only 0.7 percentage points, compared to 8–12 percentage points typical for the end of 2022 and 2023 H1.

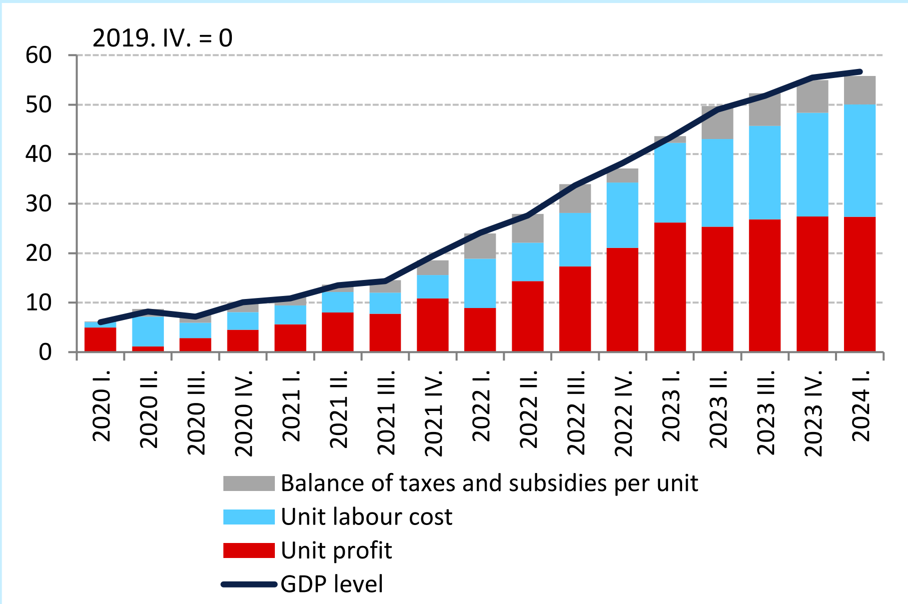
Chart 3-18: Income-side breakdown of the GDP deflator



Source: Eurostat, MNB

Despite the lower year-on-year indicator, the profit content of GDP at current prices remained at a high level. Based on seasonally adjusted data, GDP prices increased by 56.7% compared to the end of 2019, with profits accounting for almost half of this increase (Chart 3-19). Profits are characterised by a repricing pattern that is higher than the historical average after 2022 Q1. Profits have not increased significantly since the beginning of 2023.

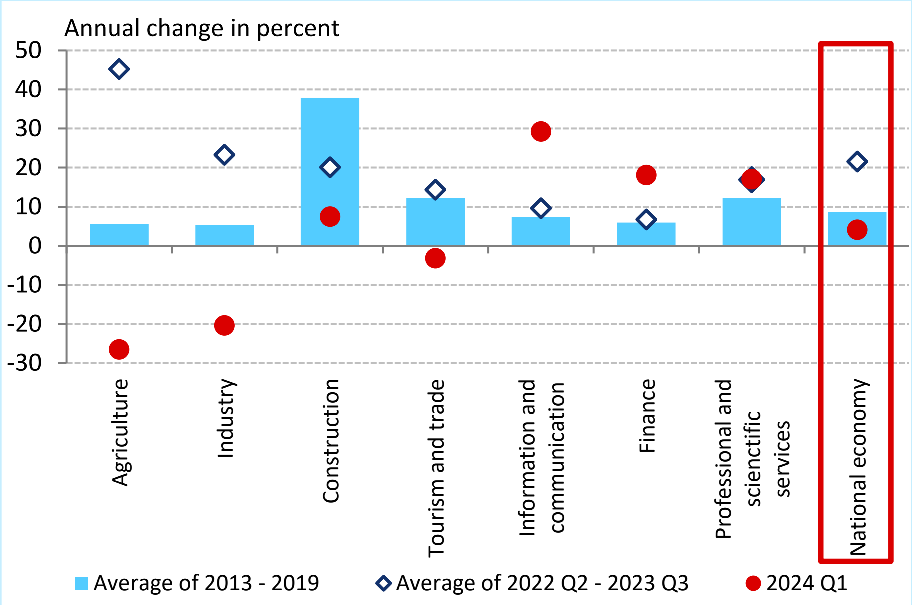
Chart 3-19: Cumulative change in the GDP price level



Note: Based on nominal, quarterly, seasonally adjusted data.
Source: Eurostat, MNB calculation

The practice of retrospective pricing also contributes to the gross operating surplus of individual sectors. In the first quarter, the gross operating result of the national economy increased in line with the average for the period 2013–2019, but the sectoral data reflect two trends. In industry, agriculture and trade, the gross operating result decreased on an annual basis; by contrast, in market services sectors that implemented retrospective price increases (mainly telecommunications and finance), profits increased significantly by 20–30 percent on an annual basis at the beginning of 2024 (Chart 3-20).

Chart 3-20: Annual change in gross operating profits by sector



Note: Based on nominal, quarterly data

Source: HCSO, Eurostat

3.3 Labour market

Employment in the national economy remains at high levels. The unemployment rate was 4.4 percent in April, with labour market activity continuously increasing in the recent period. The tightness of the labour market has eased recently. In March, gross average earnings rose by 12.7 percent in the private sector in year-on-year terms.

3.3.1 Employment and unemployment

Employment in the national economy remains at high levels. In April 2024, the number of employed persons aged 15–74 was 4,749,000, an increase of 39,000 versus the same period of the previous year (Chart 3-21). Based on seasonally adjusted data, the number of persons employed increased by 16,000 compared to the previous month.

Employment is developing differently in individual sectors. Based on detailed sectoral data available on a quarterly basis, in the first quarter of the year employment increased slightly in construction, but remained flat in manufacturing, compared to the same period of the previous year. Employment fell slightly in the market services sector, reflecting different developments at sectoral level. While a decline was registered in trade, tourism and real estate activities, the number of people employed increased in transportation and storage, administrative and support service activities, as well as financial and insurance activities (Chart 3-22). Within the public sector, employment stagnated in education, declined in public administration and increased in health services on an annual basis. The easing of labour demand is also reflected in the utilisation of available capacities, with the total number of full-time equivalent (TME) employees falling by 5.8 percent in the fourth quarter and by 4.9 percent in the first quarter compared to the same prior-year period.

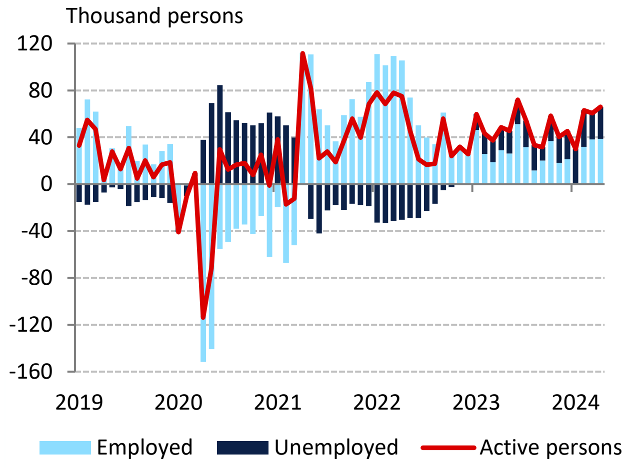
Raw data show that unemployment stood at 4.4 percent in 2024 April. The unemployment rate, calculated using the methodology of the HCSO based on a three-month moving average, averaged 4.5 percent between February and April 2024. The domestic unemployment rate remains low in international comparison.

The labour force continued to increase due to the simultaneous growth in employment and unemployment levels. Based on seasonally adjusted data, the number of persons in the labour force continued to rise. In April 2024, the labour force level was 66,000 higher compared to the same period last year.

3.3.2 Wages

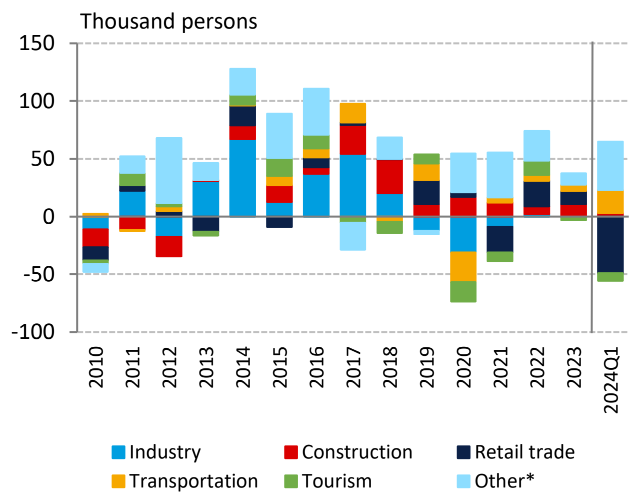
Wage developments remain strong, but wage growth has eased since May 2023 as inflation declined. In March 2024, average gross earnings in the private sector increased by

Chart 3-21: Decomposition of annual changes in the labour force participation



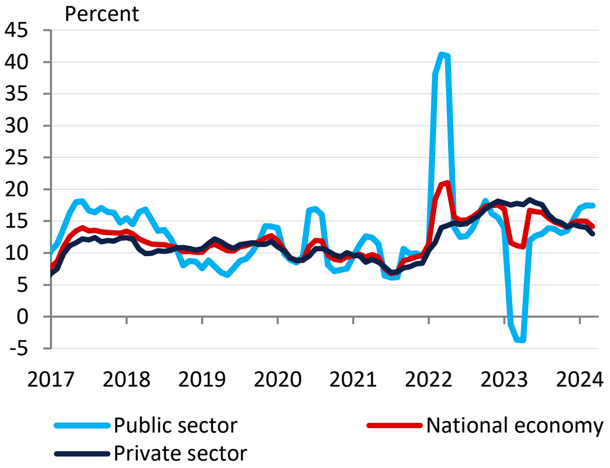
Source: HCSO

Chart 3-22: Decomposition of annual changes in private sector employment



Note: *Agriculture, other industry and service sector branches.
Source: HCSO

Chart 3-23: Annual change in gross average wages in the national economy



Note: Quarterly moving averages.
Source: HCSO

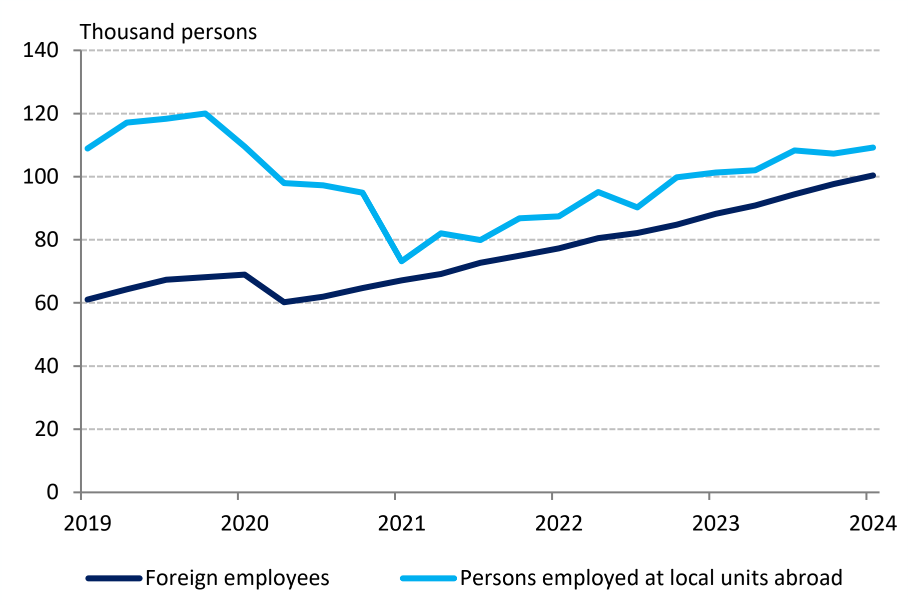
12.7 percent and regular earnings increased by 13.3 percent on an annual basis, while bonus payments fell short of last year, but exceeded those of previous years. Regular earnings rose by 3.8 percent on a monthly basis, indicating wage increases in the private sector in March similar to those seen last year. In the public sector, sectoral wage measures effective from the beginning of the year (e.g. salary increases in education, law enforcement and defence) resulted in stronger gross average wage growth, which reached 17.4 percent in March. Looking at the national economy as a whole, gross average earnings rose by 13.9 percent (Chart 3-23).

Among the countries in the region, nominal wage growth in Hungary was the second highest after Romania in March 2024. Earnings grew by 16.6 percent in Romania, 12.0 percent in Poland and 8.7 percent in Slovakia in year-on-year terms. For the Czech Republic, wage data are only available at quarterly frequency, with average wages rising by 7.0 percent in the first quarter. Real wages in Hungary rose at the fastest pace in the region in March. In the first quarter, real wage dynamics were already positive in all of the countries of the region.

Box 3-3: Foreign workers in the Hungarian economy

The number of foreign workers employed in Hungary has increased over the last few years. The historically high level of employment in Hungary continued to expand, and the rate of labour force participation also improved. In a situation close to full employment, recruitment has become difficult for companies. Therefore, one solution for employers may be the recruitment of foreign workers. The number of foreign employees has been increasing since 2020, rising by a total of about 40,000 people so far. HCSO data shows that in February 2024 the number of such workers exceeded 100,000. Simultaneously with the increase in the number of foreigners working in Hungary, the number of members of Hungarian households employed at local units abroad is also rising, approaching the highest values before the COVID-19 epidemic (Chart 3-24).

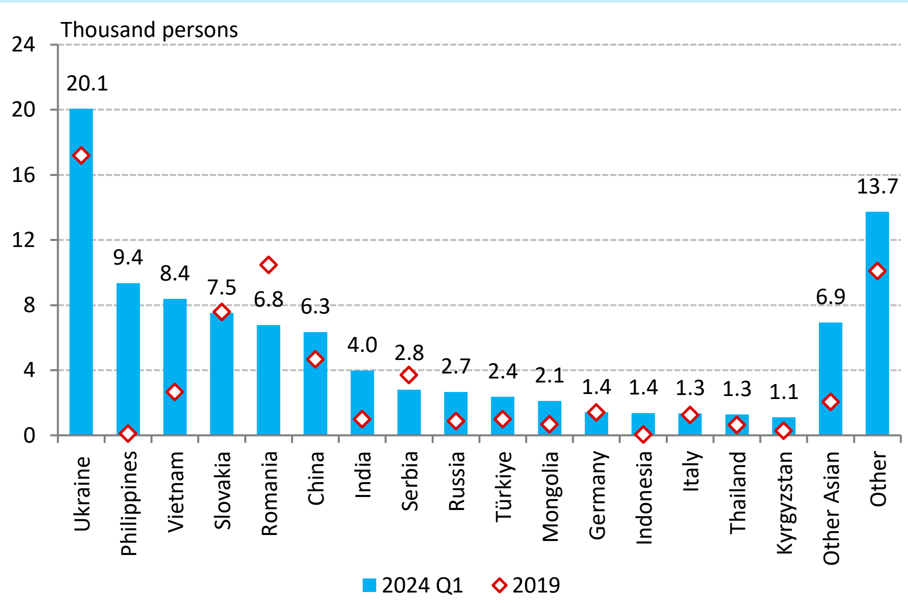
Chart 3-24: Number of foreign employees and persons employed at local units abroad



Note: Data for foreign employees include those working less than 60 hours per month. Seasonally adjusted data.
Source: HCSO

Ukrainian citizens make up the largest group of foreigners employed in Hungary, but the proportion of employees from Asian countries is increasing. One fifth of foreign employees are Ukrainian citizens. Their number peaked in the quarter after the outbreak of the Russia-Ukraine war and has been slowly decreasing since then. The proportion of people from other neighbouring countries (Romania, Slovakia, Serbia) is also declining, with stagnating or decreasing numbers. The proportion of citizens from Asian countries rose from 18.5 percent in 2019 to 41.0 percent in the first quarter of this year, with the Philippines, Vietnam and China standing out among the sending countries (Chart 3-25). In recent years, in addition to Ukrainians, Slovakian and Romanian workers constituted the most populous groups, but both these groups were overtaken by Filipinos and Vietnamese in the first quarter. The two latter groups have grown by 139.4 percent and 110.1 percent compared to the same period of the previous year, respectively.

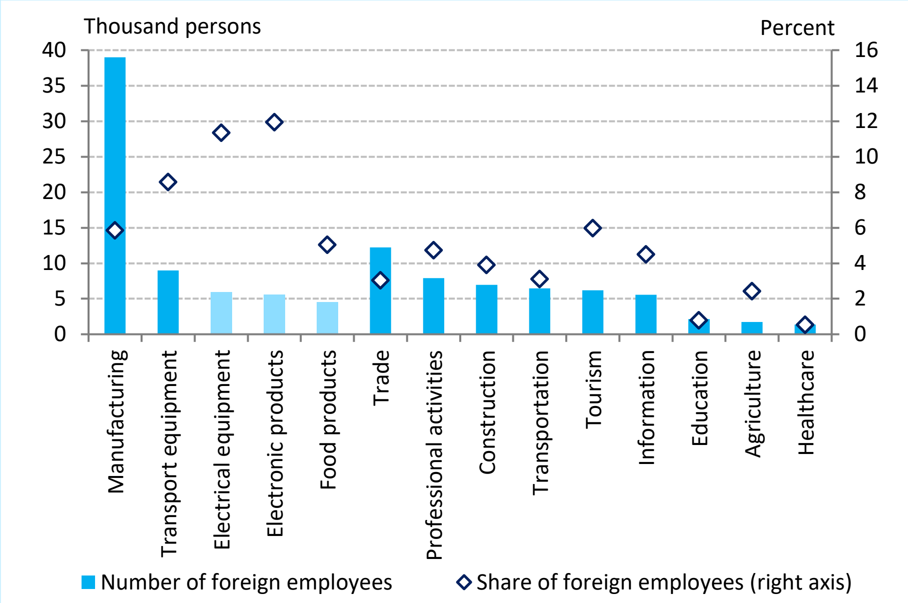
Chart 3-25: Number of foreign employees by nationality



Note: Including those working less than 60 hours per month.
Source: HCSO

The largest number of foreign citizens is employed in manufacturing subsectors. About one quarter of foreigners are employed through temporary employment agencies. The largest share of foreign nationals is employed in the administrative and support service sector, in manufacturing and in trade. The statistics of the administrative and support service sector are strongly influenced by the fact that this sector includes the workers employed by temporary employment agencies who mostly work in other sectors as temporary employees (27.4 percent of all foreign employees belonged to this sector in the first quarter of this year). Considering the actual sectoral distribution of the latter, we estimate that almost two fifths of foreigners, or 39,000 people, are employed in manufacturing. Another one fifth of them are employed in trade or in professional, scientific or technical activities. Among the manufacturing subsectors, foreigners are employed in the largest proportion in the manufacture of transport equipment, the manufacture of electrical equipment, as well as the manufacture of computer, electronic and optical products (Chart 3-26).

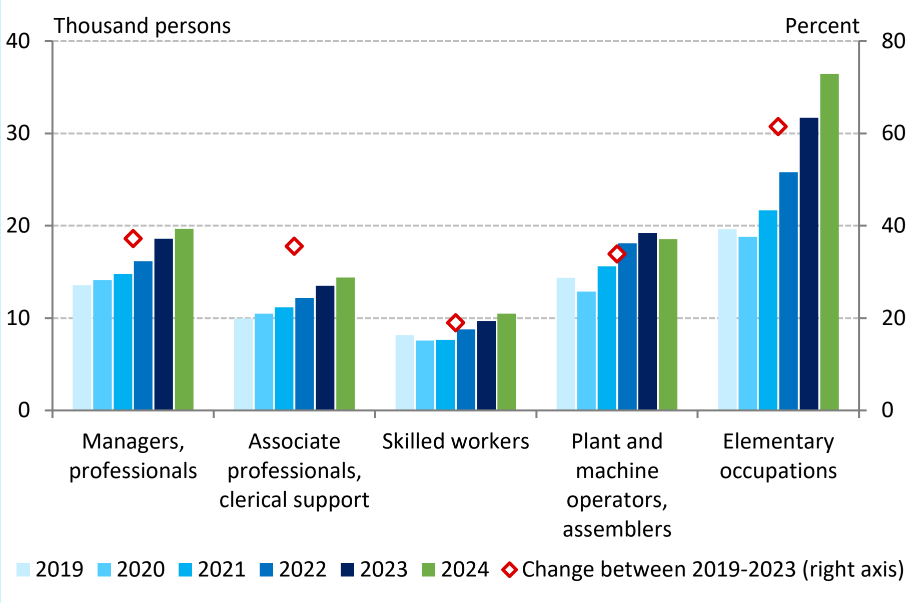
Chart 3-26: Number and share of foreign employees in economic sectors and manufacturing subsectors



Note: 2024Q1 data. Including those working less than 60 hours per month as well as the number of those employed by temporary work agencies divided between sectors and subsectors based on MNB estimates. Foreign employees as a percentage of full-time employees of the sectors.
Source: MNB estimate based on HCSO data

The largest group of foreign nationals employed in Hungary works in occupations that do not require professional qualifications. These group of workers accounted for 36.6 percent of foreign employees on average in the first quarter of this year, and their number has grown the most in recent years. A significant number is employed in occupations requiring higher education or as plant and machine operators, and assemblers requiring low qualifications. 10.5 percent of foreign employees work in occupations requiring a professional qualification (agriculture, service and sales, craft and related trades) (Chart 3-27).

Chart 3-27: Foreign employees by major occupational groups

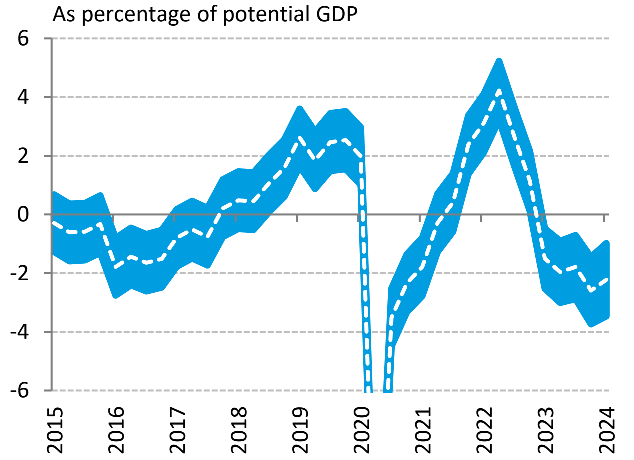


Note: For 2024 Q1 data. Occupations requiring higher education = FEOR division 1 (economic, administrative, interest representation leaders, legislators) and division 2 (occupations requiring independent application of higher education); other higher or secondary level, office work = FEOR division 3 (other occupations requiring higher or secondary education) and division 4 (office and administration (customer relations) occupations); occupations requiring professional qualifications = FEOR division 5 (trade and service occupations), division 6 (agricultural and forestry occupations) and division 7 (industrial and construction occupations); machine operators, assemblers, drivers = FEOR division 8; simple occupations = FEOR division 9 ((simple) occupations not requiring professional qualifications).
Source: HCSO

3.4 The cyclical position of the economy

In 2024 Q1, the Hungarian economy grew at a year-on-year rate of 1.1 percent, while economic output expanded by 0.8 percent, in a quarter-on-quarter comparison. The subdued economic performance in recent quarters was largely due to negative contributions from industry and market services. The cyclical position of the economy has been negative since the beginning of 2023 and thus has a disinflationary effect. We estimate that GDP was somewhat below its potential level in 2024 Q1, but the gap started to close in parallel with the recovery of the economy. The capacity utilisation and production expectations of manufacturing companies remain below the historical average.

Chart 3-28: Uncertainty band of the output gap



Note: The estimation uncertainty band covers one standard deviation. Output gap excluding agriculture performance.
Source: HCSO, MNB estimation

The cyclical position of the economy is estimated to have been negative since the beginning of 2023 and thus has a disinflationary effect. According to our current estimate, the domestic output gap was in slightly negative territory, but started to close in parallel with the recovery of the economy (Chart 3-28). In 2024 Q1, Hungary's economy grew by 1.1 percent, in year-on-year terms, while the output gap excluding the performance of agriculture started to close. From the aspect of external economic activity, however, the generally tense geopolitical situation and the subdued European growth prospects pose a certain amount of risk. The external output gap continued to be in slightly negative territory, which has an impact on the domestic cyclical position.

According to questionnaire surveys, the capacity utilisation and production expectations of manufacturing companies remain below the historical average. Production expectations for the coming months have not changed significantly over the past period.

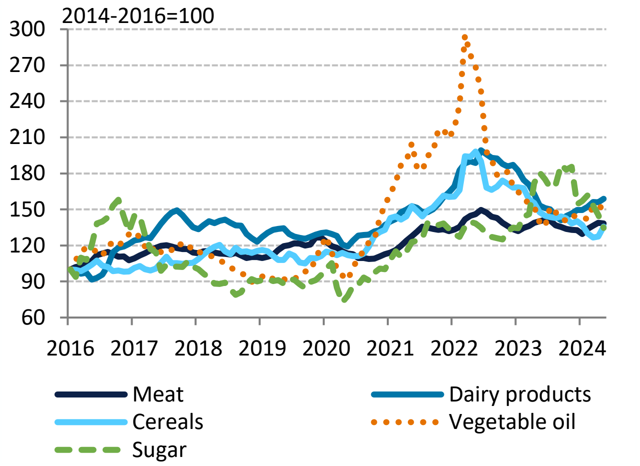
3.5 Costs and inflation

In May 2024, consumer prices rose by 4.0 percent year-on-year. Core inflation and core inflation net of indirect taxes continued to fall, with both indicators easing to 4.0 percent. Annual core inflation fell by 0.1 percentage point. The Bank's measures of underlying inflation developments capturing persistent inflationary trends, calculated on a year-on-year basis, also fell. In monthly terms, the price of the representative consumer basket fell by 0.1 percent, and in the case of core inflation it rose by 0.5 percent. In the case of inflation, price increases from last month were below the historic average usually seen in this time of the year, while they were above the historical average in the case of core inflation. In the case of industrial goods and food, the repricing in May was below the historical average, while in the case of market services it was higher than the historical average.

3.5.1 Producer prices

In May, global food prices rose by 0.9 percent. The increase in cereal and dairy product prices was only partially offset by the monthly decrease in sugar and oilseed prices. According to the FAO data release, compared to May 2023, food prices decreased by 3.4 percent, and the prices of all product groups decreased year-on-year, with the exception of vegetable oil and dairy products. Cereal prices fell by 8.2 percent on an annual basis, while prices rose by 6.3 percent on a monthly basis. Vegetable oil prices rose by 7.7 percent year-on-year and by 2.4 percent on a monthly basis. Dairy product prices increased by 3.5 percent compared to the same period of the previous year and by 1.8 percent compared to April. Meat prices were 1.3 percent lower than in May last year, and 0.2 percent lower than in April. Global sugar prices fell by 25.5 percent year-on-year and 7.5 percent on a monthly basis, driven by the favourable production outlook in Brazil and above-average supplies in India and Thailand (Chart 3-29).

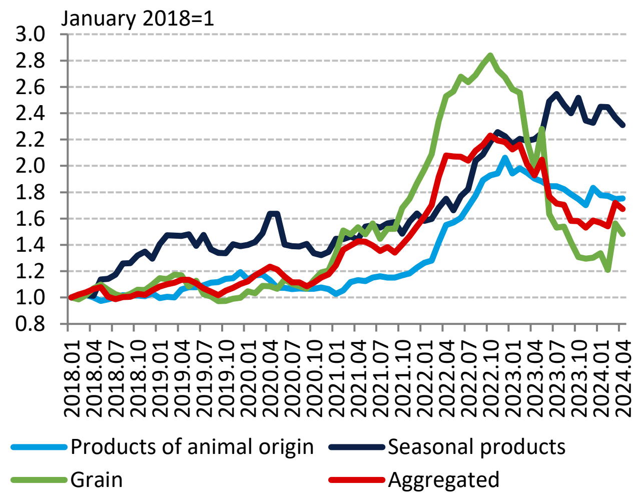
Chart 3-29: Development of world market prices of food



Source: FAO

In April, domestic agricultural producer prices declined by 2.6 percent month-on-month. Prices were 13.3 percent lower than in the same period of 2023. Among the component items, similarly to earlier months, only the producer price index for seasonal products rose, at a year-on-year rate of 6.1 percent. The decrease in the price of animal products seen since February of last year halted, and prices dropped by 7.9 percent on an annual basis in April. Producer prices for cereals declined by 5.1 percent compared to March and were 25.4 percent lower than in April 2023 (Chart 3-30).

Chart 3-30: Development of agricultural prices

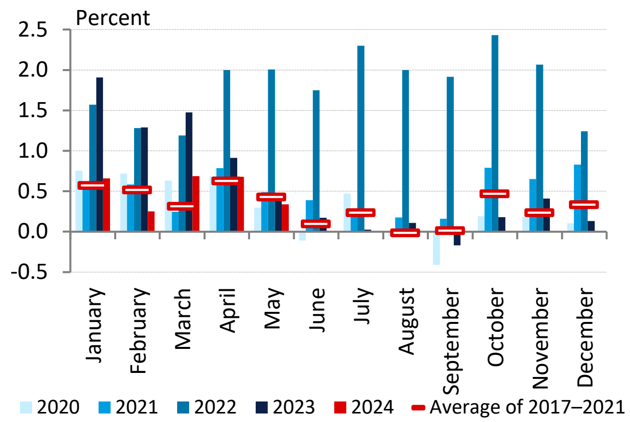


Note: Based on seasonally adjusted data.

Source: HCSO

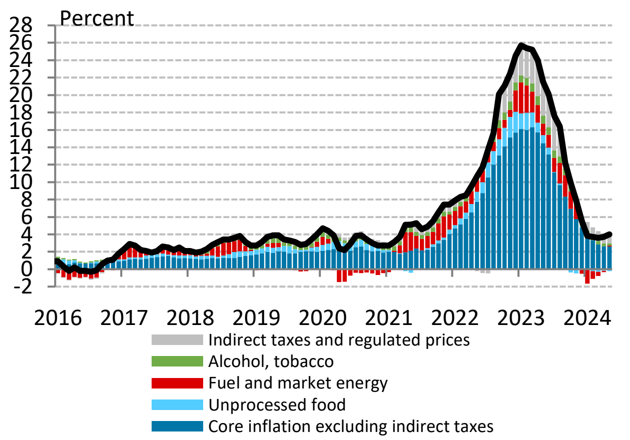
Producer prices of manufactured goods for domestic sales increased by 0.4 percent on an annual basis in April 2024. Domestic sales prices for industry overall fell by 5.0 percent compared to April of the previous year. Producer prices were 15.3 percent lower in the energy sector and 5.9 percent lower in the food sector compared to the same period last year.

Chart 3-31: Monthly price changes of consumer prices excluding fuel and regulated prices



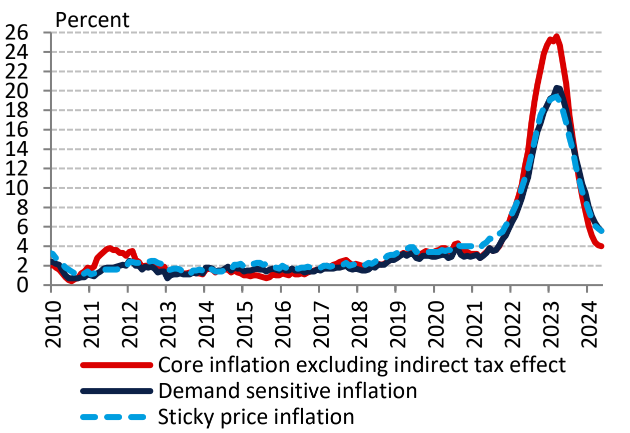
Note: Tax-adjusted, seasonally unadjusted monthly change
Source: MNB calculation based on HCSO data

Chart 3-32: Decomposition of inflation



Source: MNB calculation

Chart 3-33: Underlying inflation indicators



Source: MNB calculation based on HCSO data

3.5.2 Consumer prices

In year-on-year terms, consumer prices rose by 4.0 percent in May. The consumer price index increased by 0.3 percentage point compared to the previous month. The rise in inflation was caused by the 0.2-percentage point increases in both fuel and regulated products prices, due to base effects. This was partially offset by the disinflationary effect from the –0.1-percentage point change in market services prices (Chart 3-28). In monthly terms, the price of the representative consumer basket declined by 0.1 percent, while the price of the basket excluding fuels and regulated prices rose by 0.3 percent (Chart 3-31). Month-on-month core inflation excluding processed food, which better reflects underlying trends, rose by 0.5 percent.

Core inflation and core inflation net of indirect taxes continued to fall, with both indicators dropping by 0.1 percentage points to 4.0 percent. In May, the indicators capturing more persistent inflation trends declined (Chart 3-33). In a shorter-base comparison (annualised 3-month/3-month), both core inflation and inflation rose as a result of the retrospective repricing of certain market services. In the case of inflation, price increases from last month were below the historic average usually seen in this time of the year, while they were above the historical average in the case of core inflation.

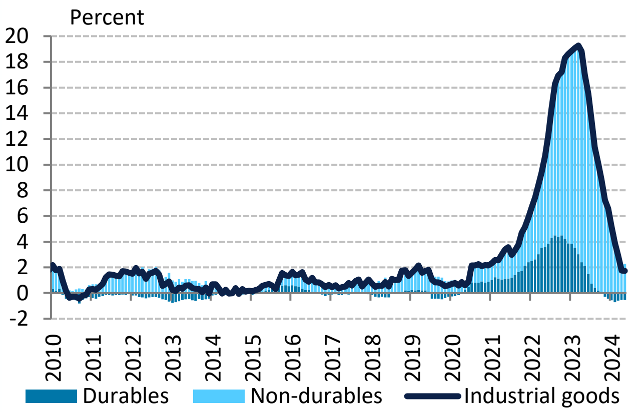
In May, the annual inflation of manufactured goods stood at 1.7 percent, similar to April. On a monthly basis, prices of manufactured goods remained unchanged. Within the product group, prices of durables fell by 0.2 percent, which was offset at the level of the total product group by a 0.1-percent rise in non-durable manufactured goods prices (Charts 3-34 and 3-35).

The year-on-year basis price index for market services fell to 9.7 percent. Month-on-month prices increased by 1.0 percent, which was primarily explained by the retrospective repricing of telecommunication and banking services (Chart 3-36).

Inflation for alcohol and tobacco products has eased to 3.5 percent. Compared to April, the price of this product group remained unchanged.

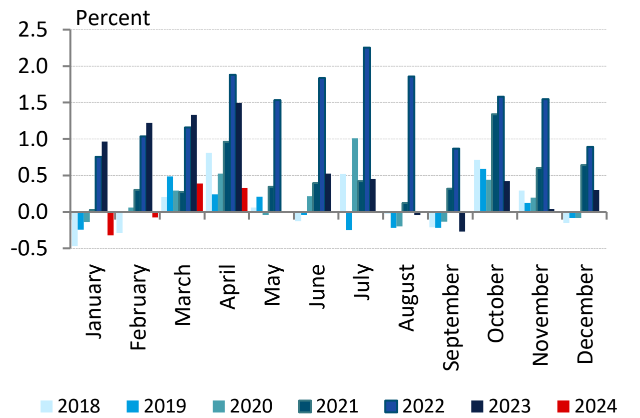
Food inflation according to MNB's classification for analytical purposes amounted to –1.9 percent in May. Within the product group, unprocessed and processed food prices fell by 1.2 percent and 2.4 percent in annual terms, respectively. HCSO data show that food prices rose by 1.0 percent, which also includes the 8.1-percent increase in the prices of restaurant meals. Compared to April,

Chart 3-34: Inflation of industrial goods



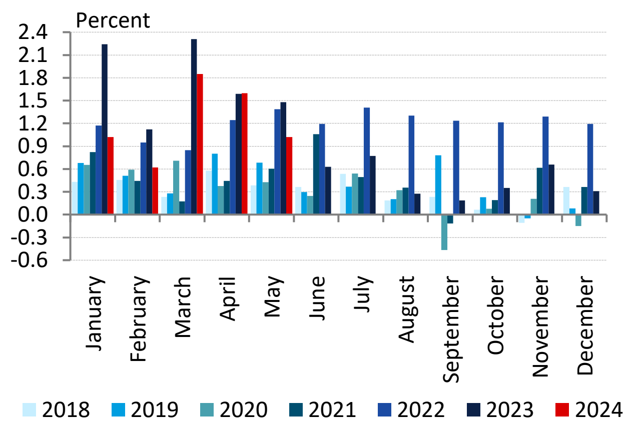
Note: Year-on-year change, excluding the effect of indirect taxes.
Source: MNB calculation based on HCSO data

Chart 3-35: Monthly price changes of traded goods



Note: Seasonally non-adjusted, tax adjusted monthly change.
Source: MNB calculation based on HCSO data

Chart 3-36: Monthly price change of market services



Note: Tax-adjusted, seasonally unadjusted monthly change.
Source: HCSO, MNB

unprocessed food prices dropped by 0.3 percent and processed food prices increased by 0.2 percent.

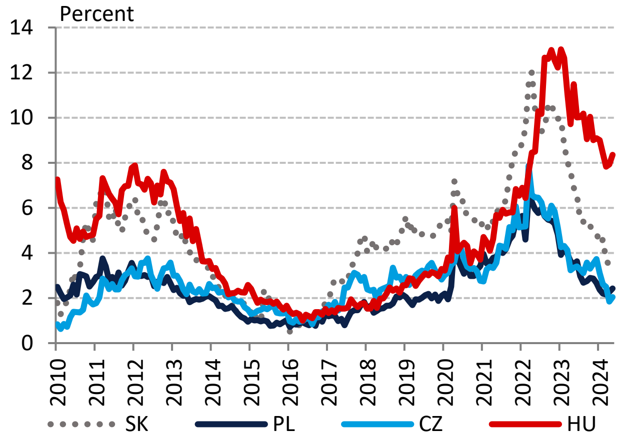
Fuel prices decreased by 4.4 percent month-on-month in May, as a result of declines in global oil prices and price margins. The average price of the product group increased by 9.2 percent on an annual basis.

Inflation in May was at the bottom of the forecast range from the March Inflation Report. Core inflation was also in the lower half of the forecast range.

3.5.3 Inflation expectations

In Hungary, households' inflation expectations increased compared to April, but are at the same level as in 2024 Q1. In May, compared to 2024 Q1, among the countries in the region, inflation expectations decreased in the Czech Republic and Slovakia, while expectations rose somewhat in Poland (Chart 3-37).

Chart 3-37: Inflation expectations in the region

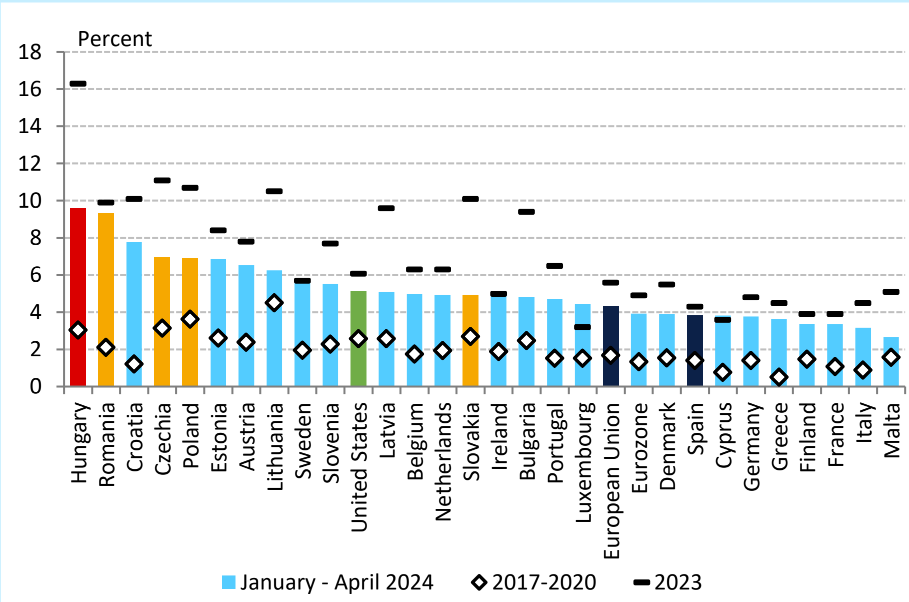


Source: MNB calculations based on European Commission data

Box 3-4: Sources of service inflation

Disinflation in services worldwide is proceeding more slowly than the decline in the price dynamics of the whole consumer basket. Even though the rate of price increase in services has decreased since the peak values in 2023 in both the EU and the US, it remains significantly higher than in the second half of the 2010s (Chart 3-38). Based on a BIS analysis, the development of disinflation in the inflation wave of 2022–2023 corresponds to historical experience both in the case of total inflation and of manufactured goods. On the other hand, inflation in services is proving to be more persistent and is falling more slowly compared to previous inflationary episodes.[1]

Chart 3-38: Inflation in services



Note: HICP data for European countries. Data by the Bureau of Labor Statistics for the USA.
Source: Eurostat, U.S. Bureau of Labor Statistics

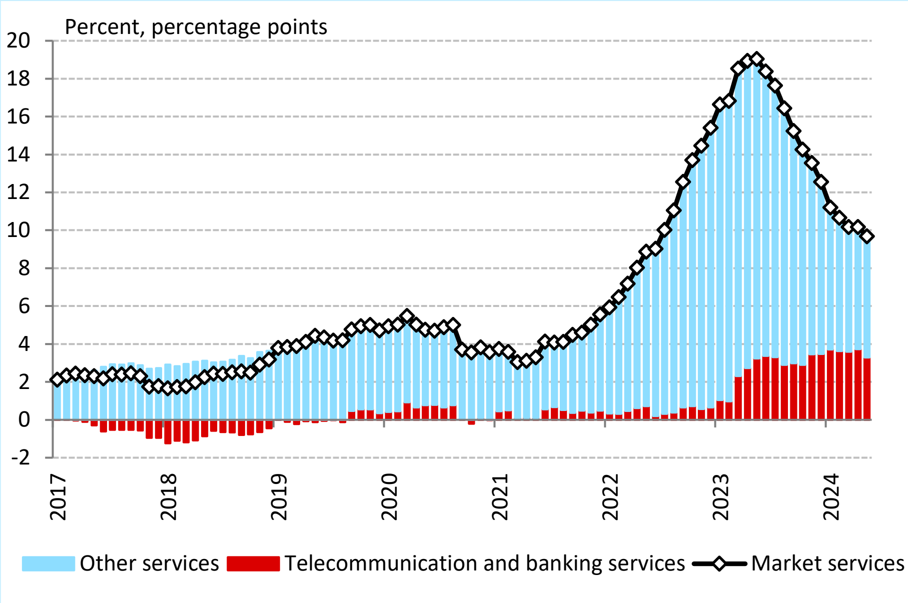
The increased demand for services and the higher work intensity of companies in the sector also contribute to the slower disinflation in services. According to HCSO data, in 2024 Q1 the consumption of services increased by 2.3 percent on an annual basis, which exceeded the 1.0-percent increase in the consumption of durables and the 1.2-percent decline in semi-

[1] Amatyakul, P., Igan, D., & Lombardi, M. J. (2024). Sectoral price dynamics in the last mile of post-COVID-19 disinflation. BIS Quarterly Review, 45.

durables. The higher work intensity is indicated by the fact that in 2022 the gross output per employee was half as much in market services as in manufacturing. In order to achieve the same economic output, twice as much labour is needed in services. With persistently higher inflation in services, the inflation target can be achieved only if imported inflation and price increases for other items are lower than in the second half of the 2010s.

Hungarian service inflation was the highest in the EU in the first months of 2024, partly due to retrospective repricing of certain sectors. In May, the annual price increase of market services was 9.7 percent, one third of which resulted from the retrospective repricing of telecommunications and banking services (Chart 3-39). By comparison, between 2017 and 2021, the average contribution of the latter items to inflation was only –0.2 percentage point. As part of retrospective repricing, the companies adjusted their spring price increases this year to last year's average inflation, with a significant inflationary effect in the current inflation environment, which is lower than it was last year.

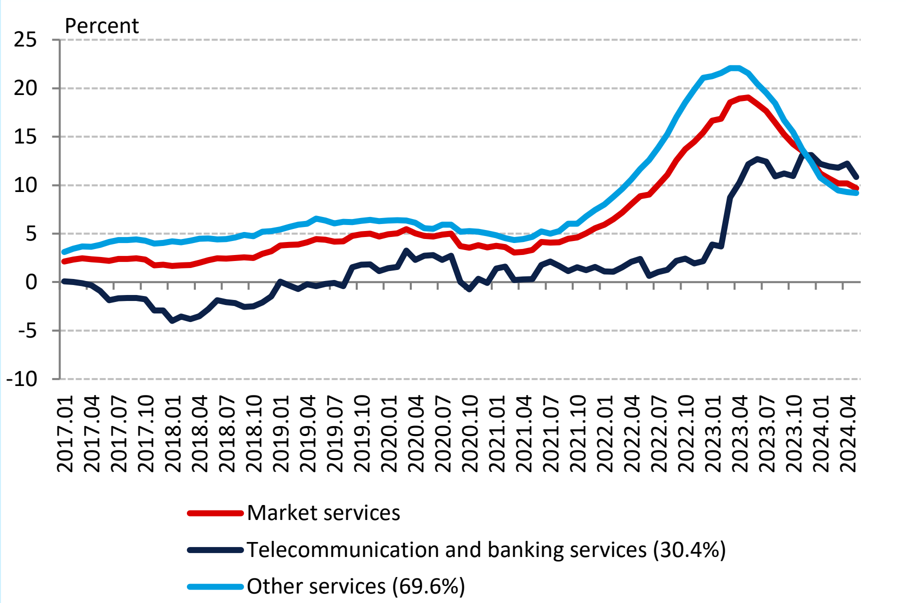
Chart 3-39: Inflation in market services



Source: HCSO, MNB calculation

Inflation in market services is high even without retrospective repricing, which may prolong disinflation in services. The average inflation of other market services not affected by retrospective repricing, representing 70 percent, was also at a high level of 9.2 percent in May (Chart 3-40).

Chart 3-40: Inflation of market services and components

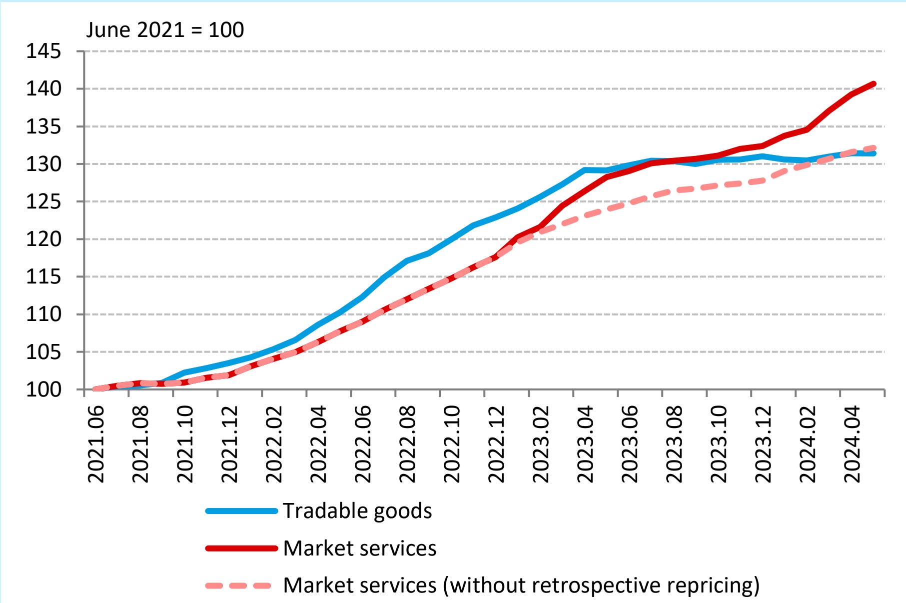


Note: The 2024 weight of the components represented within market services is provided in brackets.

Source: HCSO, MNB calculation

In recent months, the price increase in domestic services has significantly exceeded that in manufactured goods. According to the BIS study, during the pandemic, the rise in prices of manufactured products was not immediately followed by services, which is why the relative prices of services compared to manufactured goods fell. Over the last 1–2 years, however, the higher prices of services resulted in a gradual increase in relative prices. In Hungary, the price of manufactured products had been increasing at a higher rate than services until the autumn of 2022. At the same time, by 2023, the latter reached and then exceeded the aggregate price increase of manufactured goods calculated from June 2021. Apart from the effects of retrospective repricing, however, the cumulative price increase of the two groups over the past three years is approximately the same (Chart 3-41).

Chart 3-41: Cumulative price increase of industrial goods and services after June 2021



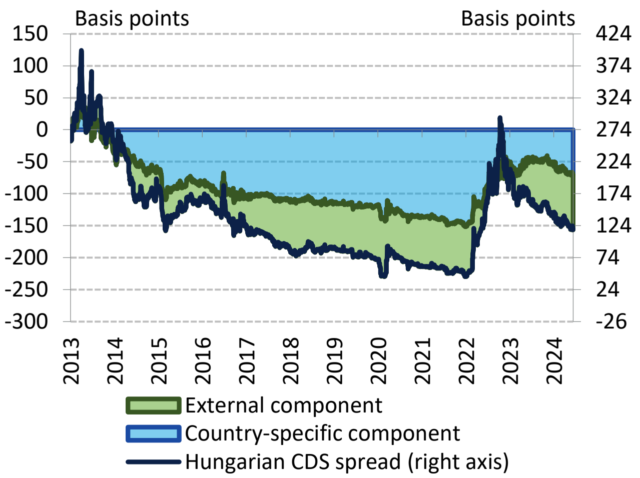
Source: HCSO, MNB calculation

4 Financial markets and interest rates

4.1 Domestic financial market developments

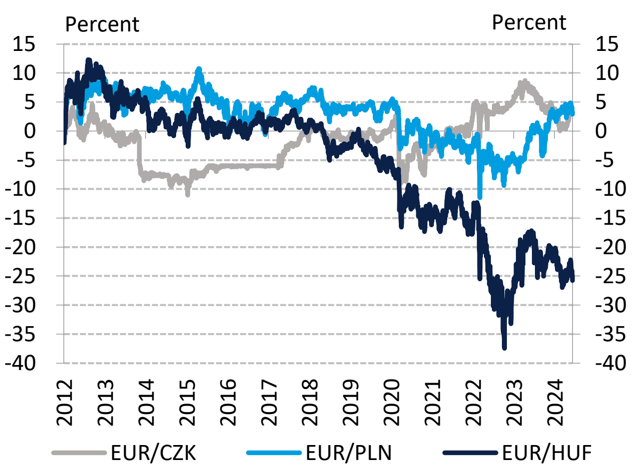
Overall, investor sentiment did not change significantly in the past quarter, but geopolitical conflicts continue to pose significant risks, for both the energy sector and global value chains. Trends in asset prices in international markets were mainly influenced by expectations about the interest rate policies of central banks in developed markets during the past period. The interest rate path as a whole priced in by market participants moved upwards in response to statements by policy-makers at the major central banks. Over the past quarter, the forint depreciated slightly, while government bond yields rose. Domestic disinflation and continued monetary easing led to a decline in domestic interbank yields and reduction in Hungary's sovereign risk premium.

Chart 4-1: Components of 5-year Hungarian CDS spread



Note: The decomposition method used can be found in the MNB Bulletin: Variance decomposition of sovereign CDS spreads, Kocsis–Nagy (2011).
Source: Bloomberg, MNB

Chart 4-2: Exchange rates in the region



Note: Changes compared to beginning of 2012. Positive values mean an appreciation of the currency.
Source: Bloomberg

4.1.1 Risk assessment of Hungary

Hungary's credit risk premium continued to fall during the period. The premium declined continuously over the past quarter, with an overall decrease of 20 basis points to 119 basis points (Chart 4-1), driven by both international and country-specific factors.

4.1.2 Foreign exchange market trends

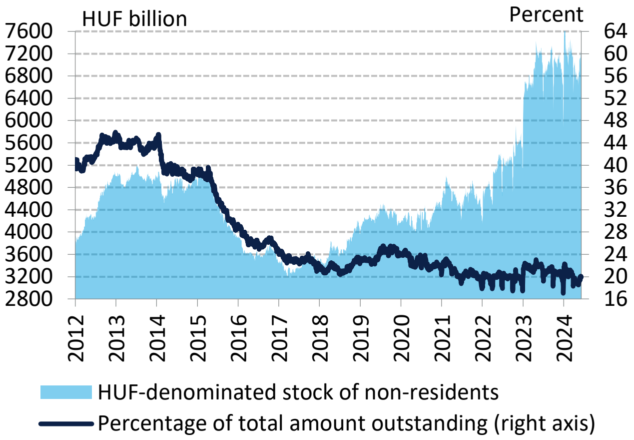
Overall, the forint depreciated by 0.3 percent against the euro during the period, due to changes in global sentiment and the strengthening of the dollar. Regionally, the Czech koruna appreciated by 2.3 percent and the Polish zloty depreciated by 0.8 percent, while the Romanian leu remained broadly unchanged during the period (Chart 4-2). Factors shaping trends in regional currencies included changing risk appetite, monetary policy decisions by developed and regional central banks and incoming macroeconomic data during the period. Versus the US dollar, the forint depreciated by 0.8 percent, the Polish zloty by 1.2 percent and the Romanian leu by 0.6 percent, while the Czech koruna appreciated by 1.9 percent during the period.

4.1.3 Government securities market and changes in yields

In the past quarter, the portfolio of government securities held by non-residents continued to expand (Chart 4-3). Non-residents' holdings of HUF government securities rose by HUF 727 billion to HUF 7,213 billion during the period. Non-residents' share in the portfolio of forint government securities rose to around 19.9 percent in the last quarter.

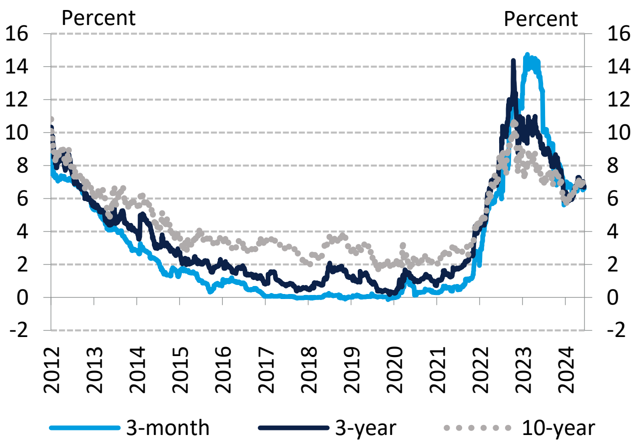
As regards the auctions of discount Treasury bills, at the beginning of the period the ÁKK accepted bids in smaller numbers than advertised, but the number of bids accepted then started to increase from mid-April onwards. By contrast, regarding government bond auctions, during the period as a whole it accepted bids in a number nearly twice that of the advertised. Average yields on short-,

Chart 4-3: HUF-denominated government securities held by non-residents



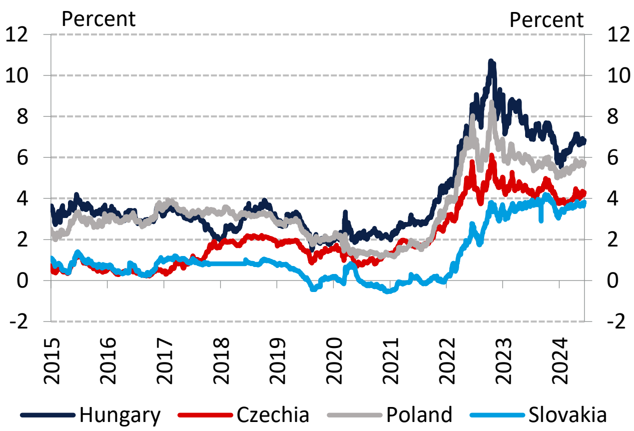
Note: The chart shows the stock of T-bills and T-bonds.
Source: MNB

Chart 4-4: Yields of benchmark government securities



Source: Government Debt Management Agency (ÁKK)

Chart 4-5: 10-year government benchmark yields in CEE countries



Source: Bloomberg

medium- and long-term bonds also rose in the past quarter, while the average yields for 3-month and 10-year T-Bills advanced by 11 basis points and 13 basis points, respectively.

The government bond market yield curve rose somewhat at both the short-end and the long end, while the 3-month T-Bill yield increased by 1 basis point (Chart 4-4). Overall, the 5-year yield increased by 1 basis point and the 10-year yield increased by 8 basis points in the last quarter. Regarding interbank yields, the 3-month BUBOR decreased by 93 basis points to 6.9 percent.

Long benchmark yields rose in the regions in the past quarter (Chart 4-5). The Czech, Polish and Slovak 10-year yield rose by 32 basis points, 30 basis points and 26 basis points, respectively.

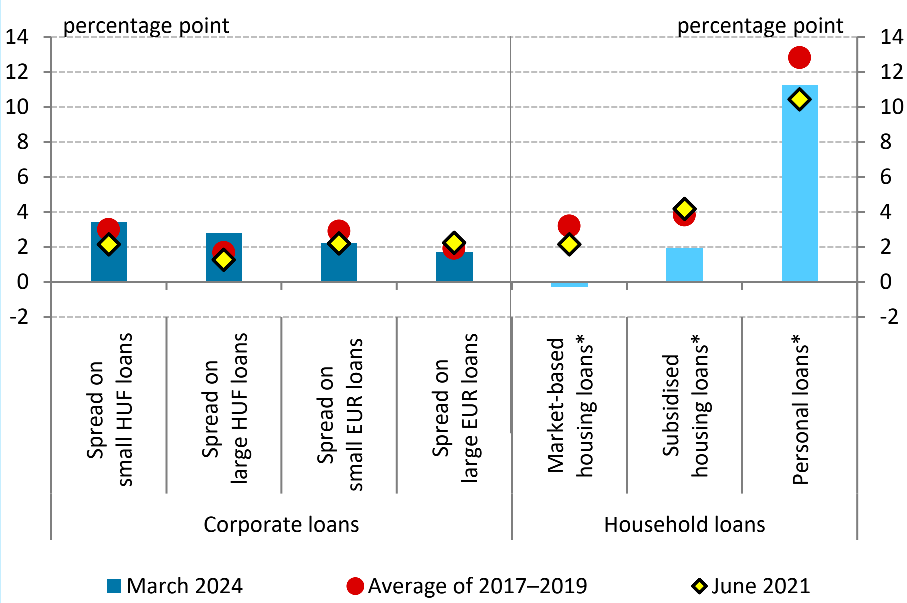
Box 4-1: Credit market overview in 2024 Q1

At the beginning of 2024, domestic credit markets show signs of a dichotomy: household lending is picking up, while the corporate sector is characterised by a wait-and-see attitude for the time being. In 2023, the value of new contracts concluded by credit institutions with households fell significantly compared to the previous year, meaning that the growth rate of the stock of retail loans was restrained in 2023 as a whole, at a rate of below 3 percent. At the same time, the value of new household loans was already 71 percent higher in 2024 Q1 than in the same period of 2023. In addition to the low base, this was due to the voluntary APR ceiling, which entered into force on 9 October 2023 and was adopted by most banks, as well as to the stimulating effect of the family subsidies available since 1 January 2024 in a different form and under different conditions and to the improving outlook (falling inflation, rising consumer confidence). Compared to the beginning of the previous year, contracts for housing loans (+130 percent), prenatal baby support loans (+60 percent) and personal loans (+48 percent) all increased substantially. With this, the annual growth rate of household loans of the entire financial intermediation system also began to rise and amounted to 3.6 percent at the end of the first quarter.

In the corporate sector, the annual transaction growth rate of loans to domestic credit institutions and financial enterprises gradually decreased in the past period, in line with European trends; it amounted to 5.8 percent in 2023. For the time being, there is subdued demand on the domestic corporate loan market, with the value of new contracts concluded in the first quarter being significantly lower than a year earlier, by around 25 percent, which was however influenced by a base effect (the launch of the Gábor Baross Reindustrialisation Loan Programme at the beginning of 2023 and the impact of certain large transaction in the same period). Thus, the growth rate of corporate loans decreased compared to the end of the year and amounted to 3.2 percent at the end of 2024 Q1.

In the case of housing loans, spreads dropped significantly, while the decrease in corporate loan interest rates lagged behind the decrease in interbank interest rates. Banks' spreads on housing loans fell substantially in the past quarter, due to changes in the voluntary APR cap and subsidised programmes (Chart 4-6). The APR for market-based housing loans fell from 9.3 percent in February 2023 to 7 percent over the span of one year. The decrease in interest rates was due to the voluntary APR ceiling introduced in October 2023 and the decline in inflation expectations. As the average APR of housing loans decreased, the average spread of market-based housing loans decreased close to zero. In the market of subsidised housing loans, the HPS Plus scheme, which is available from January 2024, may result in a reduction in spreads by reducing the maximum interest rate, while keeping customer interest rates unchanged at 3 percent or below. The average interest rate on corporate HUF loans also decreased in 2024 Q1, but spreads rose significantly. In addition to the drop in the 3-month interbank interest rate, the voluntary interest rate ceiling introduced on HUF market-based working capital loans from 9 October 2023 – and, to a small extent, the discount on the spread applied voluntarily from February 2024 – may have contributed to the reduction in interest rates on HUF loans.

Chart 4-6: Spreads on new loans to corporates and households

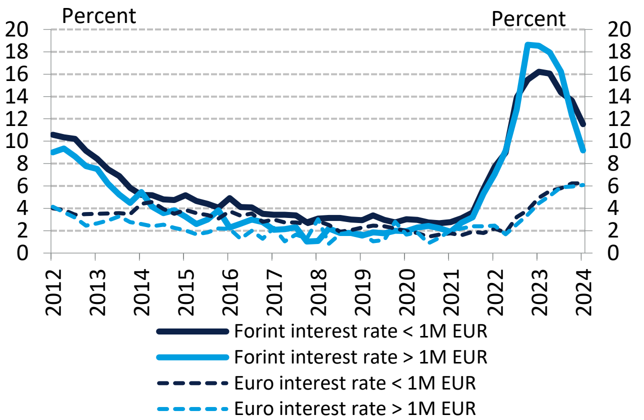


Note: In the case of corporate loans, the amount limit is EUR 1 million. In the case of corporate loans with variable interest or interest fixed for 1 year at the most, it is the smoothed spread above the 3-month BUBOR. *Subsidised loans cover FGS GHP loans, the subsidised HPS constructions, the subsidised bridging loans and the subsidised housing loans. Averages weighed by contractual amount. The spreads are calculated on the basis of relevant BIRS data observed 4 months earlier, by interest rate period, except for the new HPS constructions, available since January 2024, in which case the 5-year IRS yield observed 4 months earlier was used as a reference.
Source: MNB

4.2 Credit conditions of the financial intermediary system

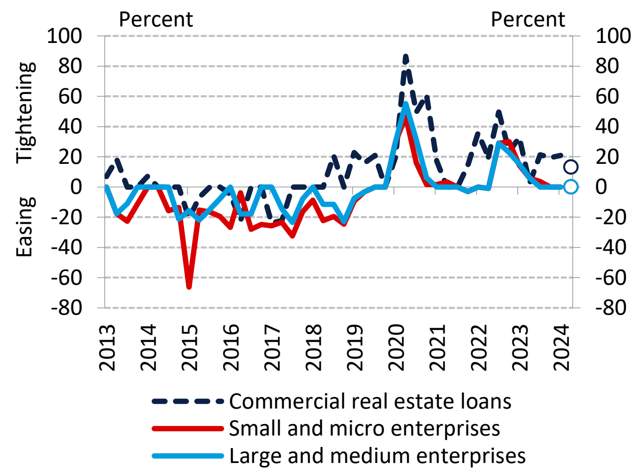
In 2024 Q1, corporate credit conditions did not change in any company size category, while a net 21 percent of banks tightened their conditions for commercial real estate loans, and further tightening for office buildings and logistics centres is expected. One quarter of banks reported a decline in demand for forint and long-term loans in the corporate segment in the first quarter of the year. Looking ahead to the next six months, 14 percent of the respondents expect an overall pick-up in loan demand; however, there is no sign of a turnaround for long-term loans, with 7 percent of banks anticipating weaker demand. Banks' lending capacity remains high. Overall, banks left housing loan conditions broadly unchanged, while 18 percent of them eased standards for consumer loans. Looking ahead to the next six months, no significant changes in lending standards are expected for any of the products. Banks reported a pick-up in demand for both housing and consumer loans in 2024 Q1, with further strengthening expected in 2024 Q2 and Q3. The average financing cost of newly contracted corporate HUF loans and the average cost of newly contracted fixed-rate long-term home loans both declined during the period under review, due to a fall in borrowing costs and partly due to regulatory action.

Chart 4-7: Interest rates on new corporate loans



Note: Loans with variable interest rate or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million.
Source: MNB

Chart 4-8: Changes in credit conditions in corporate sub-segments



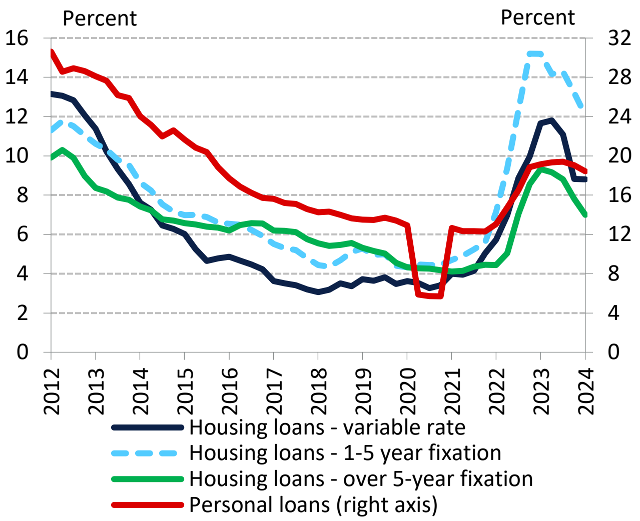
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Forecast for 2024 H1.
Source: MNB, based on banks' responses

4.2.1 Corporate credit conditions

In 2024 Q1, HUF lending rates continued to fall in conjunction with the decline in borrowing costs. Net of money market transactions, the average interest rate on newly contracted, largely market-based corporate HUF loans with variable interest rates within a 12-month period decreased by 2.1 percentage points relative to the previous quarter for low-amount loans and by 3.1 percentage points for large-amount loans. As a result, the average interest rate on HUF loans was 10.0 percent at end-March (Chart 4-7). Interest rates on low-amount EUR loans remained nearly unchanged (+1 basis point). Interest rates on large-amount EUR loans increased only moderately, by 13 basis points in the fourth quarter of the year, in line with unchanged euro area interbank interest rates. The average financing cost of EUR loans stood at 6.1 percent at the end of March.

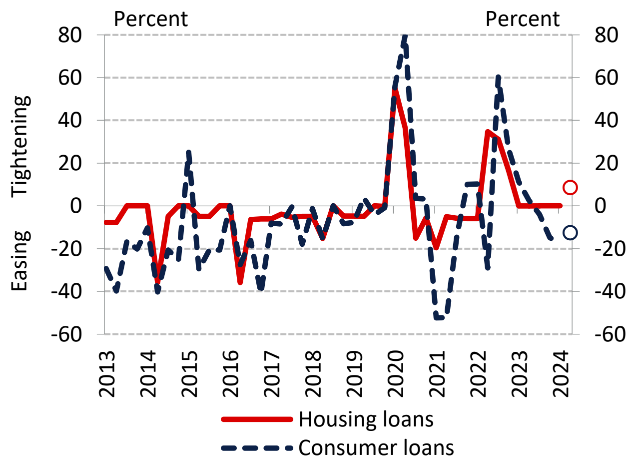
In 2024 Q1, banks left overall corporate lending conditions unchanged across all company size categories, and they do not intend to change these conditions in the second and third quarters of 2024. A net 21 percent of banks reported the tightening of credit conditions for commercial real estate loans. Among the individual factors, industry-specific problems in the corporate sector and changes in banks' risk tolerance had the largest impact on tightening. Banks' lending capacity remains high. Banks do not plan to make significant changes to corporate lending standards in any corporate size category in the next six months; however, 24 and 13 percent of banks, respectively, considered tightening credit conditions for lending for logistics centres, in addition to office buildings (Chart 4-8). Regarding credit demand, in 2024 Q1 one quarter of the institutions experienced a decline in credit demand in the corporate sector, which mainly affected HUF loans and long-term loans. Banks identified customers' weak investment intentions to be the main reason behind the decline. A

Chart 4-9: Annual percentage rate of charge on new household loans



Note: Quarterly average of lending rates on newly disbursed loans. In the case of loans with 1–5 year fixation, the most recent data cover loans subsidised by the state, in which case the interest rate shown in the figure also includes the subsidy paid by the state.
Source: MNB

Chart 4-10: Changes in credit conditions in the household sector



Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Forecast for 2024 H1.
Source: MNB, based on banks' responses

narrow range of banks, amounting to just 6 percent in net terms, experienced a pick-up in demand for short-term loans. Looking ahead, regarding 2024 Q2 and Q3, 14 percent of the respondents expect an overall increase in demand for credit; however, there is no sign of a turnaround in terms of long-term loans, with 7 percent of banks anticipating a decline in demand.

4.2.2 Household credit conditions

The average interest rate on long-term fixed-rate mortgages continued to fall during the quarter. The average APR of housing loan contracts signed in 2024 Q1 for loans with fixed interest rates for 1–5 years (mainly subsidised loans linked to the Home Purchase Subsidy Scheme for Families) was 12.1 percent, down by 1.1 percentage points from the previous quarter; while the average cost of credit for loans with fixed interest rates for a term of more than 5 years was 7.0 percent in March 2024, down from 7.8 percent in December 2023 (Chart 4-9). The application of the voluntary APR ceiling by the majority of banks from 9 October may have contributed to the reduction. The APR ceiling was initially set at 8.5 percent and then reduced to 7.3 percent from January 2024.[2] In 2024 Q1, the volume of Certified Consumer-friendly Housing Loans (CCHL) with an interest-rate period of at least 5 years accounted for 31 percent of newly disbursed housing loans, while the share of loans with a fixed term of at least 10 years was 74 percent. The average smoothed APR for personal loans decreased by 63 basis points to 18.4 percent at the end of the period under review.

Overall, the standards for housing loans have not changed, and looking ahead, no substantial changes are expected. Based on responses to the Lending Survey, banks left credit standards for housing loans broadly unchanged in 2024 Q1; however, in terms of the requirements for the loan-to-value ratio, 62 percent of banks eased the LTV limit made available by the MNB for first-home buyers. 18 percent of the banks eased standards for consumer loans (Chart 4-10). Looking ahead to 2024 Q2 and Q3, responding banks did not indicate any significant changes in the trends expected for the evolution of credit conditions for either home or consumer loans. The respondent banks experienced a surge in demand for both housing loans and consumer loans in the first quarter, and looking ahead to 2024 Q2 and Q3, an even greater number of them expect a further increase.

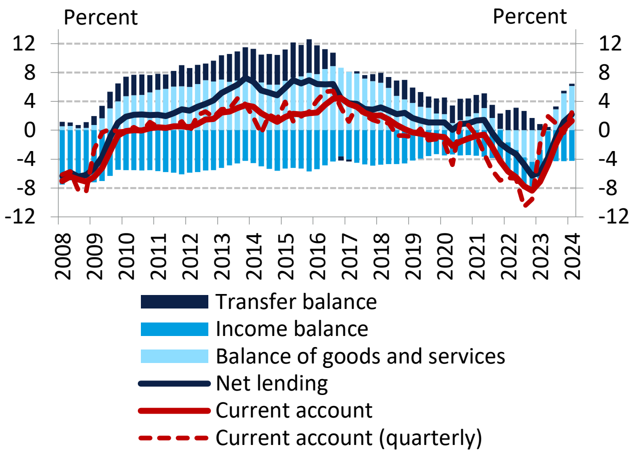
[2] For a more detailed analysis of the effects of the APR ceiling, see Box 3 in the May 2024 Financial Stability Report.

5 Balance position of the economy

5.1 External balance and financing

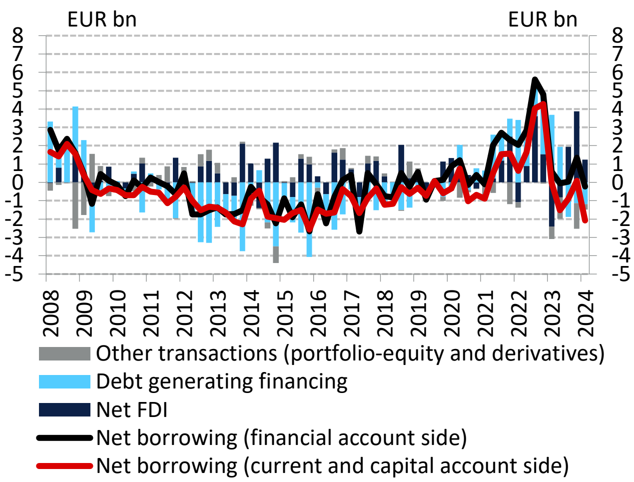
The current account surplus had increased to 1.3 percent of GDP by 2024 Q1, while the economy's financing capacity rose to 2.2 percent of GDP. The improvement in the external balance was due to an increase in the goods balance, which in turn was linked to falling imports. On the financing side, net FDI inflows continued, while debt liabilities decreased at the beginning of the year. In 2023 Q4, the country's external debt-to-GDP ratios declined moderately, with gross external debt at 63.6 percent of GDP and net external debt at 11.8 percent of GDP.

Chart 5-1: Changes in net lending and its components



Note: Cumulated four-quarter values, as a percentage of GDP.
Source: MNB

Chart 5-2: Structure of net lending



Note: The net lending from the financial account side corresponds to the sum of current account, capital account and the BOP balance of statistical errors and omissions. From an economic point of view, fundamental developments in the dynamics of debt ratios are not affected by the switch between gold bullion and unallocated gold accounts so this technical effect is excluded from time series.
Source: MNB

5.1.1 Developments in Hungary's external balance position

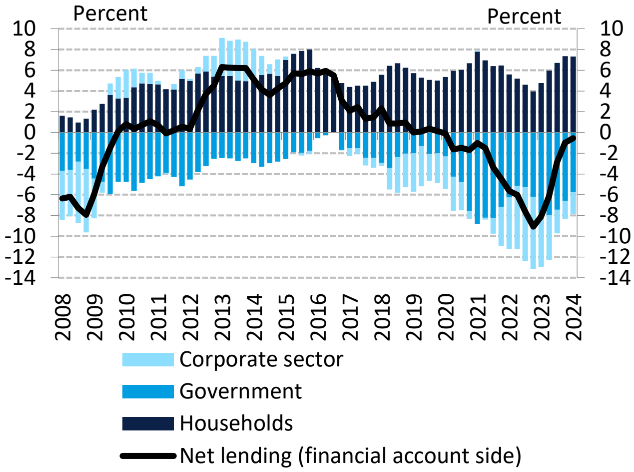
In 2024 Q1, the current account balance and the country's financing capacity continued the improving trend that began in 2023 (Chart 5-1). Based on preliminary monthly data, this was mainly due to developments in the foreign trade balance, including the balance of goods. The improvement can be traced primarily to the decline in imports, which was driven by the declining energy balance and significantly lower investment activity compared to the previous year. The other component of the foreign trade balance, the surplus of the balance of services over GDP, remained at the consistently high level of 5 percent in recent quarters. Compared to the higher level of previous years, the surplus of the transfer account was moderate, below 0.5 percent of GDP, as a result of the moderate inflow of EU funds.

5.1.2 Developments in financing

In 2024 Q1, net FDI inflows continued at a slower pace, while debt liabilities indicated an outflow (Chart 5-2). In 2024 Q1, net FDI inflows continued at a lower rate in Hungary, but this still represents large improvement compared to the FDI outflows recorded in 2023 Q1. Transaction data show that in the first quarter of the year the decrease in debt liabilities stayed almost unchanged compared to the previous quarter. The decrease in the net external debt of the general government and companies was partially offset by the increase in the debts of banks.

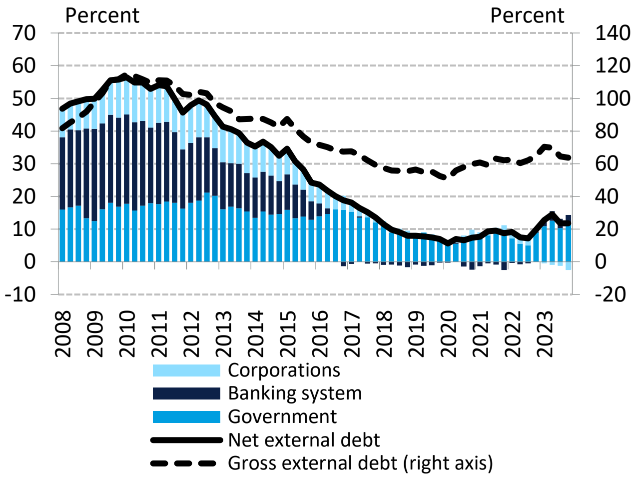
In 2024 Q1, the decrease in net borrowing was mainly due to the activity of the general government, while the financing capacity of the private sector decreased somewhat (Chart 5-3). Net borrowing of the general government has decreased, due on the one hand to substantially lower public sector investments and on the other hand to the increase in tax revenues charged to labour, but its level remains high. The net financial savings of the private sector have declined somewhat, probably as a consequence of increasing consumption and economic activity. After the increase reported in the previous year,

Chart 5-3: Decomposition of net lending by sectors



Note: Four-quarter cumulation, as a percentage of GDP.
Source: MNB

Chart 5-4: Development of net external debt by sectors



Note: From an economic point of view, fundamental developments in the dynamics of debt ratios are not affected by the switch between gold bullion and unallocated gold accounts so this technical effect, as well as intercompany loans are excluded from time series. As a percentage of GDP.
Source: MNB

the net financial savings of households stabilised at around 7.3 percent. Net borrowing by companies increased somewhat after the previous period of continuous decline.

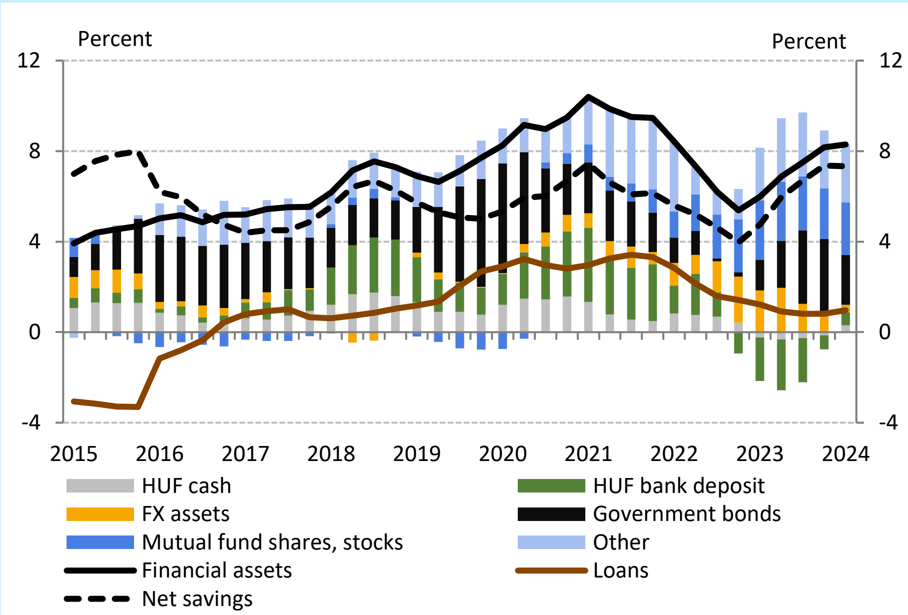
By the end of December 2023, the economy's net external debt fell to 11.8 percent of GDP (Chart 5-4). The moderate decrease in the indicator was the combined result of contrasting effects. The stock-reducing effect of transactions was supported by the expansion of nominal GDP, while revaluation had the opposite effect, and therefore the indicator moved only to a small degree overall. The reduction in net external debt was mainly linked to the decrease in the index of companies and the banking system, which was partially offset by the increase in the debt ratio of the general government. The country's gross external debt declined almost by 1 percentage point, to 63.6 percent of GDP by the end of 2023.

Box 5-1: Household savings are at a high level

In 2023, the increasingly uncertain economic and geopolitical environment, as well as high inflation, significantly influenced the increase and the structure of savings. From the middle of the previous decade until 2021, the period of the epidemic, gross savings of households as a proportion of GDP increased continuously, albeit with minor interruptions (Chart 5-5). Growing real earnings contributed to the increase, but as the outlook improved, the surge in borrowing had the same positive effect on the financial assets of households. In the low-inflation environment, in addition to liquid assets, retail government securities providing fixed returns were the most important investment targets of the population. The gross accumulation of financial assets by households peaked in the middle of the pandemic, when the savings forced by the curfew were reflected in the growth of liquid assets, primarily HUF deposits and cash, while demand for government securities gradually weakened. As the effects of the pandemic subsided, the accelerating inflation and the increasingly uncertain economic environment reduced household borrowing, thus resulting in lower gross savings. After the temporary decrease following the pandemic, the outbreak of the war and the rising inflation caused the accumulation of financial assets to start growing again.

Households responded to the increasingly high inflation and uncertain environment by reducing their liquid HUF assets and increasing their foreign currency assets. Demand for foreign currency assets increased substantially in the first three quarters of 2022. In addition, demand for high-yield retail government securities increased, and – with the rise in retrospective yields – the stock of investment bond funds also expanded significantly. In 2023 H2, as inflation stalled, the decline in HUF deposits and cash holdings, which are regarded as liquid assets, began to slow down and then began to expand again at the beginning of 2024. At the same time, demand for foreign currency instruments has continuously decreased. Nevertheless, demand for longer-term government securities and investment funds remained strong, which contributed significantly to the once again expanding financial wealth of households.

Chart 5-5: Financial wealth of households (four-quarter values as a percentage of GDP)



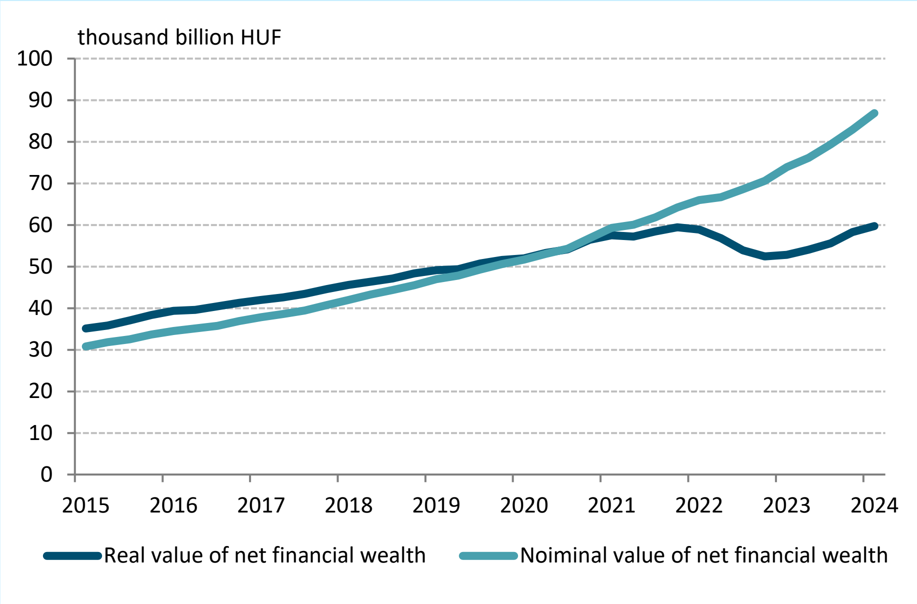
Note: Without the effect of PIT repayment

Source: MNB

High inflation significantly reduced the real value of households' financial assets, which was partly compensated by the strong accumulation of gross financial assets (Chart 5-6). Between 2015 and 2020, during a period of stable growth, a predictable economic environment and low inflation, the real financial wealth of the population almost doubled. On the one hand, this was linked to higher new savings based on increased real earnings, and, on the other hand, to the appreciation of financial assets, so-called revaluation, which had its roots in the expansion of the economy. However, during the period of high inflation, neither the steadily expanding savings nor revaluation could offset the loss in the real value of financial assets, a fact that was reflected in a significant, almost 12-percent decrease in real assets in the year before 2022

(Chart 5-6). From 2023, however, in addition to new savings, the interest accrued on financial assets, primarily retail government securities, as well as the significant positive revaluation, led real financial assets to reach their previous highest level, recorded at the end of 2021.

Chart 5-6: Nominal and real value of the financial assets of households (at 2020 prices)



Source: MNB

At the beginning of 2024, household savings faced another turning point. In the first quarter of this year, after reaching the previous peak of real financial assets, the growth of gross savings in proportion to GDP stalled at above 8 percent, while borrowing as a proportion of GDP also reflected a slight increase. The MNB's survey indicates that households' expectations regarding their financial situation are gradually improving (for more information, see the focus topic in Chapter 6.2), which suggests an easing of the precautionary motive. The interest income paid on government securities in 2024 may have made a significant contribution to this. The majority of this interest will be reinvested by households, but, according to the survey, about 30 percent of the interest is to be used for regular or one-off major expenses.

Current developments show that gross savings are likely to decline from their current high level. It is important to note, however, that a healthy level and structure of household savings is essential for successful convergence, as this can make a significant contribution to the stable financing of the country. In addition, more conscious decisions are needed about household savings than those currently observed, which will not only promote the growth of household wealth through higher yields available (thereby mitigating the negative consumption effect of a possible new shock), but also facilitate the direct financing of companies with longer maturity instruments, thereby providing a better stimulus to economic growth.

In summary, with the recovery of real financial wealth, the precaution of households may gradually fade, which may result in a slow decrease in gross financial asset accumulation and an increase in propensity to consume.

5.2 Forecast for Hungary's net lending position

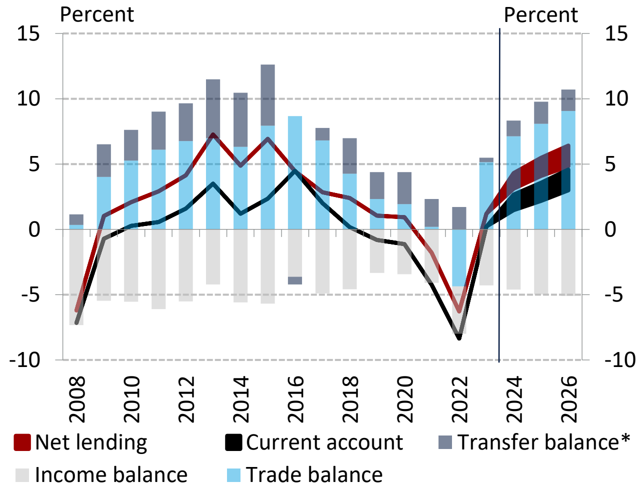
The current account balance continues to rise over the forecast horizon, driven mainly by an improved external balance. In 2024, this is due mainly to improved terms of trade supported by low energy prices and moderating investment. Export dynamics will improve in the coming years as new export capacity becomes operational and the global economic environment normalises. In the longer term, the impact of these favourable developments will be partly offset by the fact that this year's growth in household consumption and growth in investment in the coming years will also lead to import growth. Trends in the financing position of the sectors suggest that the external balance is improving, mainly as the general government deficit is gradually narrowing; the financial position of the private sector is also somewhat better.

An improving external balance leads to a further increase in the external balance indicators over the forecast horizon (Chart 5-5). The current account balance as a share of GDP was in moderate surplus in 2023 after an improvement of over 8 percentage points. Improving terms of trade, due to low energy prices, and subdued imports in 2024, caused by a moderating investment momentum, will improve the external balance. Exports are also expected to accelerate from 2025, as new export capacities put into operation, and a normalising global economic environment will increase Hungary's market share of exports significantly. The income balance deficit will expand somewhat in the context of rising interest expenditure attributable to the carry-over effect of higher interest rates. Overall, the current account surplus will continue to rise in the coming years, which, together with an expected increase in EU transfers, implies an increasing financing capacity.

The reduction in the energy balance will contribute significantly to an improved external balance this year, but only to a lesser extent from 2025 onwards. Energy prices are expected to be lower in 2024 relative to the 2023 average, which, together with subdued energy demand and rising nominal GDP, is expected to further reduce the energy deficit as a share of GDP. The surplus in the other goods balance is increasing at a slower pace in 2024, in line with a decline in capital expenditure; it will continue to rise in the longer term, with export dynamics accelerating as external demand picks up. The surplus on the services balance is likely to continue gradually increasing in the coming years (Table 5-1).

Financing trends in the individual sectors suggest that the net position of the private sector will keep improving in the coming years, and the general government deficit will gradually narrow (Chart 5-6). The decline in the budget deficit in 2024 is linked mainly to lower energy prices, subdued investment dynamics, and from 2025 onwards to lower interest expenditure. The net financial savings of households – which have been at a high level for a longer period –will start to decline slowly over the forecast horizon as consumption recovers; nevertheless, households' net

Chart 5-7: Evolution of net lending



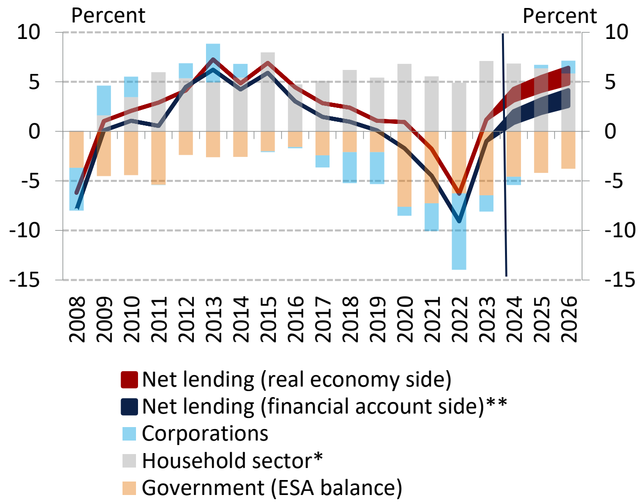
Note: As a percentage of GDP* The sum of the balance of the current transfers and the capital account balance.
Source: MNB

Table 5-1: Development of trade balance as a percentage of GDP

	2023	2024	2025	2026
Balance of goods	0.1	1.9	2.7	3.7
Balance of energy	-4.4	-3.2	-3.0	-2.7
Balance of other goods	4.6	5.1	5.7	6.4
Balance of services	5.0	5.2	5.4	5.4
Trade balance	**5.1**	**7.1**	**8.1**	**9.1**

Source: HCSO, MNB

Chart 5-8: Changes in the savings of sectors



Note: As a percentage of GDP. * Net financial saving of households does not contain the pension savings of those who return to the public pension system. The net savings in the financial accounts differ from the data in the chart. ** We expect that 'Net errors and omissions' (NEO) will return to the historical average.
Source: MNB

financial savings are expected to remain above 5 percent of GDP. Rising profits, higher EU transfers and lower energy prices will improve the net position of companies, which will also be supported by the rebalancing effect of a recovering external environment in the coming years.

5.3 Fiscal developments

The budget deficit-to-GDP ratio is projected to be 4.5–5.0 percent in 2024, 3.5–4.5 percent in 2025 and 2.8–3.8 percent in 2026, depending on macroeconomic developments and the degree of fiscal discipline. The reduction of the deficit is supported by stabilising global energy prices and falling inflation; however, it is slowed down by a shortfall in tax revenues and high government interest expenditure. According to our forecast, the government debt-to-GDP ratio is projected to decline steadily, but the set deficit targets must be achieved in order for this to occur.

5.3.1 Main balance indicators

The government sector's accrual deficit-to-GDP ratio may be 4.5–5.0 percent according to our forecast in 2024 (Table 5-2). The budget deficit, at 6.7 percent in 2023, is expected to narrow substantially in 2024, mainly as a result of lower energy prices, a more vibrant macroeconomic environment and the reduction in public investment expenditures. High inflation over the last two years has led to a significant increase in interest expenditures on government debt, which will also place a heavy burden on the budget in the following years as well.

The budget deficit is expected to be in the range of 3.5-4.5 percent in 2025 and to narrow further to 2.8-3.8 percent in 2026. In the absence of adopted budgets, our projections based on the current macroeconomic and fiscal base suggest that the deficit-to-GDP ratio will narrow gradually to close to 3 percent of GDP in 2026 (Chart 5-9).

Table 5-2: General government balance indicators

	2023	2024	2025	2026
ESA balance	-6.7	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Primary ESA balance (point estimate)	-2.0	0.1	-0.2	0.1
Gross interest expenditures	-4.7	4.8	3.8	3.4

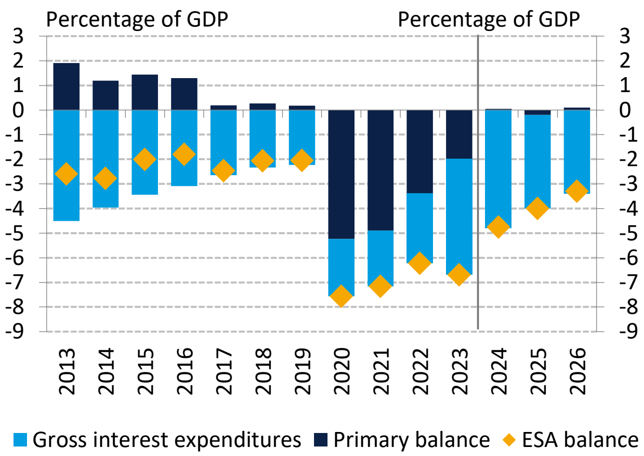
Note: As a percent of GDP. The time series of the primary ESA balance (point estimate) are consistent with the midpoint of the ESA balance forecast bands.
Source: MNB

5.3.2 Budget balance in 2024

We forecast the budget deficit to be between 4.5 and 5.0 percent of GDP in 2024. Based on the general government data of the preliminary fiscal accounts released by the MNB, the first quarter accrual deficit accounted for around 6 percent of quarterly GDP (Chart 5-10). The cash deficit stood at HUF 2,549 billion at the end of May and still exceeds the annual appropriation despite the May surplus, accounting for 64 percent of the EDP report's cash target of approximately HUF 4,000 billion. A major contributor was the impact of paying interest on inflation-linked government securities sold to households concentrated in the first quarter of the year, which doubled compared to the same period in 2023.

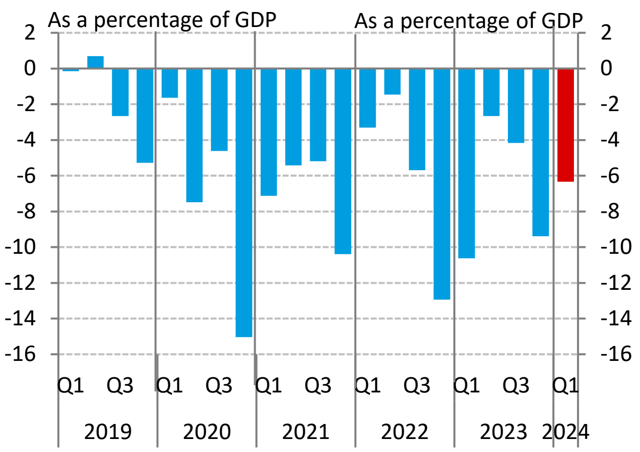
The reduction of the budget deficit relative to previous years is supported by the stabilisation of global energy prices at a level lower than in the previous years, as well as the reduction of domestic government investment. At the same time, reaching a lower deficit is hampered by tax revenues falling short of the appropriation (Chart 5-11) and by an increase in government interest expenditures to 4.8 percent of GDP, reflecting the high inflation of the past two years.

Chart 5-9: Changes in the fiscal balance and government interest expenditures



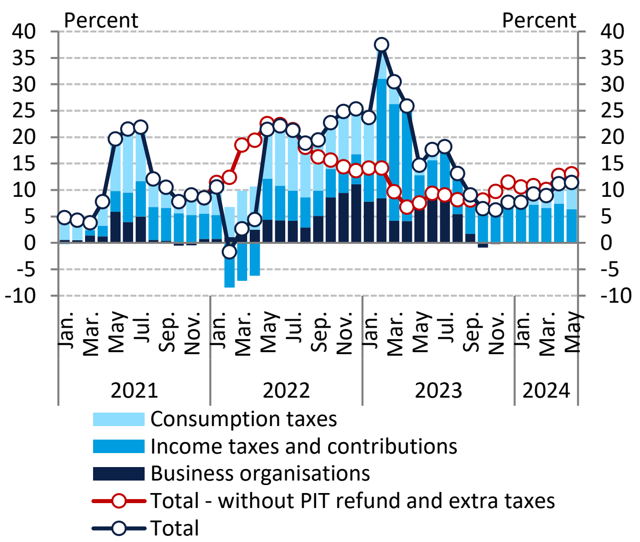
Note: The time series of the ESA balance and the primary ESA balance after 2023 are point estimates, which are consistent with the midpoint of the ESA balance forecast bands.
Source: HCSO, MNB

Chart 5-10: Accrual balance of the general government sector



Note: The Q1 2024 data shows the net lending capacity of general government as reported in the preliminary financial accounts published by the MNB.
Source: HCSO, MNB

Chart 5-11: Evolution of tax and contribution revenues in 2021–2024, year-on-year, 3-month moving average



Source: HST, MNB

The drawdown of EU funds for 2021–2027 has begun this year, with a total of around EUR 12 billion available following an EU decision at the end of 2023. By early June 2024, Hungary will have drawn down 7 percent of the available cohesion funds for the 2021–2027 period, the 8th highest rate in the EU. The amount specified in the effective contracts for the resources of the cycle is close to HUF 3,000 billion, around one third of the total cohesion budget of EUR 21.7 billion. Around HUF 1,700 billion had been paid out to the beneficiaries of the applications by the beginning of June. Hungary has already drawn down 98 percent of the 2014–2020 cohesion fund, which also places it in 8th place in the EU. The remainder is somewhat over EUR 600 million.

Based on data received in May, the development of tax and contribution revenues to the general government show a more favourable picture than at the beginning of this year. Although revenues may continue to fall short of the expectations in the Budget Act significantly this year, this shortfall is expected to be limited to VAT revenues. Corporate tax revenues and taxes and contributions on labour are expected to be in line with the appropriation.

5.3.3 Budget balance for 2025 and 2026

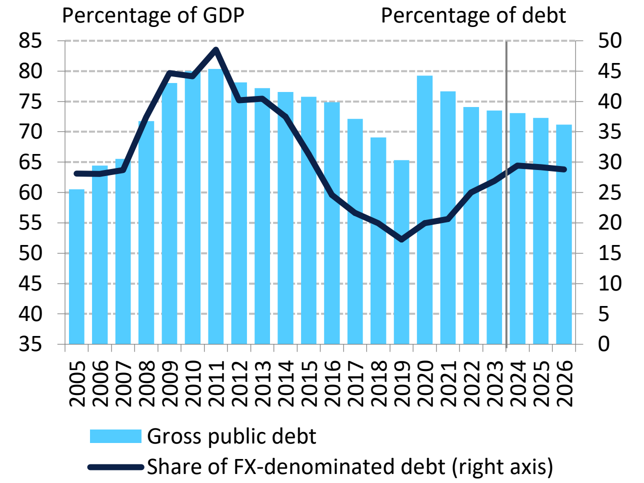
Our forecast for the accrual deficit-to-GDP ratio is 3.5-4.5 percent in 2025 and 2.8–3.8 percent in 2026. In the absence of available budget appropriations, we have made technical projections for 2025 and 2026, according to which, based on the expected macroeconomic path and estimated expenditures, the deficit will decline further in addition to the mitigation of risks. The deficit target-to-GDP ratio for 2025 is 3.7 percent, while the government plans to keep the deficit below the Maastricht threshold of 3 percent in 2026. This target can be achieved through a substantive control of fiscal expenditure and a dynamic increase in revenues.

5.3.4 Risks surrounding the baseline scenario

The macroeconomic environment has a significant impact on tax revenues. The fall in inflation and the rise in real wages led to an increase in consumption, which was also reflected in VAT revenues. However, the rise in consumption also depends on the moderation of the precautionary motive, which has strengthened in recent years. A faster recovery in consumption will increase expected VAT revenues, while a delay will lower such.

The limited access to EU funds continues to create uncertainty for budgetary processes. Hungary has access to a total of EUR 12.2 billion in the 2021–2027 cohesion cycle. However, access is still not available to the Recovery

Chart 5-12: Gross public debt forecast



Note: The time series of the gross public debt and the share of FX-denominated debt after 2023 are point estimates, which are consistent with the midpoint of the ESA balance forecast bands.

Source: MNB, ÁKK

and Resilience Facility (RRF) and cohesion funds representing an amount of close to EUR 20 billion, which is linked to the implementation of the 27 super-milestones defined by the Commission. Budget data early this year reveal that EU payments are lower than expected on the basis of the appropriations; which indicates a reduction in advance payments. The advance payments and the absorption of funds affect the level of government debt, while the timing of the utilisation of funds affects the accrual-based balance and real economic developments.

5.3.5 Expected developments in public debt

According to preliminary data, the gross public debt-to-GDP ratio stood at 75.9 percent at the end of 2024 Q1. The debt ratio thus rose by 2.4 percentage points from its value at the end of 2023, and was 0.4 percentage points higher compared to the same period of the previous year. The increase in the public debt ratio in the first quarter of the year was driven by a high cash deficit and the related higher net issuance of government securities, which had reached close to 80 percent of the annual net issuance plan by the end of April. However, this was partially offset by the increase in nominal GDP.

We project that the gross debt-to-GDP ratio will decrease slightly by the end of 2024 if the deficit target is met. The decline in the debt ratio is supported by the moderation in the deficit and an increase in nominal GDP. Subsequently, the public debt ratio is likely to decline by nearly 1 percentage point per year on average over the forecast horizon, falling to nearly 71 percent by the end of 2026 (Chart 5-12).

Changes in the HUF/EUR exchange rate affect the debt ratio through the revaluation of foreign currency debt. The lower the share of foreign currency debt in government debt is, the more modest this effect. A HUF 10 change in the EUR/HUF exchange rate alters the public debt-to-GDP ratio by over 0.6 percentage point. The share of foreign currency-denominated debt in central debt increased as a result of significant foreign currency issuances during the year.

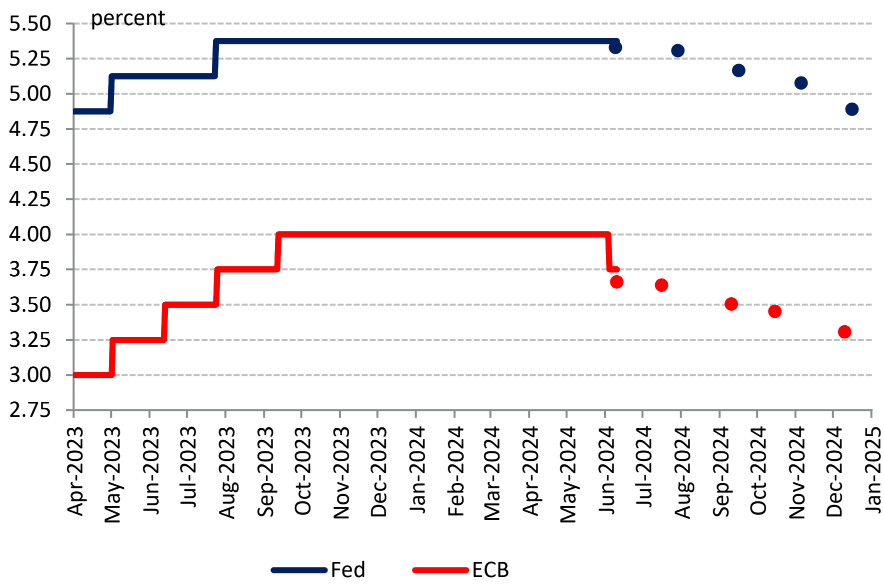
6 Special topics

6.1 Divergence between the monetary policy of the Fed and the ECB

In line with global trends, inflation rose to a high level in the US and the euro area in 2022. The CPI price index on an annual basis peaked at 9.1 percent in the USA, while the HICP price index rose to a high of 10.6 percent in the euro area. In response to rising inflation, the Fed increased interest rates by 525 basis points and the ECB by 450 basis points in less than a year and a half. In 2022 Q4, rapid disinflation began both in the US and in the euro area, as a result of which annual inflation in the US dropped back close to the target in June 2023, and in the euro area half a year later. Even though inflation has exceeded the target in both economies in the recent period, market expectations for interest rate cuts intensified due to the proximity of the inflation target. In June, the ECB reduced its policy rate by 25 basis points, and market participants expect the first rate cut from the Fed in September. However, there has been a significant divergence in the market expectations regarding the interest rate path of the two central banks over the past year, which means that looking ahead the current interest rate differential may persist. In this focus topic, we discuss this process and the underlying reasons.

For the first time in its history, the ECB started the interest rate reduction cycle before the Fed. The ECB decreased its policy rate by 25 basis points at its June meeting, while the Fed did not change monetary conditions, and market participants expect that the first interest rate cut of 25 basis points will occur in September at the earliest. The Fed is expected to cut interest rates by just over 40 basis points for the rest of the year, while in the case of the ECB, in addition to the 25 basis points in June, an additional 35 basis points are expected to be cut compared to the current effective interest rate. The difference between the central banks' effective policy rate is currently 167 basis points (Chart 6-1).

Chart 6-1: Policy rates of the Fed and ECB, and market pricing for interest rates



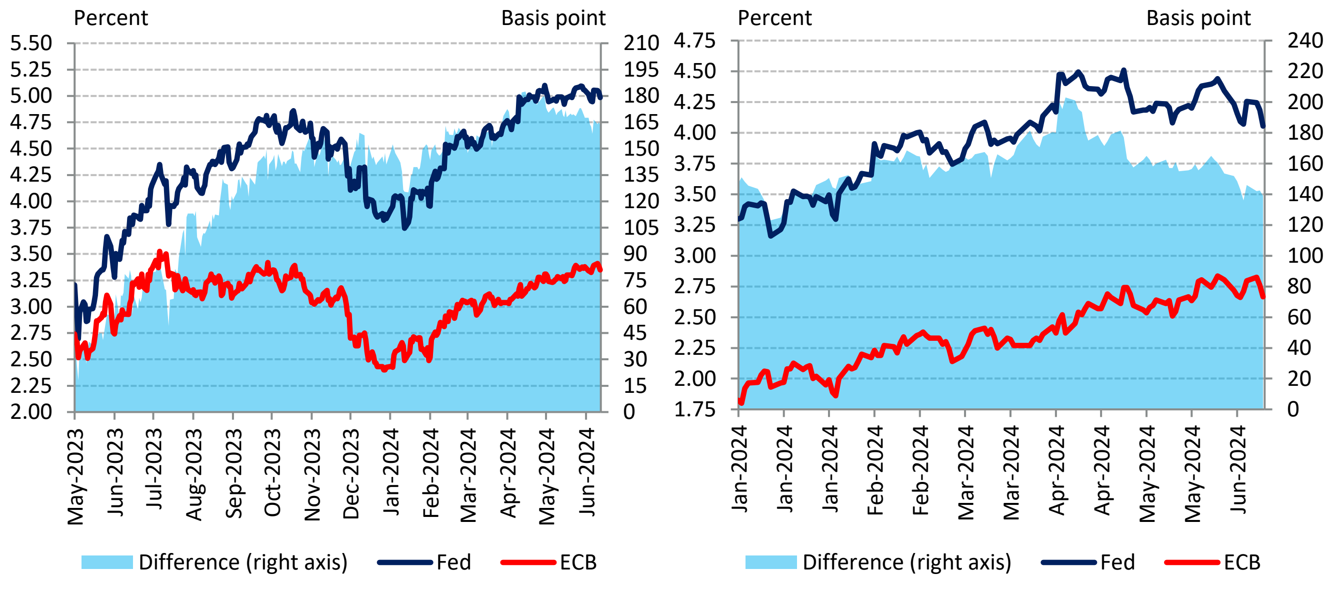
Note: The chart shows the centre of the target range for the Fed and the interest rate of the deposit facility for the ECB. The first points indicate the current unsecured interbank market interest rate (the effective federal funds rate for the Fed and the euro short-term rate for the ECB).
Source: Bloomberg, Fed, ECB

One year ago, the divergence between the interest rates of the Fed and the ECB was still considered a temporary phenomenon by market participants. In May 2023, inflation was 4 percent and 6.1 percent in the US and the euro area, respectively, and the policy rates of the two central banks were at 4.75–5.00 percent and 3 percent, respectively. The markets priced in a steeper downward trajectory for the Fed and expected that the difference between the policy rates would decrease from the then-existing 190 basis points to 30 basis points by the end of 2024 (Chart 6-2, left).

As a result of the different inflation and growth trajectories, the expected interest rate trajectories of the two dominant central banks diverged significantly from each other. In the US, the stalling of disinflation was followed by a temporary rise in the CPI inflation index in 2023 Q2 and Q3, while the already strong economic growth continued to accelerate, and labour market conditions eased only gradually. The pace of the decline in inflation slowed down in the euro area as well, while economic growth on a quarterly basis fell into negative territory at the end of last year. The Fed raised interest rates by another 25 basis points, while the ECB raised its rates by another 75 basis points by September 2023. As a result of the accompanying strict central bank communication, market expectations for permanently high interest rates increased. Pricing for the December 2024 level of the Fed's policy rate rose to 4.8 percent by October, while expectations for the ECB peaked near 3.4 percent, meaning that the gap between the two central banks' expected interest rates widened to 140 basis points.

The communication of the decision-makers also further reinforced the growing divergence. As a result of the American CPI inflation data in March, which exceeded expectations for the third time in a row, the communication of the Fed's decision-makers became tighter. While at the beginning of March Fed Chairman Jerome Powell stated that they an interest rate cut was imminent, at the beginning of April he again stressed the need for a high policy rate for longer than expected. In recent months, other decision-makers of the Fed have also expressed uncertainty regarding the sustainability of disinflation and made interest rate cuts in the second half of the year dependent on future inflation data. At the same time, more and more ECB decision-makers committed themselves to the interest rate cut in June, which Christine Lagarde also confirmed, while also emphasising the ECB's independence from the Fed when deciding about the interest rate. At the press conferences following the June meetings, the presidents of both central banks emphasised the data-driven approach of decision-makers and did not commit themselves to any interest rate path in advance.

Chart 6-2: Market expectations for the average level of Fed and ECB policy rates in December 2024 (left) and December 2025 (right), together with the difference between the two



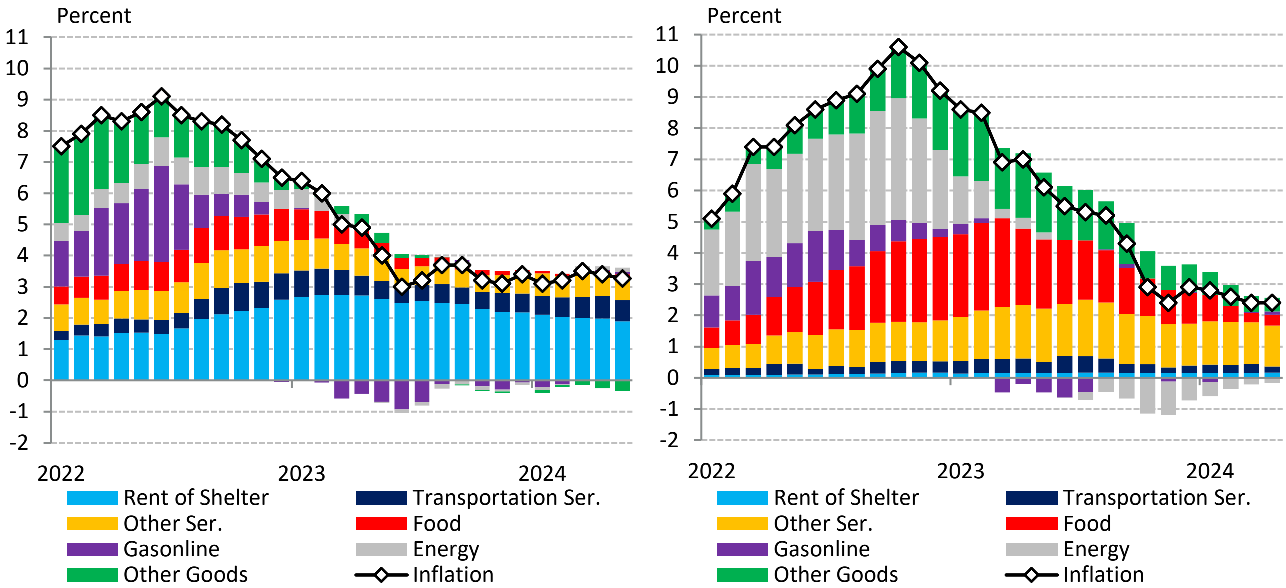
Source: Bloomberg, edited by MNB

In April of this year, the divergence between forward-looking interest rates reached a new peak. As a result of US inflation data that consistently exceeded forecasts, the Fed's communication became more and more cautious during the first quarter of this year, which had a significant impact on market interest rate expectations. The level of the Fed's policy rate set for this year's December interest rate meeting rose from 3.7 percent to 5.1 percent between January and April, and has since stayed between 4.8 percent and 5.0 percent. Since, in the case of the ECB, the effect of market expectations for a permanently higher interest rate was less pronounced, and the market pricing for the December level of this year's policy rate rose from 2.4 percent to 3.3 percent. As a result of diverging expectations, the divergence between the expected interest rates of the two central banks rose to a new peak, exceeding 180 basis points in April this year, and currently stands at around 165 basis points.

Based on market pricing, the difference between interest rates may persist. While the difference between policy rates expected by the end of 2024 rose to a new high as of April this year, the difference between the pricing in December 2025 also increased by 50 basis points to 200 basis points. The difference between the pricing of policy rates in December 2025 has since decreased to around 140 basis points, and thus compared to the interest rate differential expected for December this year, the policy rates may be somewhat closer to each other (Chart 6-2, right).

The different inflation dynamics contributed to the divergence in forward-looking interest rates, while inflation in the US and the euro area is also characterised by structural differences. In the US, the decrease in the CPI inflation index stopped at 3 percent, and, after a temporary increase, the annual rate of price increase stabilised at a level exceeding the central bank target by 1.1–1.5 percentage points (Chart 6-3, left). The disinflation trend in the euro area first reached its lowest point at 2.4 percent in November last year, and after a short, moderate rise, it returned to this level in the last two months (Chart 6-3, right). In the US, rent has been the dominant item in the annual consumer price index for more than a year, and the contribution of transport services has also become significant in recent months. The contribution of the latter two components to inflation is not significant in the euro area, where other services (e.g. hospitality and accommodation services or education) are keeping the annual price dynamics at an elevated level. In the US, goods net of food, fuel and energy moderated annual inflation to an increasing degree this year, in contrast to the euro area, where the contribution of these items is still positive, due to spirits and tobacco products, albeit to a lesser extent. Fuel and energy items, which play a major role in the upsurge of inflation in both economies, have contributed to disinflation for a long time. However, in recent months, their contribution has once again been in positive territory in the US, while the annual price index in the euro area was increased only by fuels in April.

Chart 6-3: Annual CPI inflation in the US (left) and HICP inflation in the euro area (right) by main items

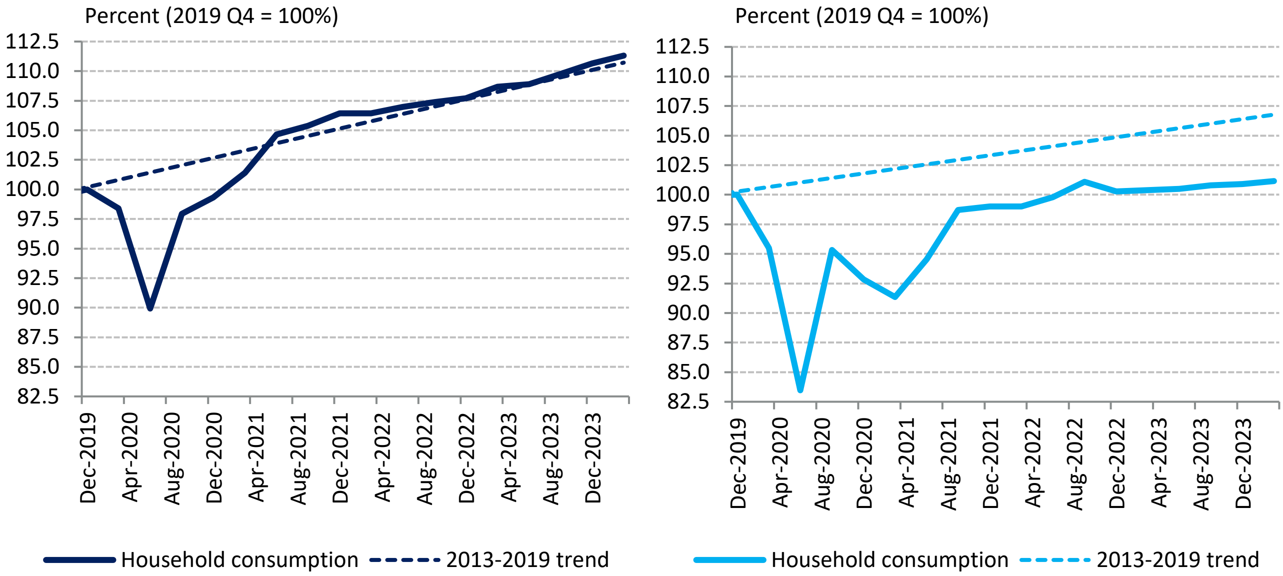


Note: In the figure, the latest inflation data is from May for the USA and April for the euro area.
Source: U.S. Bureau of Labor Statistics, Eurostat, edited by MNB

In addition to inflation exceeding the target to a greater extent, strong consumption may also justify a consistently stricter monetary policy in the US. In the recent period, the US economy expanded dynamically, while the economy of the euro area began to stagnate at the end of 2022 and contracted somewhat in the second half of 2023. After the pandemic, the consumption of households recovered in the US as early as in mid-2021, and since then has stayed at a level exceeding the trend between 2013 and 2019, which, due to the pressure on the demand side, may have contributed to keeping inflation high (Chart 6-4, left). By contrast, the euro area suffered a much more emphatic decline, with a weaker recovery. As a consequence, the consumption of households only reached the pre-pandemic level in 2022 Q3, and despite the decrease in inflation, it shows only slow growth (Chart 6-4, right).

In spite of the different cyclical positions, the labour market is tight in both economies. The unemployment rate in both economies is close to a historic low, at 3.9 percent in the US and 6.4 percent in the euro area in April of this year. In the euro area, the growth rate of wages based on wage negotiations accelerated again to 4.7 percent in 2024 Q1 from 4.5 percent in 2023 Q4, which may prompt ECB decision-makers to exercise caution. In the US, annual wage growth was at 3.9 percent in April, while the annual employment cost index was unchanged at 4.2 percent in 2024 Q1, which is still above a level consistent with the central bank's 2-percent inflation target.

Chart 6-4: Household consumption in the US (left) and the euro area (right)



Source: U.S. Bureau of Economic Analysis, Eurostat, edited by MNB

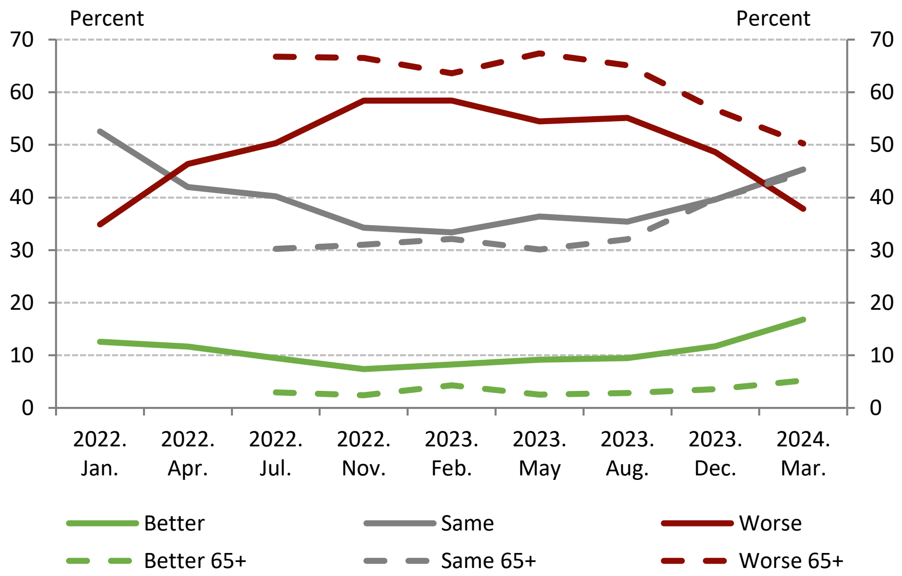
While market interest rate expectations for both the Fed and the ECB moved up in the past year, a significant divergence took place in terms of expectations regarding the durability of high interest rates, and the current interest rate differential between the two central banks may persist in the future. The primary reasons for this are the different dynamics of inflation and the cyclical position of economies. Overall, both central banks may take a cautious and gradual approach in their interest rate cuts, considering that there has been no material step forward in the disinflation process for a long time and that the labour markets are still tight in both economies, despite the significant tightening of monetary conditions.

6.2 The MNB's quarterly household survey indicates that households expect a better year ahead

In recent years, the MNB has been conducting a new, regular survey of the household sector, focusing primarily on the evaluation of households' financial wealth and their savings behaviour. Based on the experiences of the 2008 crisis, several new household-level data sources emerged in the 2010s (for example, the household credit register or the Household Finance and Consumption Survey [HFCS], conducted every three years) which had a significant contribution to tracking changes in the *distribution* of household wealth. At the same time, **COVID-19 highlighted that the three-year cycle of HFCS is too long in turbulent times, and the distribution of household wealth should be observed more frequently.** Therefore, from the summer of 2021, the MNB – similar to several other central banks – uses a small-sample survey to ask households about these processes and about their expectations, which also significantly influence economic decisions, on a quarterly basis. The unit of observation in the online survey is a household, and the sample is representative of the gender, age and education of the reference person and the region of the household. Originally consisting of 1,000 households with working-age household heads, the sample was supplemented with 300 households of retirement-age household heads starting from the fourth wave of the survey, i.e. from 2022 Q3.

According to the latest surveys, the perception of the financial situation of families has been gradually improving since the second half of 2023 (Chart 6-5). In 2022 H2, nearly 60 percent of those surveyed felt that they were in a worse situation than a year ago, and by the beginning of 2024, this ratio had fallen to 38 percent. Almost half of the respondents now feel that they are in roughly the same financial situation as they were a year ago, and 17 percent perceive their situation to be better. One typical trend is that households with a retirement-age household head are more pessimistic than those with a working-age household head, although the dynamics in the two groups are similar. (In the rest of this article, retirement-age and working-age will always refer to the head of the household.)

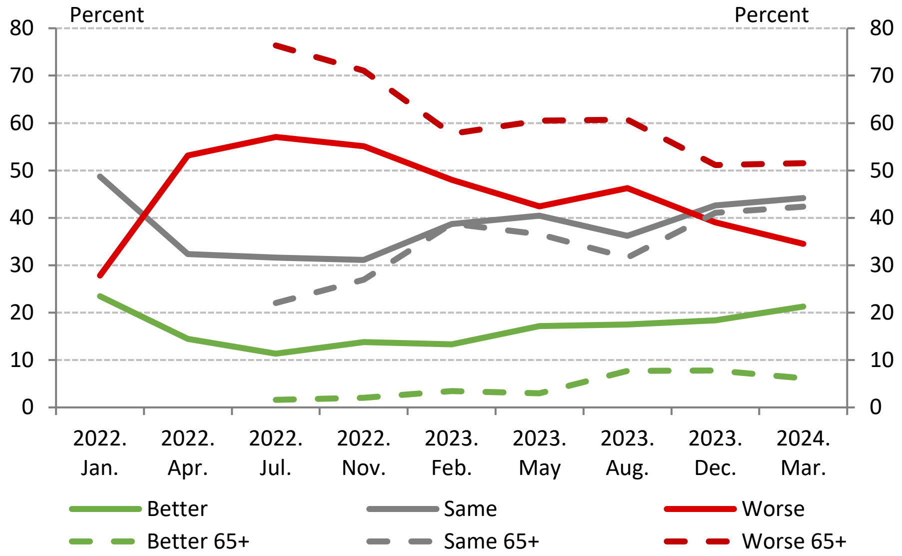
Chart 6-5: Assessment of the financial situation of households compared to the situation 12 months earlier



Source: MNB

Among working-age households, the proportion of optimists is even higher looking ahead to the next 12 months than when assessing the current situation (Chart 6-6). This has not always been the case throughout the survey's history. In April 2022, for example, most families already saw that they were facing a difficult year, and their predictions for the future were gloomier than their view of their situation at the time. The survey conducted in the first quarter of this year indicated one of the highest ratios of optimists and one of the lowest number of pessimists. More favourable values were measured only in January 2022, after the announcement of family tax refunds and before the outbreak of the Russian-Ukrainian war.

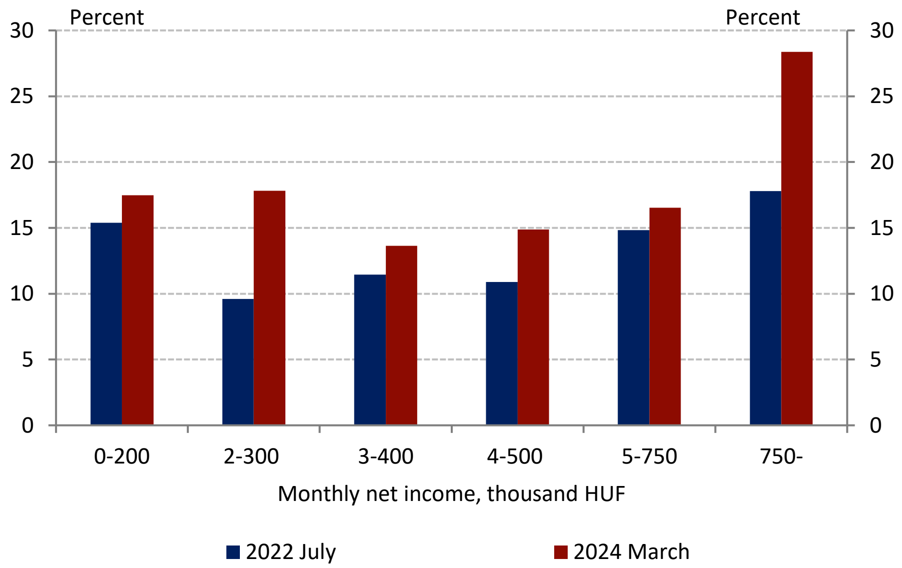
Chart 6-6: Expected development of the financial situation of households in the following year



Source: MNB

The improved perception is closely related to the fact that working-age households see a much higher chance of an increase of real wages than in the summer of 2022 (Chart 6-7). Households with the highest incomes have the most optimistic expectations for income growth. But even among low-income earners, the proportion of those who believe that their wages will increase more than their living costs in the next 12 months has increased significantly.

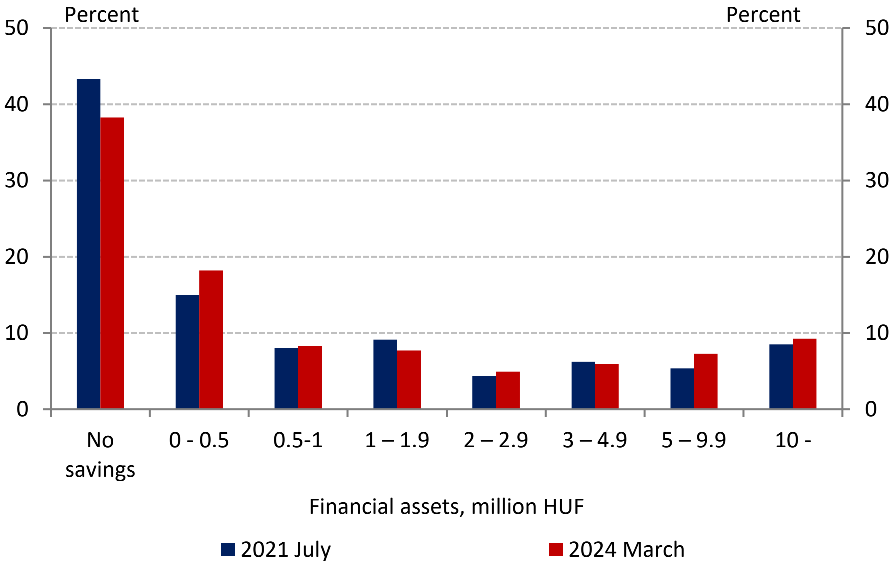
Chart 6-7: Chance of an increase in income exceeding the increase in the cost of living, among the employed by income group



Source: MNB

The increase in household savings has been widespread over the past nearly three years. Currently, 5 percentage points fewer people say that they have no savings, while the number of those with savings between HUF 0 and 0.5 million has risen (Chart 6-8). There was a significant shift at the other end of the distribution as well, with the proportion of those with more than HUF 5 million in savings having increased by 2.7 percent. Even though our survey methodology is unlikely to provide an accurate picture of very wealthy families, there was a shift in the same direction here as well.

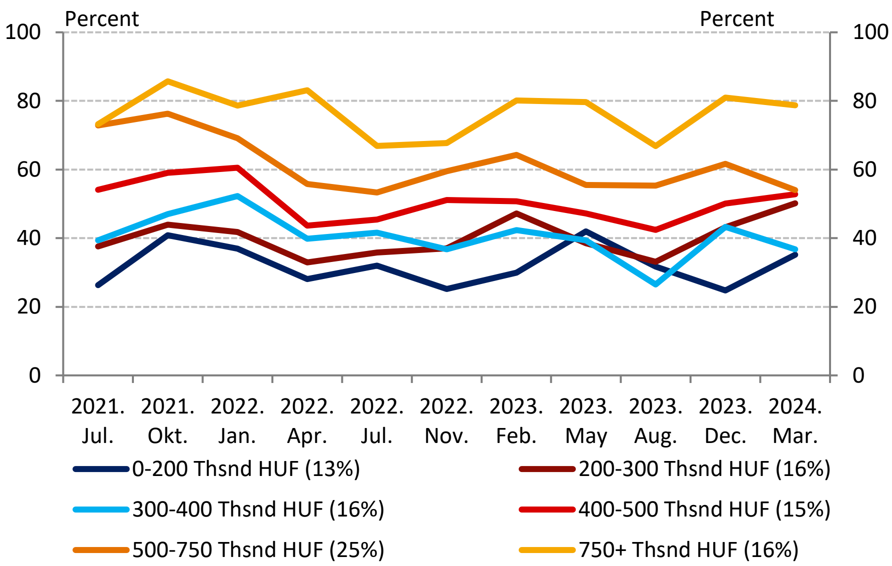
Chart 6-8: Distribution of financial savings among working-age people



Source: MNB

Looking ahead, savings plans remain high in most income categories. According to the survey, the proportion of those planning to save increases together with the income, but remains stable for most groups. In other words, a significant reduction or increase in the intention to save in the future is not typical. The only exception to this is the group with the second highest income, where the proportion of those planning to save has dropped significantly. Although the 73-percent figure measured in the summer 2021 survey is probably an exceptionally high value due to the forced savings during the pandemic, this figure has fallen by 19 percentage points for this group since then. In the spring of 2024, other income groups, however, reported similar figures for planned savings as in the previous quarters (Chart 6-9).

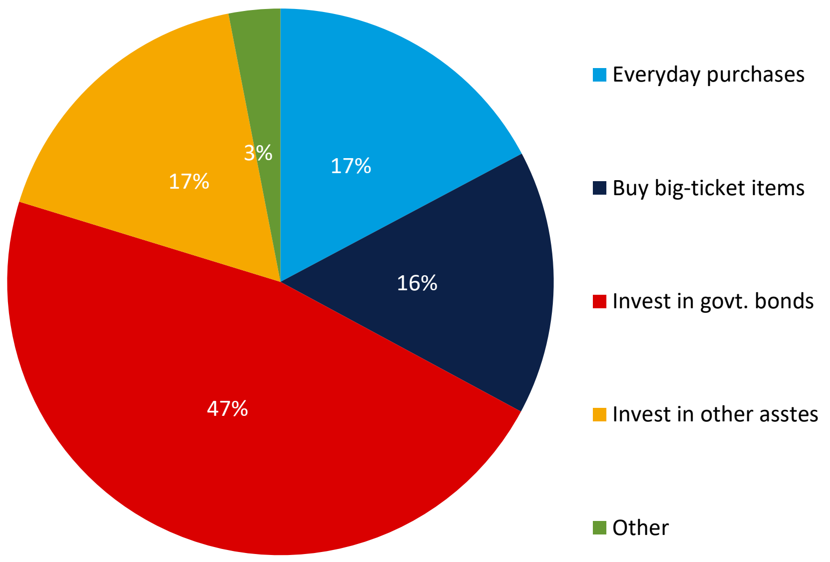
Chart 6-9: Savings plans in various income groups, among working-age people



Note: The share of income groups among households with a working-age main earner is shown in brackets
Source: MNB

Interest incomes from retail government bonds are likely to be saved by two thirds of the bondholders (Chart 6-10). In 2024, households will receive a significant interest income of more than HUF 1,400 billion from government securities. The use of this significant amount of interest income is a key issue for the development of savings and consumption decisions this year. The survey has shown that more than 65 percent of those receiving interest incomes plan to reinvest it, with about one half of the respondents planning to reinvest it in government securities. Of the more than 30 percent that plan to consume this income, about one half are planning to use it for regular expenditures and the other half for larger expenditures.

Chart 6-10: Planned use of interest paid on government securities



Note: The question was posed to 18.7 percent of the sample, who held government securities based on the March 2024 survey.
Source: MNB

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Mátyás Hunyadi

(23 February 1443 – 6 April 1490)

He ruled from 1458 to 1490 as King of Hungary, and had been Czech king from 1469 and Prince of Austria from 1486. Hungarian tradition regards him as one of the greatest Hungarian kings whose memory is preserved in many folk tales and legends. He is also known as Matthias Corvinus, King Matthias the Just or officially as Matthias I, but commonly he is simply denoted as King Matthias.

His father, János Hunyadi, the regent of Hungary, was one of the most outstanding military leaders and strategists in the country's medieval history who triumphed at the Battle of Nándorfehérvár in 1456. Matthias' mother was Erzsébet Szilágyi, and he had an elder brother, László Hunyadi. The future king was brought up by his mother and nurse until the age of six, and was subsequently placed under the supervision of his tutors. János Hunyadi did not have a chivalrous education in mind for his son: first, it was a Polish humanist, Gergely Szánoki who introduced him to the realm of knowledge, then this task was assigned to János Vitéz. Mátyás was brought up and educated in a humanistic spirit to become a versatile and curious-minded person who had been taught canon and constitutional law, arts and Latin. In addition to Hungarian, he also spoke German and Czech.

After the death of László V, his uncle, Mihály Szilágyi, and the armed forces supporting Hunyadi exercised pressure to have Matthias crowned as King of Hungary on 24 January 1458. Even in the early years of his reign Matthias had troubles both with the magnates of the country and Emperor Frederick III of the Holy Roman Empire. As the king was still a minor, parliament appointed Mihály Szilágyi to act as regent on his behalf. However, Matthias did not tolerate any guardianship and pushed his uncle to the background who devised a plot against the king in response. Returning from battle with the Turks, the king had the rebels captured and he imprisoned his uncle in the castle of Világos.

Upon his ascension to the throne the annual income of the treasury hardly exceeded 110 to 120 thousand forints. During his rule spanning thirty-two years the king managed to multiple revenues from taxes. Considering the average of the taxes levied, less the revenues from the Czech and Austrian provinces, this yearly amount approximated 628,000 forints and may as well reached 900,000 gold forints in the most prosperous years. This was still much less than the annual revenue of the western powers of the age. In order to raise the low income of the treasury, reform-like and comprehensive financial actions were needed. Matthias recognised that a centralised, nationwide financial system was the only solution to the problem, and that the royal revenues had to be directed to a single person, the treasurer. The reforms of Matthias were adopted by parliament and his decrees were promulgated on 25 March 1467.

We can get a glimpse of the cultural life in the royal court, which represented the elite of European civilisation at the time, at the partly reconstructed Royal Palace in Visegrád. The most distinguished pieces of the cultural legacy of Matthias are the Corvinian books, richly illustrated volumes of the former royal library.

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