INFLATION REPORT

2024
SEPTEMBER

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

Miklós Zrínyi: The Life of Matthias Corvinus

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Act CXXXIX of 2013 on the Magyar Nemzeti Bank designates achieving and maintaining price stability as the primary objective of the Magyar Nemzeti Bank (MNB), the central bank of Hungary. Over the long term, low inflation ensures higher economic growth and a more predictable economic environment, while moderating the cyclical fluctuations that impact both households and companies. Without prejudice to its primary objective, the MNB supports the maintenance of the stability of the financial intermediary system and the enhancement of its resilience and its sustainable contribution to economic growth, as well as the economic and environmental sustainability policy of the government using the instruments at its disposal.

In the inflation targeting system in use since August 2005, the central 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 Monetary Council takes its decisions on the basis of and in accordance with the objectives set out in the Act on the Magyar Nemzeti Bank. Accordingly, in its decisions, it takes into account, among other things, 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 the central bank's monetary policy works and to enhance transparency, the Bank publishes the information available at the time of making its monetary policy decisions. The Inflation Report presents the inflation forecasts prepared by the Directorate Economic Forecast and Analysis, the Directorate Monetary Policy and Financial Market Analysis, the Directorate Fiscal 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 Executive Director of Economic and Fiscal Analysis 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 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 19 September2024.

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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 and environmental sustainability policy.

Although economic output in the European Union expanded somewhat, in line with expectations, the adverse outlook for European industrial production, the ongoing war between Russia and Ukraine and a generally tense geopolitical situation remain key risks.

The EU economy expanded by 0.8 percent in 2024 Q2 year-on-year. However, the economic performance of Germany, Hungary's main trading partner, stagnated on an annual basis, primarily due to falling investment. On a quarter-on-quarter basis, the German economy contracted again after 2023 Q4, and most sentiment indicators suggest that no meaningful trend change is expected in the near future. In 2024 Q2, US GDP grew at an accelerating pace of 3.1 percent, while growth in the Chinese economy slowed down somewhat to 4.7 percent. The external outlook is uncertain due to the weak outlook for European industrial production, while the ongoing Russia-Ukraine war and the generally tense geopolitical situation remain key risks.

In the European Union, after a halt in disinflation at the end of last year, inflation fluctuated between 2.6 and 3.4 percent over the past six months before falling to 2.4 percent in August.

Eurozone inflation eased to 2.2 percent in August from between 2.4 percent and 2.8 percent in previous months. In most EU countries – 20 countries – inflation moderated compared to July. In the region, inflation rose somewhat in Poland (4.3 percent) and Slovakia (2.8 percent), remained stable (at 2.2 percent) in the Czech Republic, and fell in Romania (5.1 percent) in August, according to their respective national statistical offices. Inflation in the United States fell to below 3 percent for the first time in two years, to 2.9 percent in July and to 2.5 percent in August.

Regarding major global central banks, the European Central Bank (ECB) cut its policy rate by 25 basis points in September. At the Federal Reserve's (Fed's) September rate decision meeting, the key policy rate was decreased by 50 basis points to 4.75–5.00 percent. In the region, the Czech central bank continued to cut its policy rate, and its Romanian counterpart also started lowering interest rates. The Bank of Poland kept the base rate unchanged over the past quarter.

In the United States, the Fed cut the federal funds target range by 50 basis points to 4.75–5.00 percent at its September policy meeting. In recent months, although there has been further progress towards the central bank's 2 percent inflation target, inflation has remained somewhat elevated. According to policymakers' new interest rate path forecast, the policy rate may, in total, fall by a further 50 basis points this year. At the press conference following the decision, the chair of the Fed said that the interest rate cut was aimed at keeping the US labour market and economy in their current strong state. The ECB continued to decrease its policy rate at its September policy meeting, after keeping it unchanged in July. At the press conference following the decision, the President of the ECB said that the central bank would continue to base its decisions on incoming data. The ECB has reduced its holdings of securities purchased under the pandemic emergency purchase programme (PEPP) by an average of EUR 7.5 billion per month since the beginning of July.

In the region, the Czech central bank continued the interest rate reduction started last December by 50 basis points in June and by 25 basis points in August, reducing the policy rate to 4.5 percent. Poland's central bank kept its base rate unchanged at 5.75 percent, while Romania's central bank cut its benchmark rate by 25-25 basis points in July and August, bringing it down to 6.5 percent.

In the past quarter, global investor sentiment was primarily influenced by the financial market turbulence of early August, expectations about the interest rate policy of major central banks and concerns about geopolitical conflicts.

At the beginning of August, global financial markets experienced a temporary period of considerable volatility. This was driven by deteriorating investor sentiment due to weaker-than-expected US data, as well as financial market turbulence in Japan following the Japanese central bank's interest rate hike. Movements were the strongest in equity markets, but exchange rates and long-term yields also moved significantly.

Statements by policymakers of major central banks and incoming macroeconomic data led to a substantial downward shift in interest rate paths as priced by markets. Based on these, the Fed and the ECB may cut their policy rates multiple times this year. At the same time, long-term bond yields also fell in developed and emerging markets. The US and German 10-year yields fell to around 3.6 and 2.1 percent, respectively, while regional yields declined by 30-50 basis points. Currencies in developed economies mostly strengthened against the dollar in the past quarter.

Oil prices moderated, while European gas prices rose somewhat over the period. The intermittent intensification of the conflict in the Middle East temporarily pushed up per barrel oil prices, but expectations of demand weakening further led to an overall decline in the last quarter.

Regarding the forint, overall, band trading was typical over the past quarter, with several changes in direction. Similar to interbank yields, government bond yields fell in the quarter.

The forint strengthened against the euro following the June interest rate decision, before depreciating as global sentiment deteriorated. As investor sentiment improved, the domestic currency strengthened in mid-August, then showed moderate movements. Overall, the forint was characterised by several changes to its direction, however, on a quarter-on-quarter basis, similar to most other currencies in the region, it was characterised by slight movements against the euro, while it strengthened against the US dollar. The short and the long section of the government bond yield curve declined by 90 and 35-45 basis points, respectively. Short-term interbank interest rates decreased by 40-50 basis points across all maturities, allowing submarket rates to track the decline in the base rate.

Inflation in Hungary fell back into the tolerance band in August, with consumer prices rising by 3.4 percent year-on-year. On average, inflation may range between 3.5–3.9 percent this year, between 2.7–3.6 percent in 2025 and between 2.5-3.5 percent in 2026.

In July 2024, inflation rose to 4.1 percent, before easing back into the tolerance band in August to 3.4 percent, in line with the forecast in the June Inflation Report. The fall in inflation in August was primarily due to a decline in fuel price inflation which was largely driven by base effects. Higher food repricing in July was followed by a correction in prices in August. The year-on-year rate of increase in core inflation was 4.6 percent in August. Household inflation expectations are on a downward trend, but display more volatility than usual.

Although the volatility of inflation will persist until the end of this year, the disinflationary trend is expected to continue from 2025 Q1. The consumer price index is expected to fall further in September and to rise slightly above 4 percent by the end of 2024. Continued disinflation in 2025 Q1 will be underpinned by a lower external cost environment and more moderate retrospective repricing next year. Core inflation capturing underlying developments is likely to rise in the coming months, fluctuating around 5 percent during the rest of the year. According to the MNB's projection, annual inflation is expected to be between 3.5 and 3.9 percent this year on average. Inflation is expected to be between 2.7 and 3.6 percent in 2025 and between 2.5 and 3.5 percent in 2026. The MNB's projection for 2025 has been revised upward compared to the June inflation projection, primarily reflecting the pass-through of a rise in financial transaction fees into consumer prices. Anchoring inflation expectations, preserving financial market stability and a disciplined monetary policy are crucial for the consumer price index to return to the central bank target in a sustained manner in 2025.

Although GDP growth continued on an annual basis in 2024 Q2, domestic economic performance was weaker on a quarterly basis. Therefore, growth, mainly supported by household consumption, is likely to remain subdued this year. The Hungarian economy is expected to grow by 1.0–1.8 percent in 2024, by 2.7–3.7 percent in 2025 and by 3.5-4.5 percent in 2026.

In 2024 Q2 the Hungarian economy grew by 1.5 percent on an annual basis, while it contracted by 0.2 percent on a quarterly basis, according to the Hungarian Central Statistical Office. Consumption growth continued in line with rising real wages and a historically high level of employment. Household consumption picked up by 4.2 percent in the second quarter on a yearly basis, supporting GDP growth by 2.0 percentage points. A sharp fall in investment held back economic growth by 4.3 percentage points. Investment fell in the sectors producing for the domestic and export markets and in others indirectly linked to the state, which was only partly offset by the increase seen in the sectors directly linked to the government and household sectors. With exports falling by 1.8 percent and imports by 3.2 percent, the contribution of net exports to economic growth was 1.0 percentage point in the second quarter of the year. With employment at high levels, labour market tightness has eased in recent quarters. The unemployment rate stood at 4.2 percent in July.

Gradually rising household consumption will be the main driver of domestic GDP growth in 2024. The consumption-boosting impact of strong real wage growth and stable employment will become more pronounced over the rest of the year. At the same time, public and corporate investments are expected to fall this year, while residential investments are expected to rise. Overall, the volume of investments is expected to moderate this year, causing a significant slowdown in economic growth. Underinvestment in the corporate sector will start to be partially offset with a permanent improvement in demand from 2025 onwards. Subdued European economy will continue to hold back domestic exports in the short term. However, ongoing and newly announced, significant capacity-enhancing foreign direct investment projects will continue to stimulate exports in the coming years as demand returns; therefore, Hungary's export market share is likely to increase. Hungary's GDP is expected to grow by 1.0–1.8 percent in 2024, by 2.7–3.7 percent in 2025 and by 3.5–4.5 percent in 2026.

The household credit market picked up in 2024 H1; however, the corporate sector is still characterised by a wait-and-see approach regarding credit demand.

The annual growth rate of corporate loans in the total financial intermediary system accelerated by 1.6 percentage points compared to the previous quarter, reaching 4.7 percent at the end of 2024 Q2. However, the annual credit dynamics for micro, small and medium-sized enterprises was only 0.7 percent. In the second quarter of the year, the value of newly originated corporate loans other than current account loans was approximately the same as a year earlier. At the same time, banks' responses to the Lending Survey showed no change in demand in the second quarter; nevertheless, several institutions indicated an increase in demand looking ahead to 2024 H2. Given the continued uncertain outlook for economic growth, the annual growth rate of corporate credit is expected to be 4 percent at the end of 2024 before stabilising at around 8–9 percent from 2025 H2.

In 2024 Q2, the annual growth rate of household credit accelerated by 1.5 percentage points compared to the previous quarter, reaching 5.1 percent. The total amount of home loans originated by credit institutions in the second quarter of the year increased by 167 percent compared to the low base of the previous year, while that of personal loans originated was 55 percent higher. The increase in new loan contracts was also supported by changes to family allowances at the beginning of the year, and the voluntary APR cap in place between 9 October 2023 and 30 June 2024. Based on the responses to the Lending Survey, banks reported rising demand for both home loans and consumer loans in the second quarter, and they expect further growth in demand in the consumer loan market. The annual growth rate of household loans is expected to reach nearly 9 percent at the end of 2024 and to fluctuate around 10 percent from the beginning of 2025.

The current account continues to improve gradually.

The improvement in the external position is likely to continue in 2024. The increase in the current account surplus this year will be largely due to a more favourable goods balance, driven by a further rise in the terms of trade and falling imports, coupled with a decline in investment. From 2025 onwards, a rising export market share resulting from the more intense use of existing capacities and new investments will be reflected in a further improvement in the external position. The surplus on services will stabilise above 5 percent of GDP in the coming years. As a result, the current account surplus is expected to reach 2 percent of GDP in 2024 and is likely to be around 2.0–3.4 percent of GDP in 2025 and around 2.3-3.9 percent of GDP in 2026.

The announced deficit reduction measures will support the attainability of fiscal deficit targets for 2024 and 2025, which also requires keeping fiscal expenditure under control. The budget deficit-to-GDP ratio is likely to be between 4.3 and 4.7 percent in 2024, 3.2 and 4.2 percent in 2025 and between 2.8 and 3.8 percent in 2026. According to the MNB's projection, the primary balance excluding interest expenditures is likely to reach near equilibrium levels over the entire forecast horizon. In parallel with a gradual decline in government interest expenditures, the fiscal balance is expected to improve in the coming years. For the debt ratio to continue declining in 2024 and Hungary's risk perception to improve, it is necessary to achieve the set deficit targets in a credible manner. With the improvement in economic activity over the forecast horizon and the decline in government deficit, the government debt-to-GDP ratio is expected to decrease from the projected level of 73.2 percent in 2024 to 72.3 percent in 2025 and to 70.8 percent in 2026.

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

The Monetary Council highlighted four alternative risk scenarios around the baseline projection in the September Inflation Report. A scenario that assumes faster-than-expected interest rate cuts by major central banks is consistent with lower inflation and higher growth. Both economic growth and inflation are likely to be lower compared to the baseline in a scenario that assumes prolonged weakness in European economic activity. A faster unwinding of precautionary motives means that the path would suggest a faster recovery in consumption, which is consistent with a higher growth and inflation path. A scenario reckoning with slower growth in investments assumes a lower inflation and growth path.

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	4.6 - 4.9	3.2 - 3.8	2.6 - 3.3
Core inflation excluding indirect tax effects	18.1	4.6 - 4.9	3.0 - 3.6	2.6 - 3.3
Inflation	17.6	3.5 - 3.9	2.7 - 3.6	2.5 - 3.5
Economic growth				
Household final consumption expenditure	-2.2	3.4 - 4.0	3.4 - 4.4	2.9 - 3.9
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	(-7.2) - (-5.8)	1.5 - 4.5	1.5 - 4.5
Domestic absorption	-5.6	(-1.1) - 0.3	2.1 - 3.7	1.9 - 3.4
Exports	0.9	(-1.5) - (-0.3)	4.9 - 6.7	5.3 - 7.1
Imports	-4.3	(-3.8) - (-2.6)	4.7 - 6.7	3.4 - 5.4
GDP	-0.9	1.0 - 1.8	2.7 - 3.7	3.5 - 4.5
Labour productivity[2]	-1.1	0.9 - 1.2	2.6 - 3.6	3.3 - 4.6
External balance[3]				
Current account balance	0.2	1.4 - 2.6	2.0 - 3.4	2.3 - 3.9
Net lending	1.2	2.7 - 3.9	4.0 - 5.4	4.2 - 5.8
Government balance[3]				
ESA balance	-6.7	(-4.7) - (-4.3)	(-4.2) - (-3.2)	(-3.8) - (-2.8)
Labour market				
Whole-economy gross average earnings[4]	14.3	12.8 - 13.2	7.5 - 8.6	7.8 - 9.1
Whole-economy employment	0.6	0.4 - 0.5	(-0.3) - 0.4	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	11.6 - 11.9	8.0 - 8.9	7.1 - 8.2
Private sector employment	1.0	0.3 - 0.4	0.0 - 0.5	0.0 - 0.5
Unemployment rate	4.1	4.2 - 4.3	3.6 - 3.9	3.3 - 4.0
Private sector nominal unit labour cost	17.7	11.4 - 12.0	3.5 - 5.0	2.7 - 4.4
Household real income[5]	0.7	5.7 - 6.1	2.6 - 3.8	2.6 - 3.8

[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.

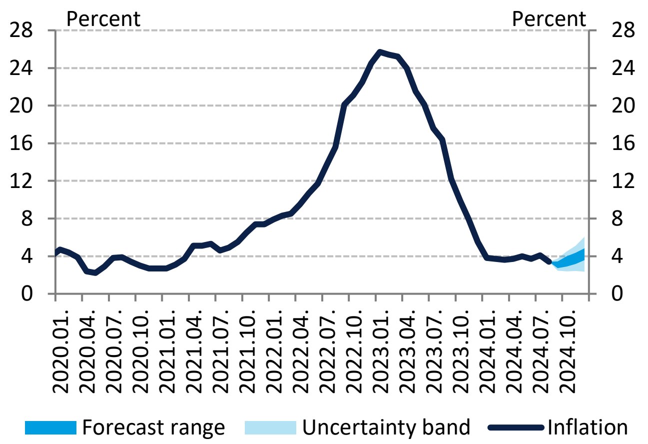
[5] MNB estimate.

1 Inflation and real economy outlook

1.1 Inflation forecast

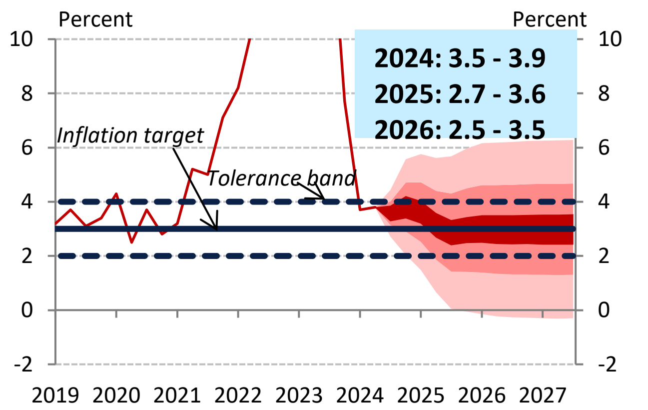
Inflation returned to the tolerance band in August, with consumer prices rising at a year-on-year rate of 3.4 percent. The volatility in inflation is expected to persist this year, the disinflationary trend will resume from the first quarter of 2025. According to our forecast, inflation will continue to decline in September, before rising moderately to above 4 percent by year-end. Core inflation, which captures underlying processes, will rise in the coming months, and likely remain at around 5 percent for the rest of the year. In the first quarter of 2025 disinflation will resume, which will be supported by a low extrernal cost environment, and next year's lower backward-looking repricings. 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. Inflation may average between 3.5 and 3.9 percent this year, between 2.7 and 3.6 percent in 2025 and between 2.5 and 3.5 percent in 2026. Annual core inflation excluding indirect taxes is projected at 4.6–4.9 percent in 2024, 3.0–3.6 percent in 2025 and 2.6–3.3 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



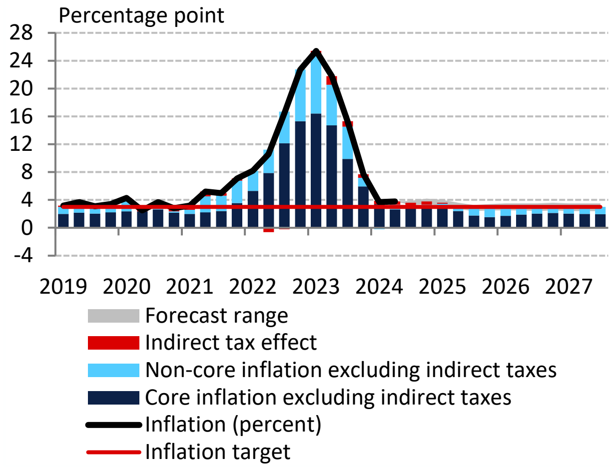
Note: Based on seasonally unadjusted data.
Source: HCSO, MNB

The volatility in inflation is expected to persist this year, the disinflationary trend will resume from the first quarter of 2025. Inflation is forecast to continue declining in September and then rise moderately above 4 percent by year-end (Chart 1-1). Core inflation, which reflects underlying developments, will rise in the coming months, and likely remain around 5 percent for the rest of the year. **In the first quarter of 2025 disinflation will resume, which will be supported by a low extrernal cost environment, and next year's lower backward-looking repricings. The consumer price index will return to the central bank's inflation target on a sustained basis in 2025**. Compared to our June forecast, we project unchanged inflation this year and moderately higher inflation next year. Our higher forecast for 2025 is explained by the pass-through of the increase in the financial transaction levy into consumer prices. **Inflation may range between 3.5 and 3.9 percent in 2024, between 2.7 and 3.6 percent in 2025 and between 2.5 and 3.5 percent in 2026 on an annual average** (Chart 1-2).

We forecast that core inflation excluding indirect taxes, which captures underlying inflation developments, will range from 4.6–4.9 percent in 2024, 3.0–3.6 percent in 2025 and 2.6–3.3 percent in 2026. Our forecast for core inflation excluding indirect taxes next year is higher compared to the June forecast. The main reason for this is that from January 2025 the increase in the financial transaction levies will primarily be reflected in higher prices for market services.

The subdued food price changes seen in recent months have been supported by year-on-year declines in global food commodity prices. For unprocessed food products, annual inflation in this product group is projected at around

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		4.6 - 4.9	3.0 - 3.6	2.6 - 3.3
Core inflation		4.6 - 4.9	3.2 - 3.8	2.6 - 3.3
Non-core inflation	Unprocessed food	1.0	4.6	4.3
	Fuel and market energy	-0.7	-0.6	2.9
	Regulated prices	2.4	2.3	2.2
	Alcohol and tobacco	4.6	3.5	3.4
Inflation		**3.5 - 3.9**	**2.7 - 3.6**	**2.5 - 3.5**

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

1.0 percent this year, 4.6 percent next year and 4.3 percent in 2026.

The price of fuel and market energy is expected to decrease by an annual average of 0.7 percent this year. The annual price change for this product group may amount to -0.6 percent next year and 2.9 percent in 2026 (Table 1-1). Our assumption for global oil prices in USD has declined versus the June report. The price of Brent crude oil fluctuated around USD 80/barrel in August, with significant volatility, but then dropped to around USD 70 in early September. The elevated volatility of global oil prices in recent months adds uncertainty to our fuel price forecast. European gas and electricity prices remain below levels from before the Russia-Ukraine war, with prices moving in a span of EUR 30–40/MWh. Inflation for goods and services with regulated prices is forecast to average around 2.4 percent in 2024. Our analysis is based on the technical assumption that the 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 developments in external factors. A brief presentation of 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	1.08	1.09	1.08	1.11	1.08	1.11	0.8%	2.2%	2.2%
Oil (USD/barrel)	81.1	79.7	77.0	71.8	75.7	71.2	-1.7%	-6.7%	-5.9%
Oil (EUR/barrel)	74.9	73.1	71.0	64.9	69.8	64.3	-2.4%	-8.7%	-9.6%
Gas (EUR/MWh)	33.4	33.4	37.9	38.5	37.6	38.8	0.0%	1.6%	3.3%
Euro area inflation (%)	2.5	2.5	2.2	2.2	1.9	1.9	0.0 pp.	0.0 pp.	0.0 pp.
Euro area real GDP (%)	0.9	0.8	1.4	1.3	1.6	1.5	-0.1 pp.	- 0.1 pp.	-0.1 pp.
GDP growth of Hungary's main export partners* (%)	1,2 - 1,8	1,2 - 1,8	1,9 - 2,7	1,5 - 2,2	1,3 - 2,2	1,3 - 2,2	0.0 pp.	-0.4 pp.	0.0 pp.

Our forecast for external demand this year is unchanged, while it has been lowered somewhat for next year. In the second quarter, economic growth in the European Union was 0.8 percent, in line with expectations. Growth was supported by a small increase in household consumption in most Member States. In the US, GDP growth accelerated moderately, with the US economy expanding by 3.1 percent on an annual basis and 0.7 percent on a quarterly basis. China's annual growth in 2024 Q2 was in line with expectations: the rate of 4.7 percent was lower than in the first quarter, while GDP expanded by 0.7 percent on a quarterly basis. With consumer confidence low, retail sales growth slowed, while industrial production showed steady growth on an annual basis. In terms of external economic trends, there continue to be risks related to the unfavourable outlook for industrial production in Europe, as well as the ongoing war between Russia and Ukraine and the generally tense geopolitical situation. In 2024 Q2, global industrial production remained subdued and world trade stagnated. Business confidence indicators reveal that consumer confidence in EU economies remains low, despite some improvement. Business sentiment stagnated in services and deteriorated somewhat in industry. The global and European growth outlook for this year is unchanged from the June forecast, and our external demand assumption for this year has also not changed. Given the risks to the European economy and industrial production in particular, our expectations for next year are lower than in June.

The ECB expects the inflation path to remain unchanged from its June forecast over the full forecast horizon. According to the ECB's September forecast, euro area inflation may reach 2.5 percent this year, 2.2 percent in 2025 and 1.9 percent in 2026. The ECB projects euro area GDP growth in 2024 to be 0.1 percentage point lower than the previous forecast, thus anticipating growth of 0.8 percent this year. Growth in 2025 is expected to also be 0.1 percentage point lower compared to June, and thus next year's growth rate may come in at 1.3 percent.

The price of Brent crude oil was volatile in the summer months and then fell sharply from end-August. In early September, the price of Brent reached a three-year low. The decline was driven by OPEC+'s downward revision of its demand forecast, weaker-than-expected economic performance in China and strong storms in the Gulf of Mexico. The price of Brent crude oil is currently at around USD 70 per barrel. Geopolitical conflicts may continue to pose significant risks to the evolution of global oil prices. The difference between the price of Brent and Russian Ural crude persisted during the past period.

Domestic prices for petrol and diesel have fallen significantly, in line with global oil prices in recent months. Russian Ural crude oil continues to reach Hungary via pipeline. Brent is the benchmark for petrol 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, market prices of petrol and diesel increased in Hungary from the second half of June, but from the end of August onwards both fuel prices started to fall significantly.

Global gas and electricity prices remain below pre-Russia-Ukraine war levels. 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. Following a steady decline in gas prices since December 2022, the Dutch TTF gas price is currently around EUR 30–40/MWh. In 2024 Q3, European gas prices are more volatile than in the first half of the year, driven by elevated geopolitical risks, in particular uncertainties over transit flows in Ukraine, and unpredictable weather conditions. Changes in gas prices also affect electricity prices through gas-fired power plants. Electricity prices spiked in early September, but have since consolidated. The 7-day moving average for the German Phelix electricity price was around EUR 86 last month, which is still well below the average price of nearly EUR 100 for 2023.

The budget deficit-to-GDP ratio is projected to be between 4.3–4.7 percent in 2024, 3.2–4.2 percent in 2025 and 2.8-3.8 percent in 2026, depending on macroeconomic developments and the degree of fiscal discipline. The deficit-reducing measures announced in early July, lower energy expenditures due to the stabilisation of energy prices and decreasing public investment expenditure are factors that support the achievement of the deficit target for 2024, while lower-than-planned tax revenues and high government interest expenditure make it difficult to reach the target, therefore it is necessary to maintain control over expenditures for the rest of the year. Continued reduction in the debt-to-GDP ratio in 2024 and improvement in domestic risk require that the deficit targets be achieved in a credible manner.

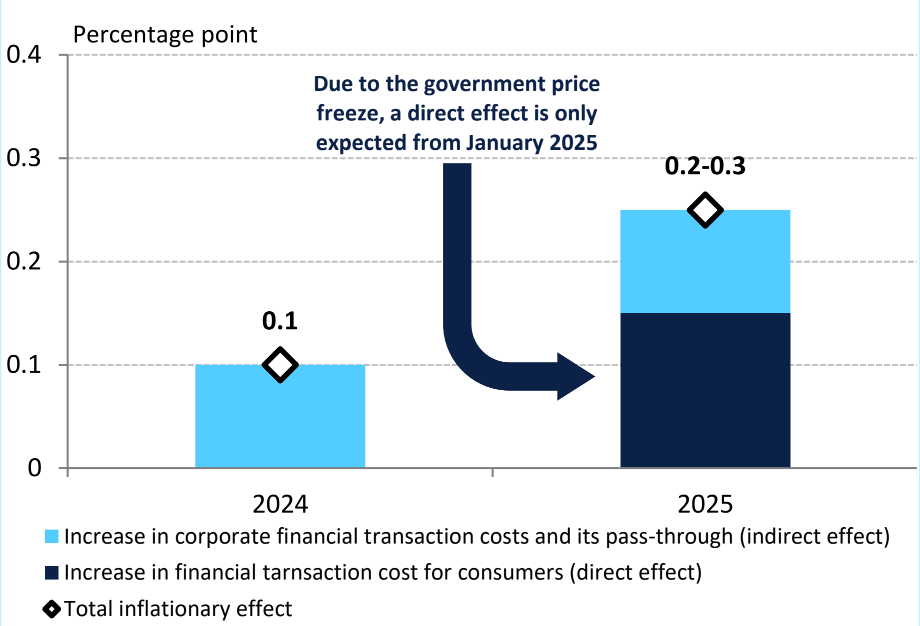
Based on August budget data, EU payments continue to be substantially lower than expected on the basis of the appropriations. Hungary has access to a total of EUR 12.2 billion in the 2021-2027 cohesion cycle. However, access is still not available to the Recovery and Resilience Facility (RRF) and cohesion funds representing and amount of close to EUR 20 billion, which is linked to the implementation of the 27 super-milestones defined by the Commission.

Box 1-2: Inflationary impact of the introduction of the transaction levy

Pursuant to the Government's July budget measures, the financial transaction levy is increasing from 1 August 2024. The decision will affect the rate of tax paid on general bank transfers, which will increase from 0.3 percent to 0.45 percent, and its maximum amount will increase from HUF 10,000 to HUF 20,000. For cash withdrawals, the levy will increase from 0.6 percent to 0.9 percent. At the same time, the tax-free limit for transfers, postal payments and securities transactions will also increase from HUF 20,000 to HUF 50,000. The government has also introduced a freeze on the increase of fees and charges for retail payment accounts until 31 December 2024. The measure includes the introduction from 1 October 2024 of an additional levy on top of the current one, which will be 0.45 percent on top of the standard levy for transactions involving foreign currency conversion. The maximum additional levy is HUF 20,000 per transaction.

The Magyar Nemzeti Bank estimates that the increase in the transaction levy may increase average annual inflation by 0.1 percentage point this year and by 0.2-0.3 percentage point next year. The measure may feed through to consumer prices via two channels: while the increase in bank charges for the public has a direct impact on inflation, the increase in bank charges for businesses has an indirect impact. Credit institutions and payment service providers will not be able to pass on the increased levy to retail consumers on existing contracts until the end of 2024, so the direct effects will not be felt in market services inflation until the beginning of 2025 at the earliest. By contrast, indirect effects could affect inflation trends already for the rest of 2024, but the pass-through could be gradual, in parallel with corporate repricing to take place this year and early next year. The extent of the pass-through into prices may be moderated by the continued subdued level of demand and the fact that corporate profits, which have risen during the inflationary surge of previous years, remain high and provide an opportunity for enterprises to limit the passing on of the additional costs to consumers.

Chart 1-4: Expected inflationary impacts of the increase in the transaction levy



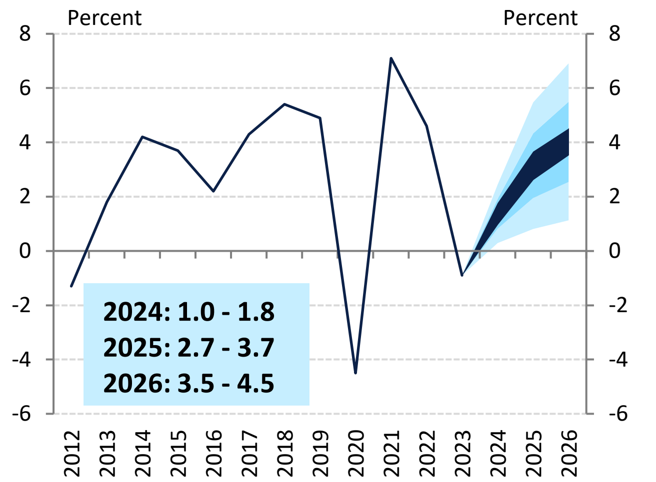
Source: MNB estimation

The additional levy on currency conversion transactions is expected to have a moderate additional inflationary impact. This is because the measure has no direct impact on inflation, as the levy associated with currency conversion represent only a minimal share of household consumption. In addition, the indirect impact may also be more limited, as the measure will only have a significant cost increase for companies with a significant volume of foreign trade and will not affect firms serving domestic residents and not engaged in import-export activities.

1.2 Real economy forecast

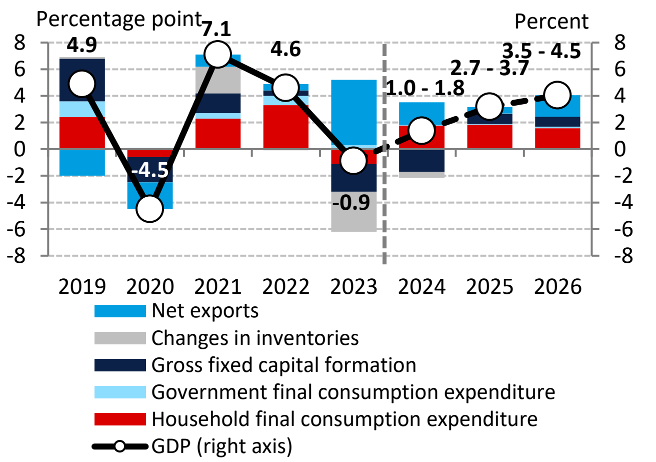
In the second quarter, GDP increased by 1.5 percent on a yearly basis, but compared to the previous quarter the HCSO registered a decline. GDP growth for this year as a whole is expected between 1.0 and 1.8 percent. Consumption growth has continued in line with real wage growth and rising household income, making a positive contribution to economic performance. Investment fell more than previously expected in the second quarter. Services and construction stimulated economic activity, while falling industrial and agricultural output had a detrimental effect. Looking ahead to 2024, market services should be the main growth driver, while low order books and business confidence indices suggest that industrial performance may remain subdued over the year. The adverse weather conditions at the end of the summer may reduce the value added of agriculture this year, slowing economic growth. On the consumption side, household consumption and net exports are expected to be the main contributors to GDP growth this year, while investment is expected to slow as a result of the sharp drop in business sentiment. From 2025, a partial rebound in deferred investments and an improvement in external demand trends should start to take hold, leading to more balanced growth. We forecast GDP growth to continue at a rate of 2.7–3.7 percent in 2025 and 3.5–4.5 percent in 2026, and thus the economy will return to its long-term growth trend in 2026.

Chart 1-5: Fan chart of the GDP forecast



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

Chart 1-6: Expenditure side decomposition and forecast of GDP

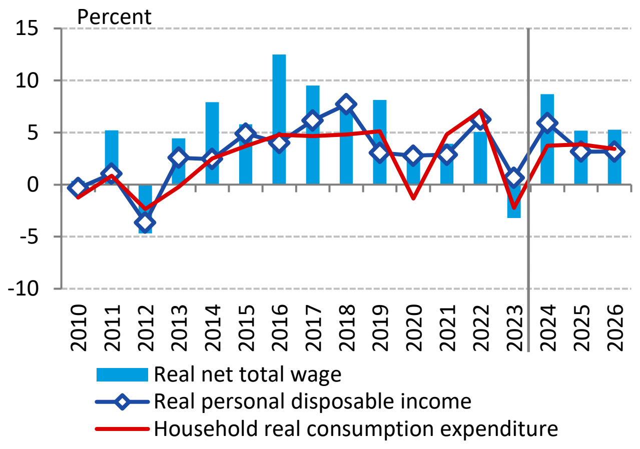


Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions. Source: HCSO, MNB

Domestic GDP expanded at a rate of 1.5 percent on an annual basis in 2024 Q2, with value added falling by 0.2 percent versus the previous quarter. Incoming data fell short of the expectations in the June Inflation Report. Among the main economic sectors, services and construction were the main contributors to economic growth in the second quarter, while the performance of industry and agriculture had a negative impact. Household consumption continued to expand, rising by 4.2 percent year-on-year in the second quarter, driven by increasing real wages and historically high employment. Gross fixed capital formation fell by 15.4 percent year-on-year, slowing economic growth by 4.3 percentage points. Exports declined on an annual basis, but the contribution of net exports to growth was positive (+1.0 percentage point), as imports contracted more than exports. Unlike in previous quarters, the change in inventories supported GDP growth.

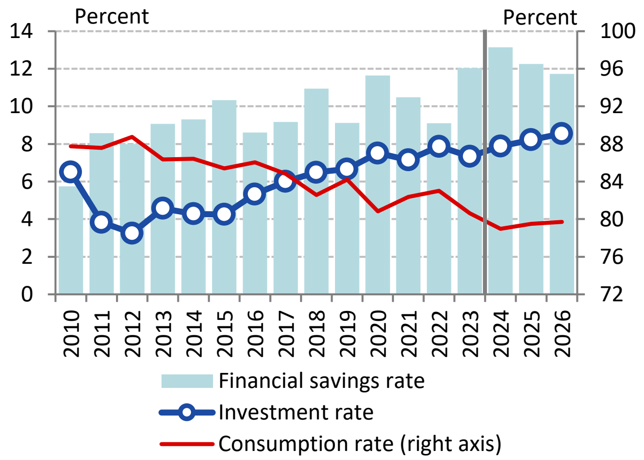
The GDP growth rate may continue to fluctuate in the second half of the year; overall, the Hungarian economy will expand by 1.0–1.8 percent this year according to the forecast. Positive real wage growth and higher household incomes are supporting the year-on-year rise in demand for services. Looking ahead, indicators suggest that industry may be characterised by subdued performance in the short term. Despite the positive performance in the first half of the year, construction output is exposed to downside risks, with the annual growth rate of value added in the sector expected to slow by the end of the year. The drought at the end of the summer has had a significant impact on the outlook for agriculture, with negative impacts expected mainly in the third quarter, when the most affected crop, maize, is harvested. As economic output picks up from end-2024, we forecast a return to the long-term growth trend in 2026, with **GDP growth continuing at a rate of**

Chart 1-7: Annual changes in net total wage, personal disposable income and household consumption expenditure in real terms



Source: HCSO, MNB

Chart 1-8: Evolution of households' consumption, investment and financial savings rates as a percentage of disposable income



Source: HCSO, MNB

2.7-3.7 percent in 2025 and 3.5–4.5 percent in 2026 (Charts 1-4 and 1-5).

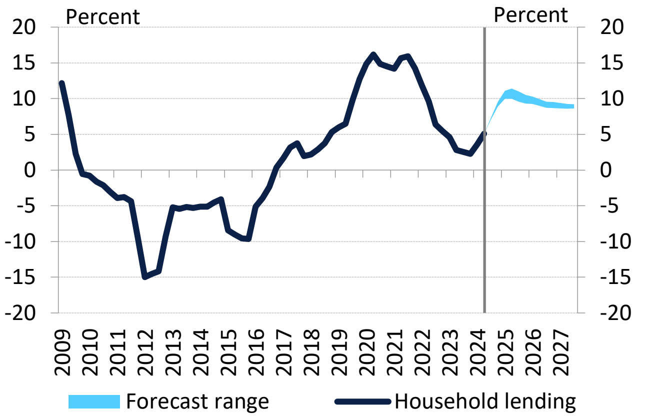
Favourable wage and income trends in 2024 may result in household consumption underpinning economic growth, but at the same time, households remains cautious, as indicated by the historically high savings rate. In addition to rising real wages, household demand is boosted by an expected increase in household credit (Chart 1-8). Banks saw a pick-up in demand for credit in the household loan market in 2024 Q2. Inflation and wage trends point to an increase in the real income of households this year that should also support household consumption growth. Consumption is projected to grow at a rate of between 3.4-4.0 percent this year and 3.4–4.4 percent in 2025 and 2.9–3.9 percent in 2026 (Chart 1-7).

Over the forecast horizon, we expect a moderate decline in the savings rate, in parallel with a moderate increase in the household investment rate, while consumption rate remains stable. In response to an uncertain economic environment and high inflation, households accumulated substantial savings in 2023, while at the same time the consumption rate fell. In recent quarters, household income, which determines consumption, has risen overall at a lower rate than wages, due to more moderate increases in pensions, profits and other income. In line with favourable wage developments and the easing of precautionary motives, the savings rate should start to decline from this year onwards, leading to an increase in the household investment rate (Chart 1-8). Developments in the income and consumption expenditure of households were also analyzed in detail as a special topic (Chapter 6).

Investment is forecast to be a significant negative factor for economic performance this year. Gross fixed capital formation fell by 15.4 percent in the second quarter, which was well below our expectations. In 2024, low capacity utilisation, weak external demand, geopolitical uncertainties, persistently high price levels and the long shadow of inflation also point to a decline in investment. This year, corporate and government investment is falling, while that of households is moderately increasing. From 2025 onwards, investment growth is expected to resume, mainly thanks to private sector development. The nominal investment rate might be around 25 percent and the real investment rate around 21 percent over the forecast horizon. The change in investment is expected to be in the range of (-7.2)–(-5.8) percent in 2024, 1.5–4.5 percent in 2025 and 2026 (Table 1-3).

Corporate investment is set to expand from 2025, following this year's slowdown. According to the MNB's

Chart 1-9: Forecast for lending to households



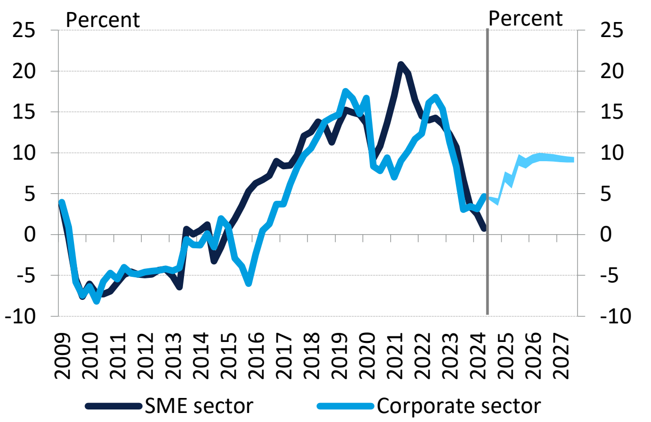
Note: Transaction-based, year-on-year data. 2019 Q3 data adjusted for transactions of lombard loans.
Source: MNB

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

	2023	2024	2025	2026
Gross fixed capital formation	-7.4	-6.5	3.0	3.0
Government investments	-8.2	-13.0	1.0	0.0
Private investments	-7.3	-5.0	3.4	3.6
Investment rate	26.3	25.3	25.3	25.3
Real investment rate	23.0	21.2	21.2	21.0

Note: The values represent the middle of the forecast range. Year-on-year growth for gross fixed capital formation and investment rate as proportion of GDP. Real investment rate calculated at 2015 prices. Source: MNB

Chart 1-10: Annual changes in lending to non-financial corporations and SMEs



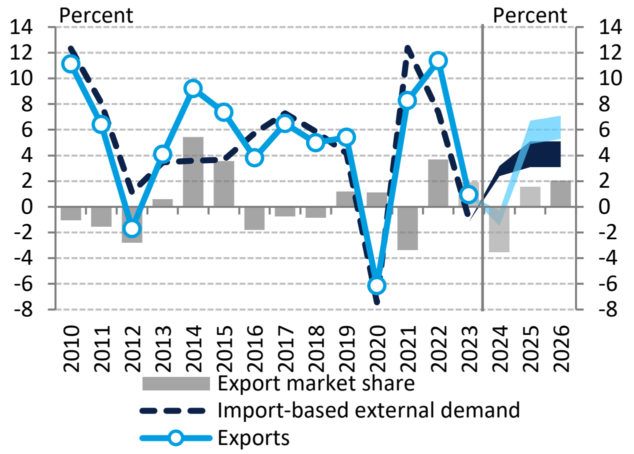
Note: Transaction-based, year-on-year data. The SME sector does not include the self-employed. The growth rate of the overall corporate sector is based on the total amount of outstanding credit to the entire financial intermediary system. Source: MNB

Chart 1-11: Changes in export market share

business survey, investment expectations in the corporate segment have been stagnating in recent months. The annual growth rate of corporate credit in 2024 Q2 was higher than expected, mainly due to the credit-increasing impact of large transactions on corporate credit dynamics. The annual growth rate of SME credit, which is more in line with underlying processes, slowed by 1.8 percentage points to just 0.7 percentage point at the end of June, leaving overall corporate credit demand at a low level in the first half of the year. Based on the responses to the lending survey, banks did not see any change in demand in the second quarter, but looking ahead to 2024 H2, a net 28 percent of responding institutions expect demand to increase. We estimate that corporate credit growth may reach 4 percent by the end of 2024 and stabilise at 8-9 percent from 2025 H2 until the end of the forecast horizon (Chart 1-10). Overall, corporate investment is expected to fall this year, but from next year, as business sentiment and external demand will improve, a partial rebound of postponed projects may start and corporate investment may rise until the end of the horizon.

Household investment is expected to increase over the forecast horizon. In 2024 Q2, the value of housing loans extended by credit institutions increased by 167 percent compared to the low base in the same period of the previous year, suggesting an increase in housing investment. Household investment as a share of disposable income is expected to be at 7.9 percent in 2024, 8.2 percent in 2025 and 8.6 percent in 2026. Public investment is expected to decline significantly this year, in line with government plans.

The volume of domestic exports may fall somewhat this year, but it should start to expand again next year, in line with trends in the European economy. Exports in the second quarter of this year were moderately below the preliminary expectations, falling by 1.7 percent on an annual basis. Industrial production and the trend in new industrial orders from abroad point to a further decline in exports in the second half of the year, with total exports growth in a range of (-1.5)–(-0.3) percent this year. **Compared to our expectations in June, exports may grow at a lower rate next year due to the significant reduction and possible rescheduling of manufacturing investments, as well as the protracted stagnation of European industrial production.** At the same time, the moderate growth dynamics of service exports measured in the past period, compared to the years before 2020, is forecast to continue both this year and next year. In parallel with the gradually recovering European economy and the increase in investments in 2025, exports may expand by



Note: Export market share based on the average of the forecast range.

Source: HCSO, MNB

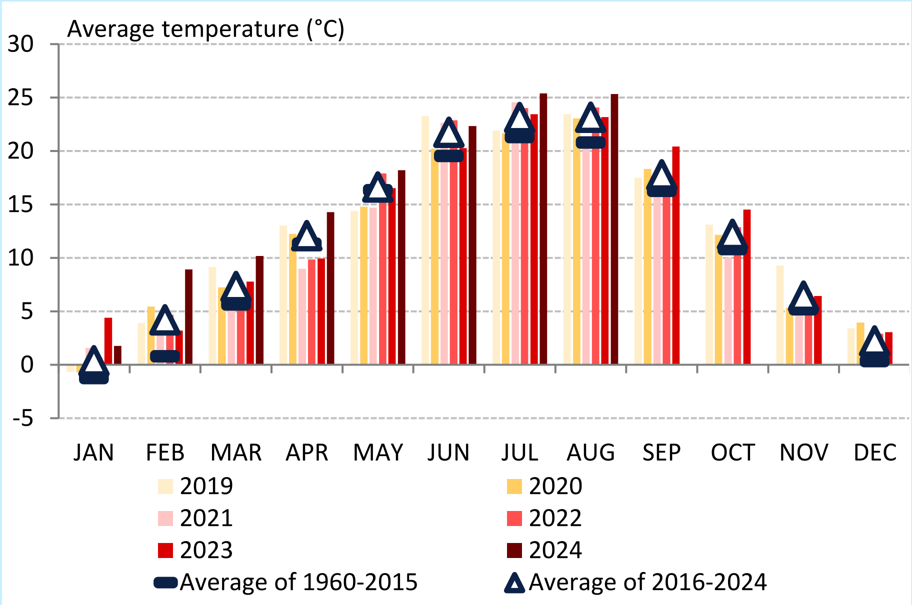
4.9-6.7 percent next year, and by 5.3-7.1 percent in 2026. Hungary's share of the export market is expected to decline temporarily this year, before rising again from next year (Chart 1-11).

In 2024, imports are expected to fall, in line with the drop in exports. The growth rate of imports in 2024 Q2 was below our expectation, with a contraction of 3.2 percent on an annual basis, mainly due to declining exports and investment, while household consumption has boosted imports moderately in the past two quarters. 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 does not lead to a sustained fall in imports, and from next year onwards, as exports and investment pick up, imports are expected to expand substantially.

Box 1-3: Expected performance of agriculture in 2024

The heatwave in the latter half of the summer and the meagre rainfall caused significant damage to agriculture. The summer months of 2024 saw all-time record high temperatures in Hungary (Chart 1-12). The average temperature in July and August even exceeded the values recorded in 2022. The area declared as damaged by drought in Hungary had increased to 390,000 hectares by the beginning of September; in the period since 2010 the drought-hit area was only larger twice: in 2012 (983,000 hectares) and in the extremely dry summer of 2022 (1.43 million hectares)

Chart 1-12: Average daily temperatures

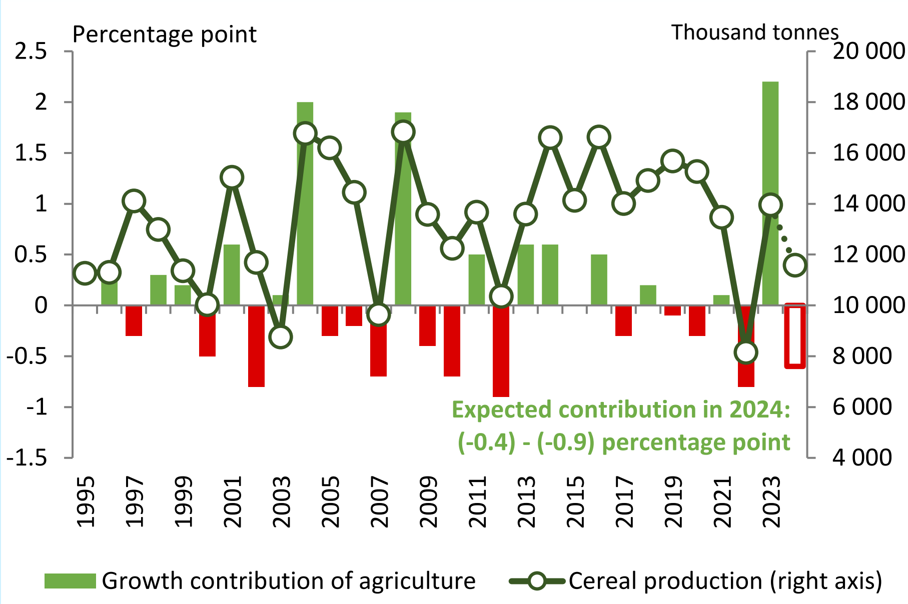


Note: Averages of the data recorded by seven weather stations (Budapest, Debrecen, Miskolc, Nyíregyháza, Pécs, Szeged, Túrkeve).
Source: HungaroMet, HCSO, media information

The drought caused significant yield losses, especially in cereals. The total quantity of wheat, an important crop for both domestic food supply and exports, probably amounted to about 5 million tonnes this year, according to preliminary estimates. This figure is 6.2 percent lower than the annual average of the past ten years and 15.5 percent lower in year-on-year terms, although it is 15.2 percent higher than in the drought-hit year of 2022. The total amount of maize, the other most important cereal in Hungary, was – on a smaller acreage, with a higher-than-average per hectare yield – 6.3 million tonnes last year while this year's output is expected to have been around 5.1 million tonnes, 32.5 percent lower than the average for the last ten years and 18.7 percent down year-on-year. Only twice during the past 15 years was the maize yield outlook in Hungary lower than in 2024: in 2012 (4.8 million tonnes) and in 2022 (2.8 million tonnes).

Due to unfavourable weather conditions, agriculture may reduce this year's GDP growth rate by 0.4–0.9 percentage point. With a heavy reliance on crop production (almost 70 percent), the structure of the domestic agricultural sector results in high exposure to weather conditions. The sector's added value is thus dominated by average yields. Due to lower-than-average crop production and the base effect of last year's historically high added value, agricultural output is expected to drop by 10–30 percent in 2024. By way of comparison, agricultural production decreased by 27 percent in 2022, which slowed down GDP growth by 0.9 percentage point. There is considerable uncertainty, however, with currently available data showing a decline of a mere 2.4 percent in the first half of the year, while Q3 and Q4 data are the key factors in the overall agricultural output.

Chart 1-13: Evolution of cereal production and the contribution of agriculture to economic growth

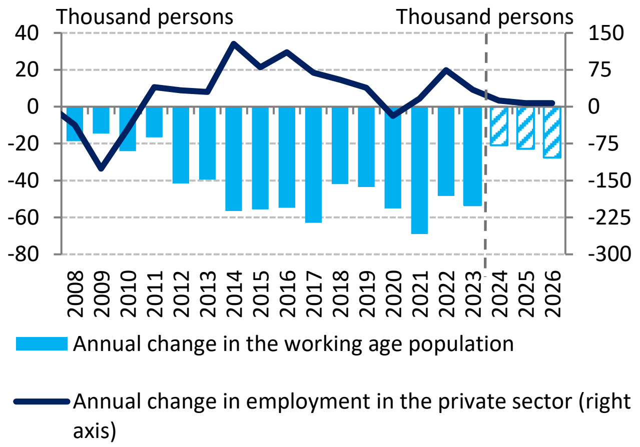


Note: * 2024 output and contribution based on press information and MNB estimates.
Source: HCSO, MNB estimates

1.3 Labour market forecast

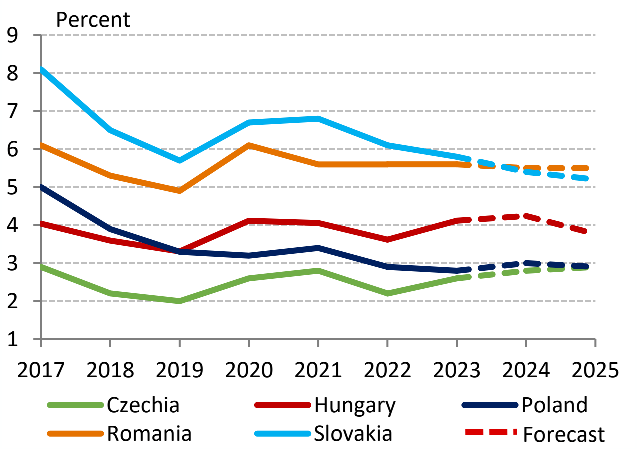
Employment continued to rise in 2024 H1 and is currently at historically high levels. Given the moderation in labour demand observed in recent quarters and the slow recovery in economic activity, we expect a moderate increase in employment levels this year. The unemployment rate may 4.2–4.3 percent this year and 3.6–3.9 percent in 2025. Wage growth in 2024 is driven mainly by easing labour market tightness and the pace of decline in inflation expectations. In the private sector, average wages are expected to rise between 11.6–11.9 percent this year and between 8.0–8.9 percent next year.

Chart 1-14: 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 1-15: Change in the unemployment rate



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

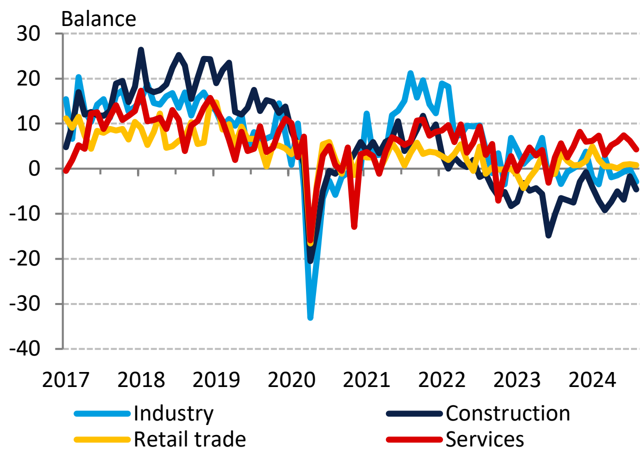
Employment in the national economy is expected to rise somewhat further this year from its historically high level. In some sectors of the economy, companies have already partially covered the labour demand resulting from the economic upturn, as they have responded to the past economic slowdown not by laying off workers, but rather by reducing the number of hours worked and labour hoarding. The recovery in economic performance is thus expected to lead to a slow increase in employment, influenced by the fact that demographic trends are becoming an increasingly effective constraint on further meaningful employment growth (Chart 1-14). According to our current forecast, the number of employed in the private sector is expected to rise between 0.3 and 0.4 percent in 2024, and to grow between 0.0 and 0.5 percent in both 2025 and 2026.

The unemployment rate may fall for the rest of the year and next year. The unemployment rate was 4.3 percent in 2024 Q2, reflecting an increase of 0.4 percentage point (23,000 people) compared to the same period of the previous year. Based on the seasonally adjusted monthly data based on the HCSO model estimate, unemployment has tended to slightly decrease since May. We expect the unemployment rate to continue to fall for the rest of the year as economic performance gradually recovers. Our current forecast for the unemployment rate for this year is 4.2–4.3 percent. In 2025, the rate may be between 3.6 and 3.9 percent, and in 2026 between 3.3 and 4.0 percent (Chart 1-15).

Labour market tightness is easing and labour demand is declining. The tightness of the labour market has eased in recent quarters. The number of job vacancies continued to fall across a wide range of sectors of the economy on an annual basis, with manufacturing, construction, ICT and transport and Based on the latest ESI survey, the proportion of companies that expect to reduce their workforce in the coming months are in majority in the construction and in industry. On the other hand, in trade and other services, the majority are companies that expect an increase in the number of their employees (Chart 1-16).

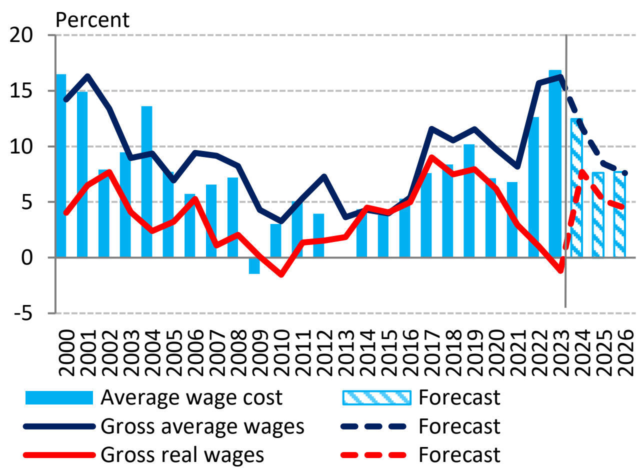
In 2024, nominal wage growth in the private sector will be more moderate than last year, but real wages are

Chart 1-16: 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 1-17: 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

expected to rise substantially. Real wages have been increasing since September 2023, following a significant reduction in inflation in 2023. Labour market tensions have eased since mid-2022, and inflation expectations remain above the actual figures. Even so, underlying wage developments remained strong. In December 2023, the minimum wage increased by 15 percent and the guaranteed minimum wage by 10 percent. Wages in the private sector may rise by 11.6–11.9 percent this year. Our forecast for 2025 and 2026 is 8.0–8.9 percent and 7.1-8.2 percent, respectively. Real wages may increase between 7.6 and 8.0 percent in 2024, then between 4.6 and 5.6 percent in 2025 and between 4.0 and 5.0 percent in 2026 in the private sector (Chart 1-17).

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	4.1 - 5.3	4.6 - 4.9	2.7 - 3.5	3.2 - 3.8	2.7 - 3.3	2.6 - 3.3
Core inflation excluding indirect tax effects	18.1	4.1 - 5.3	4.6 - 4.9	2.7 - 3.5	3.0 - 3.6	2.7 - 3.3	2.6 - 3.3
Inflation	17.6	3.0 - 4.5	3.5 - 3.9	2.5 - 3.5	2.7 - 3.6	2.5 - 3.5	2.5 - 3.5
Economic growth							
Household final consumption expenditure	-2.2	3.3 - 3.7	3.4 - 4.0	2.7 - 3.7	3.4 - 4.4	2.7 - 3.7	2.9 - 3.9
Final consumption of government[1]	1.3	(-0.1) - 0.7	(-0.1) - 0.7	(-0.3) - 0.9	(-0.3) - 0.9	(-0.1) - 1.1	(-0.1) - 1.1
Gross fixed capital formation	-7.4	(-1.5) - 0.5	(-7.2) - (-5.8)	3.1 - 6.3	1.5 - 4.5	0.7 - 3.6	1.5 - 4.5
Domestic absorption	-5.6	0.5 - 1.3	(-1.1) - 0.3	2.6 - 3.8	2.1 - 3.7	1.8 - 3.0	1.9 - 3.4
Exports	0.9	0.6 - 1.4	(-1.5) - (-0.3)	6.1 - 7.9	4.9 - 6.7	4.6 - 6.4	5.3 - 7.1
Imports	-4.3	(-1.5) - (-0.7)	(-3.8) - (-2.6)	5.4 - 7.4	4.7 - 6.7	3.1 - 5.1	3.4 - 5.4
GDP	-0.9	2.0 - 3.0	1.0 - 1.8	3.5 - 4.5	2.7 - 3.7	3.0 - 4.0	3.5 - 4.5
Labour productivity[2]	-1.1	2.1 - 2.6	0.9 - 1.2	3.4 - 4.7	2.6 - 3.6	2.8 - 4.2	3.3 - 4.6
External balance[3]							
Current account balance	0.2	1.5 - 2.7	1.4 - 2.6	2.2 - 3.6	2.0 - 3.4	3.0 - 4.6	2.3 - 3.9
Net lending	1.2	3.1 - 4.3	2.7 - 3.9	4.1 - 5.5	4.0 - 5.4	4.8 - 6.4	4.2 - 5.8
Government balance[3]							
ESA balance	-6.7	(-5.0) - (-4.5)	(-4.7) - (-4.3)	(-4.5) - (-3.5)	(-4.2) - (-3.2)	(-3.8) - (-2.8)	(-3.8) - (-2.8)
Labour market							
Whole-economy gross average earnings[4]	14.3	12.4 - 13.0	12.8 - 13.2	7.1 - 8.3	7.5 - 8.6	7.7 - 9.0	7.8 - 9.1
Whole-economy employment	0.6	0.1 - 0.3	0.4 - 0.5	(-0.3) - 0.4	(-0.3) - 0.4	(-0.2) - 0.6	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	11.0 - 11.6	11.6 - 11.9	7.5 - 8.6	8.0 - 8.9	6.9 - 8.1	7.1 - 8.2
Private sector employment	1.0	0.1 - 0.3	0.3 - 0.4	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	3.6 - 3.9	3.2 - 4.1	3.3 - 4.0
Private sector nominal unit labour cost	17.7	8.8 - 9.7	11.4 - 12.0	2.9 - 4.5	3.5 - 5.0	3.1 - 4.9	2.7 - 4.4
Household real income[5]	0.7	3.4 - 4.0	5.7 - 6.1	2.1 - 3.3	2.6 - 3.8	2.1 - 3.3	2.6 - 3.8

[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

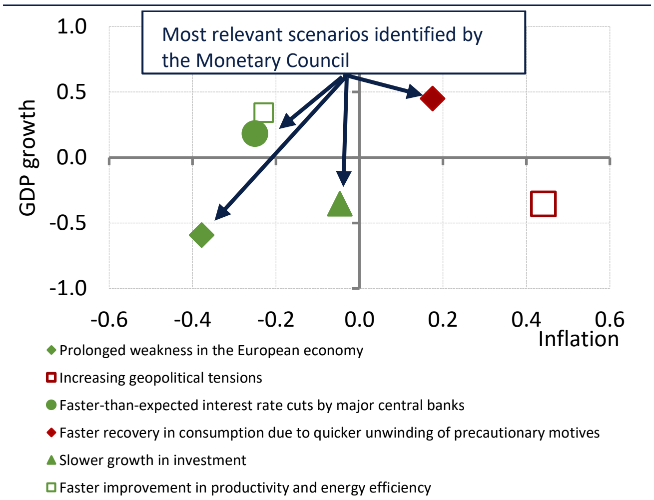
	2024	2025	2026
Consumer Price Index (annual average growth rate, %)			
MNB (September 2024)	3.5 - 3.9	2.7 - 3.6	2.5 - 3.5
Consensus Economics (August 2024)[1]	3.6 - 3.9 - 4.4	2.0 - 3.5 - 4.2	
European Commission (May 2024)[2]	4.1	3.7	
IMF (April 2024)	3.7	3.5	2.9
OECD (May 2024)	4.0	3.9	
Reuters survey (August 2024)[1]	3.7 - 3.9 - 4.0	3.4 - 3.9 - 4.2	3.1 - 3.4 - 3.9
GDP (annual growth rate, %)			
MNB (September 2024)	1.0 - 1.8	2.7 - 3.7	3.5 - 4.5
Consensus Economics (August 2024)[1]	1.4 - 1.8 - 2.3	2.5 - 3.2 - 4.0	
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 (August 2024)[1]	1.4 - 1.7 - 2.3	2.5 - 3.3 - 3.8	3.2 - 3.6 - 4.4
Current account balance[3]			
MNB (September 2024)	1.4 - 2.6	2.0 - 3.4	2.3 - 3.9
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 (September 2024)	(-4.7) - (-4.3)	(-4.2) - (-3.2)	(-3.8) - (-2.8)
Consensus Economics (August 2024)[1]	(-5.7) - (-4.9) - (-4.1)	(-4.9) - (-4.1) - (-3.5)	
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 (August 2024)[1]	(-5.5) - (-4.9) - (-4.5)	(-5.0) - (-4.2) - (-3.7)	(-4.3) - (-3.6) - (-2.9)
Forecasts on the GDP growth rate of Hungary's trade partners (annual growth rate, %)			
MNB (September 2024)	1.2 - 1.8	1.5 - 2.2	1.3 - 2.2
ECB (September 2024)	0.8	1.3	1.5
Consensus Economics (August 2024)[1]	1.2	1.7	
European Commission (May 2024)[2]	1.3	1.9	
IMF (July 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 four alternative risk scenarios around the baseline projection in the September Inflation Report. In the scenario assuming prolonged weakness in European economic activity, both economic growth and inflation are likely to be lower compared to the baseline. The scenario of faster-than-expected interest rate cuts by major central banks is consistent with lower inflation and higher growth paths. With the faster unwinding of precautionary motives, the path of a faster recovery in consumption is consistent with a higher growth and inflation path. The scenario featuring slower investment growth portends a lower inflation and growth path. In addition to the scenarios highlighted, the Monetary Council also discussed other alternative scenarios, such as an increase in geopolitical tensions and paths that assume faster improvements in productivity and energy efficiency.

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 monetary policy and the green markers represent looser monetary policy, compared to the baseline forecast.

Source: MNB

Prolonged weakness in the European economy

In 2024 Q2, GDP grew slower in year-on-year terms in both the European Union and Germany. In June, industrial production declined, while retail sales in the euro area barely expanded according to July data. Industrial production in the euro area fell by 3.9 percent on an annual basis, while retail sales rose by 0.1 percent. The economic growth of 0.6 percent in the European Union in the previous quarter was followed by an expansion of 0.8 percent, while GDP in the euro area rose by 0.6 percent on a seasonally and calendar-adjusted basis. Most of Hungary’s main export partners only recorded marginal growth in the second quarter, while Hungary’s main trading partner, Germany, saw its economy stagnate in 2024 Q2 compared to the same period last year. The slowdown in Germany's economy undermines growth prospects in the European Union.

In July, the Purchasing Managers' Index for manufacturing in the euro area declined and fell below the expansion threshold. In Germany, the preliminary August Purchasing Managers' Index fell short of expectations. In August, both German private sector business activity and the manufacturing PMI declined and remained below the threshold.

Market analysts' growth expectations for 2024 forecast suggest subdued growth in the euro area. Based on Bloomberg's median analysts’ expectations for the growth outlook, the European Union is expected to expand by 1.1 percent, Germany by 0.1 percent and the global economy by 3.1 percent in 2024.

The demand for batteries for electric cars has a significant impact on the export performance of Hungary. Compared to last year’s average, the market share of newly registered electric cars decreased in the EU in 2024 Q2. In Germany, which is Hungary's main trading partner, demand for batteries produced in Hungary fell by almost 40 percent in the first four months of the year compared to the same period last year.

If the risk scenario of a prolonged weakness in the European economy materialises, growth in the EU and accordingly in Hungary will be more moderate than in the baseline scenario. Subdued performance in 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 domestic inflation path compared to the baseline is achieved, due to lower external inflation**.**

Faster-than-expected interest rate cuts by major central banks

In the past quarter, the focus of market participants was mainly on expectations regarding the interest rate policies of major central banks, US labour market data and the possible outcome of the US elections in the autumn.

At its September meeting, the Federal Reserve (Fed) lowered the target range for the federal funds rate by 50 basis points and thus started to ease monetary conditions. The process of achieving the inflation target and the balance of risks made it possible to reduce the interest rate. The decision-makers moderated their inflation expectations and their forecast for the level of the key rate at the end of this year. At the press conference, Fed Chairman Jerome Powell stated that the previous patient attitude had made the 50-basis points loosening possible, but noted they had not yet won a victory over inflation. However, this did not mean that interest rate cuts would continue at this pace. The Committee had gained greater confidence that inflation was moving sustainably toward 2 percent. When determining the target range, the Committee had taken into account the incoming data, the changing outlook and the balance of risks. The aim was to restore price stability while maintaining a strong labour market. Market analysts expect around 90 basis points in interest rate cuts by the end of the year.

The European Central Bank (ECB) started to ease interest rate conditions in June. At the June meeting, the Governing Council decided to cut the policy rate by 25 basis points, but left the policy rates unchanged in July. Rate cuts then continued at the September meeting, in line with market expectations. According to the September decision statement, the Governing Council would continue to make decisions in a data-driven, meeting-by-meeting manner, based on incoming data, and would not commit to any predefined interest rate path. The market is pricing in another 25-basis point rate cut by the end of the year.

Disinflation continued in both the US and the euro area. In August, annualised inflation in the United States came in at 2.5 percent, down 0.4 percentage point versus the previous month. Euro area inflation eased to a year-on-year rate of 2.2 percent, down from 2.6 percent in July. At the same time, for both the Fed and the ECB, the interest rate path expected by market analysts has declined. In respect of the Fed, the expected path of interest rates shifted downwards slightly by the end of 2024 and shifted significantly lower by the end of 2025 compared to one quarter earlier. While expectations in the case of the ECB did not change significantly by the end of 2024, interest rates expected by the end of 2025 have fallen more significantly in recent months.

The alternative path assumes that, due to their data-driven approach, major central banks will cut interest rates more and faster than assumed in the baseline, as a result of better-than-expected inflation data. As a result, risk aversion to emerging markets, including Hungary, declines, i.e. the risk premium is lower and the relative interest rate spread rises, leading to exchange rate appreciation. This scenario is consistent with a lower inflation and higher growth path.

Faster recovery in consumption due to quicker unwinding of precautionary motives

In June 2024, average regular earnings (excluding bonuses) rose by 13.9 percent in the national economy, 12.0 percent in the private sector and 18.8 percent in the public sector on an annual basis. The growth rate of regular wages slowed in both the private sector and the national economy, while it accelerated in the public sector. At the same time, other earnings are rising less than wages, and the falling number of hours worked is moderating the increase in the wage bill.

In recent quarters, the dynamics of retail sales lagged behind wage developments. In July 2024, the volume of retail sales increased by 2.5 percent in year-on-year terms, continuing the growth that started in January. On a monthly basis, turnover remained stagnant in June. Among the more important determinants of household consumption, real average earnings in the national economy increased by 9.3 percent year-on-year in June 2024, while the consumer confidence index remains at a low level. Food retail sales rose by 2.0 percent in July, while turnover at service stations decreased slightly by 0.6 percent on an annual basis.

The strength of the precautionary motive is indicated by the record high household savings rate. The main increase was observed in the amount of savings, which rose 27 percent in nominal terms compared to one year earlier. As the income of higher-income families with higher savings rates increased to a greater extent, the wage distribution also points to the increase in savings.

Household net financial wealth increased by HUF 2,575 billion in 2024 Q2 compared to the previous quarter, but the pace of growth slowed. With inflation falling to a low level, households have once again been able to substantially increase the real value of their financial wealth, so that the recovery in savings should be followed by an easing of the precautionary motive and a dynamic expansion in consumption.

As inflation expectations gradually adjust to the moderating inflation environment, the combination of a higher pace of easing of the precautionary motive and favourable wage developments could lead to a faster-than-expected recovery in domestic consumption. Consumer confidence is decisive in matters related to consumption and savings. Even though GKI's consumer confidence index is still below the long-term average, it has indicated a trend-like increase since September 2022, which, combined with recent favourable trends, points to a faster recovery in consumption.

The increase in the family tax allowance could also contribute to a sharper rise in household consumption, but the timing and exact details of the measure are not yet known.

If this alternative path materialises, the additional income from persistently high real wage growth will increasingly appear in consumption as the precautionary motive eases. The faster recovery in consumption is consistent with a higher growth and inflation path compared to the baseline scenario.

Slower growth in investment

The decline in the volume of investment over the past two years continued. Seasonally adjusted data show that the volume of projects in the second quarter fell short of the value registered in the same period one year earlier by 14.5 percent. The largest contributors to the decline were manufacturing, transport and storage, and trade. The decline was moderated by rising investment activity in public administration, energy industry and real estate transactions.

Domestic business confidence indices remain low, pointing towards a postponement of investment and lower output.

Corporate loans outstanding fell by HUF 84 billion in July 2024. The annual rate of credit growth thus slowed to 1.7 percent from 3.9 percent in the previous month. In the last twelve months, the value of new contracting was 6 percent below the aggregate contracting value of the previous year.

Compared to the same period last year, the volume of industrial production fell by 8.2 percent in June and then decreased by 1.3 percent in July. Based on seasonally and working-day adjusted data, output fell by 3.8 percent on an annual basis.

In this alternative path, we expect a slower rise in business confidence indices and a sluggish recovery in industrial production to be accompanied by a delayed pick-up in business sector investment. At the same time, corporate lending remains weak in an uncertain risk environment. Overall, these factors lead to a slower recovery in investment in the national economy, consistent with a lower inflation and growth path.

Further risks

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

In the alternative path which assumes increasing geopolitical tensions, we expect global supply problems and a protracted wartime environment, which could be complemented by elevated financial market volatility. In line with this, commodity prices rise, and the external position of Hungary is less favourable than the baseline. 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 will thus be higher than expected, causing a ripple effect in domestic prices. Since the domestic economy is a commodity importer and, as a small, open economy, exposed to international financial market developments, both external and internal balance trends will develop unfavourably, which also increases the risk premium. The scenario is consistent with a higher inflation and lower growth trajectory compared to the base trajectory.

In the risk scenario with a faster improvement in productivity and energy efficiency, the shift to an intensive growth model will further stimulate growth in the domestic economy, mainly on the supply side, through improved competitiveness. Competitiveness can be improved at a degree higher than assumed in the baseline scenario if

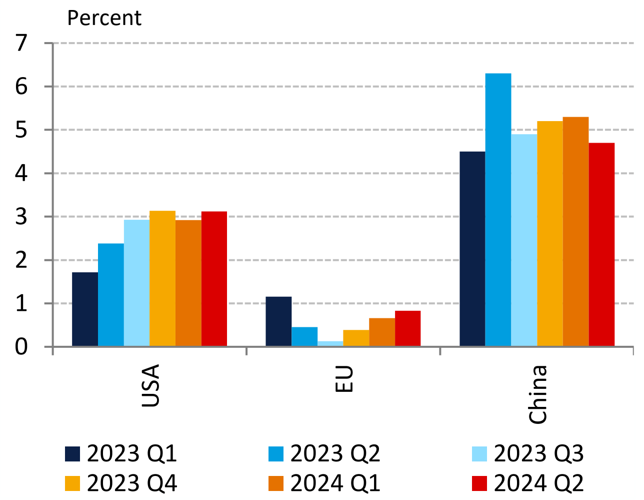
more of the 330 steps to improve competitiveness are carried out, and if energy efficiency improvements are enhanced by implementing the 144 points of the discussion paper 'Sustainable Balance and Catching-up', to accelerate the green transition. Completion of the targeted measures will significantly 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

In 2024 Q2, economic output in the European Union expanded moderately, in line with expectations, and the labour market remained tight. The US economy grew faster, while that of China slowed somewhat. The generally tense geopolitical situation and subdued growth prospects in Europe remain a major risk to the external outlook. The Federal Reserve lowered its target interest rate by 50 basis points to 4.75–5.00 percent at the last meeting in September. The decision-makers substantially modified their interest rate path forecast, they expect a 4.4 percent reference rate at the end of this year. The ECB lowered its target interest rate by 25 basis points in September. The ECB has been reducing the stock of securities purchased under the emergency asset purchase programme (PEPP) by an average of EUR 7.5 billion per month since the beginning of July. In the region, the Czech central bank cut its base rate by 50 basis points in June and 25 basis points in August. The Romanian central bank reduced its policy rate by 25 basis points in both July and August, while the Polish central bank kept interest rates unchanged.

Chart 3-1: GDP growth in the world's leading 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

3.1.1 International economic trends

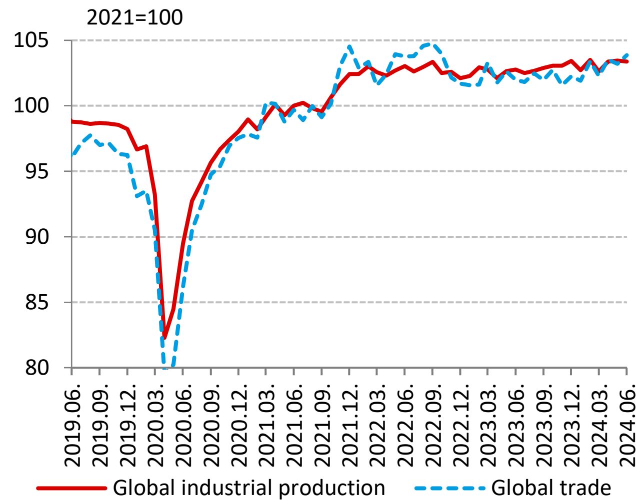
In 2024 Q2, economic growth in the European Union accelerated moderately (Chart 3-1). The performance of the European economies corresponded to the preliminary expectations. In 2024 Q2, the EU economy expanded by 0.8 percent and the euro area economy by 0.6 percent year-on-year, on a seasonally and calendar-adjusted basis. Output in Hungary's main trading partner, Germany, stagnated in 2024 Q2 on an annual basis. Among the countries in the region, GDP grew in Czechia (+0.6 percent), Poland (+4.0 percent) and Slovakia (+2.1 percent) in year-on-year terms. GDP contracted in six of the 27 countries in the European Union on a quarterly basis.

GDP growth in the US accelerated on an annual basis. The US economy grew by 3.1 percent year-on-year, while on a quarterly basis, it rose by 0.7 percent. Growth was supported by the continued strong expansion in household consumption.

China's growth momentum declined somewhat in 2024 Q2, as it recorded annual growth of 4.7 percent and a quarterly rise of 0.7 percent in its GDP. Industrial production continues to expand steadily, while consumer confidence remains low, which also affects growth: the contribution of household consumption to growth fell versus the previous quarter.

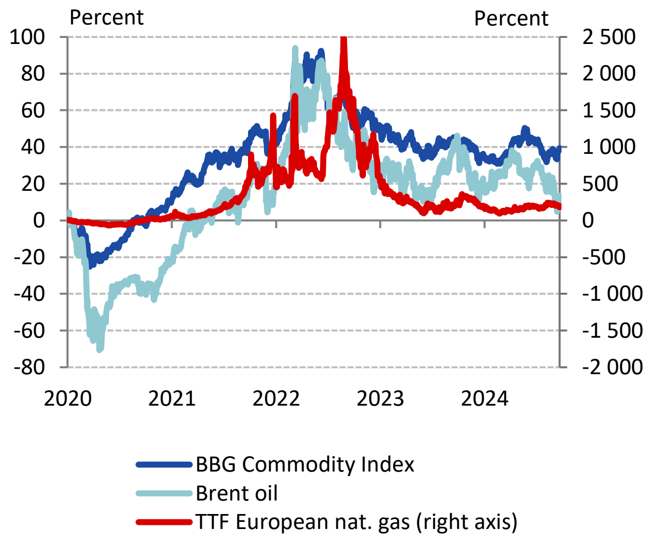
Risks to the external outlook are posed by the unfavourable outlook for industrial production in Europe as well as the ongoing war between Russia and Ukraine and the generally tense geopolitical situation. In 2024 Q2, global industrial production remained subdued and world trade stagnated (Chart 3-2). Global economic activity continued to be supported by tight labour markets in advanced economies. The global and European growth

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



Note: Based on seasonally adjusted data.
Source: CPB

Chart 3-3: Commodity prices



Note: The figure shows the change compared to January 2020.
Source: Bloomberg

outlook for this year is unchanged from the June forecast. Consumer confidence in the EU economies improved to some degree, as measured by business confidence indices. Business sentiment stagnated in services and deteriorated somewhat in industry.

3.1.2 International monetary policy, inflation and financial market trends

Global inflation moderated somewhat further during the past quarter, with several countries coming close to their central bank targets (Chart 3-4). The global price of crude oil was volatile in the summer months, then it decreased from the end of August. The price of natural gas rose marginally from a low level, but it remains below levels from before the Russia-Ukraine war (Chart 3-3).

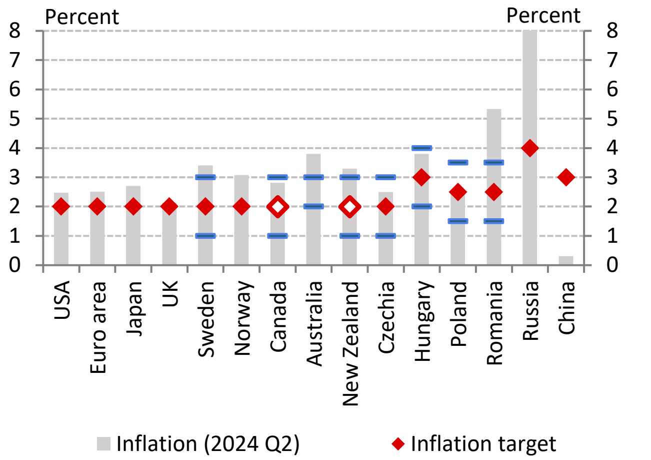
Inflation in the United States has been volatile in recent months. CPI inflation fell from 3.0 percent in June to 2.9 percent in July and 2.5 percent in August. Core inflation eased from 3.3 percent in June to 3.2 percent in July and then remained at 3.2 percent in August. The PCE inflation index dropped from 2.7 percent in April to 2.6 percent in May and 2.5 percent in June and stood at this level in July. In terms of the structure of inflation, services continued to make the largest contribution, but disinflation was widespread.

The Federal Reserve lowered its target interest rate by 50 basis points to 4.75–5.00 percent at the last meeting in September. Employment growth has slowed and the unemployment rate has risen, but remains at a low level. According to the Open Market Committee, the process of achieving the inflation target and the balance of risks made it possible to lower the benchmark rate. The decision-makers significantly modified their interest rate forecast, as they expect a rate of 4.4 percent at the end of this year. At the press conference following the decision, Jerome Powell said that the purpose of the interest rate cut was to keep the US labour market and economy in its current strong state. No further weakening of the labour market was needed to meet the inflation target, and they were not considering ending quantitative tightening.

The gradual decline in the Fed's balance sheet total continued over the past quarter, reaching USD 7,166 billion at mid-September 2024, or 25.0 percent of GDP (Chart 3-5).

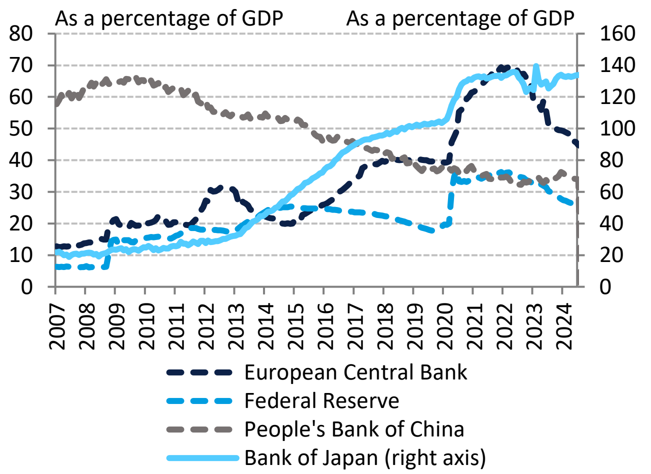
Inflation in the euro area rose from 2.5 percent in June to 2.6 percent in July, before easing again to 2.2 percent in August. Core inflation was 2.9 percent in June and July, before easing to 2.8 percent in August.

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



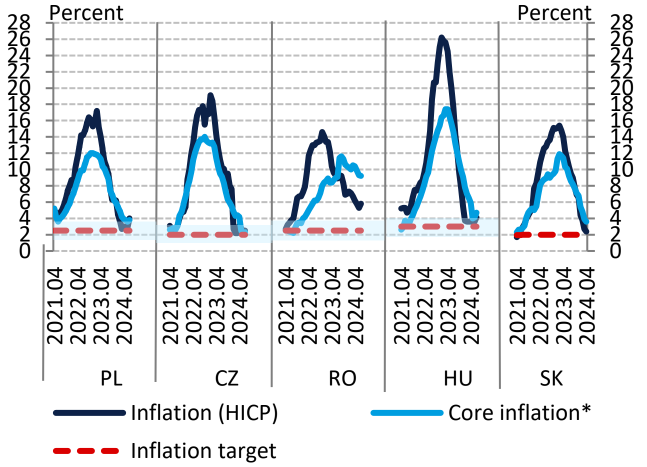
Source: Eurostat

The ECB lowered the key deposit rate by 25 basis points to 3.5 percent at the last rate-setting meeting in September, in line with expectations. The central bank justified its decision with the fact that there was further improvement in the inflation outlook, the dynamics of underlying inflation trends and the strength of monetary transmission, and accordingly another step in reducing the monetary restriction was timely. Based on the changes affecting the operational framework that ensures the implementation of the monetary policy, the central bank reduced the difference between the one-day deposit interest rate and the interest rate of the main refinancing operations from 50 basis points to 15 basis points. After the interest rate decision in September, Christine Lagarde, President of the ECB, said that the central bank had not committed itself to any interest rate path, and that the Governing Council would continue to make decisions based on data, from meeting to meeting. By mid-September 2024, the ECB's balance sheet total had fallen to EUR 6,442 billion, or 43.9 percent of GDP (Chart 3-5).

At its July policy meeting, the Bank of Japan raised the interest rate on excess reserves by 15 basis points to 0.25 percent, then hold its key rate in September. In addition, as previously indicated by the central bank, it published a detailed plan to slow down asset purchases in July. According to the central bank's decision, the rate of asset purchases would be reduced by JPY 400 billion per quarter, to JPY 2.9 billion per month by January–March 2026. The central bank considered that tightening monetary conditions was timely to achieve the inflation target. The unexpected 15-basis point interest rate hike by the Bank of Japan on 31 July may have contributed to the temporary turbulence in the money market in early August. Inflation stood at 2.8 percent in June and July and rose to 3.0 percent in August.

China's central bank maintained the medium-term lending facility at 2.3 percent. Following the earlier 20-basis point cut in the reverse repo rate in July, the 18 largest commercial banks lowered their one-year and five-year benchmark lending rates to 3.35 and 3.85 percent, respectively, by 10 basis points each. The reduction in the interest rate on the reverse repo instrument reflects the central bank's efforts to reduce the role of the medium-term lending facility in defining monetary conditions and to rely more on the shorter-term repo instrument in the context of renewing the monetary policy framework. Inflation rose from 0.2 percent in June to 0.5 percent in July and then to 0.6 percent in August. The central bank's balance sheet total stood at 33.9 percent of GDP in August.

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



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

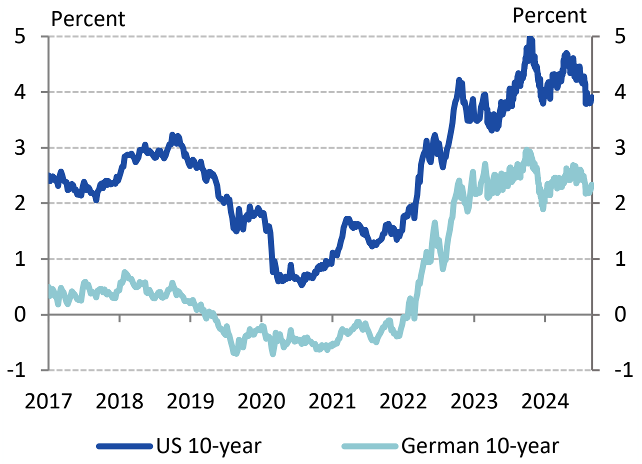
The National Bank of Poland left the policy rate unchanged at 5.75 percent at its July and September policy meeting. According to the central bank's July forecast, inflation this year and in 2025 may be higher than previously expected, while the growth forecast was revised downwards. Inflation is expected to rise in the coming quarters and may remain above the central bank's target. Inflation advanced from 2.6 percent in June to 4.2 percent in July, before climbing to 4.3 percent in August. The Harmonised Consumer Price Index was 4.0 percent in August (Chart 3-6).

The Czech central bank cut its policy rate by 50 basis points in June and 25 basis points in August to 4.5 percent. At the press conference following the latest decision, Aleš Michl, Governor of the Czech central bank, stated that the central bank would continue to maintain a tight monetary policy to keep inflation close to its target of 2 percent. Inflation rose from 2 percent in June to 2.2 percent in July, and remained at this level in August. The Harmonised Consumer Price Index was 2.4 per cent in August (Chart 3-6).

At its August policy meeting, the Romanian central bank decreased its policy rate by 25 basis points to 6.50 percent, after easing monetary conditions by 25 basis points in July. The central bank justified the interest rate cut by claiming that its latest forecast from August showed that inflation would continue to fall in the coming months, following a significantly lower path than previously expected, especially in the short term. Inflation rose from 4.9 percent in June to 5.4 percent in July, before falling back to 5.1 percent in August. The Harmonised Consumer Price Index stood at 5.3 percent in August (Chart 3-6).

Investor sentiment was mostly unfavourable in the past quarter, reflecting developments in the financial markets in early August and mounting concerns about global growth. In addition, geopolitical conflicts may continue to pose substantial risks, especially in the energy sector and international trade. At the beginning of August, the Japanese central bank's interest rate hike and worse-than-expected US macro data temporarily increased volatility in the financial markets, with some risk indicators jumping sharply. Movement was strongest in the equity markets, but foreign exchange rates and long yields also moved significantly. For much of the past period, asset price developments were driven mainly by expectations of the interest rate policies of advanced market central banks. The entire interest rate path priced into the market shifted lower on the back of statements from major central bank policymakers and macroeconomic data.

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



Source: Bloomberg

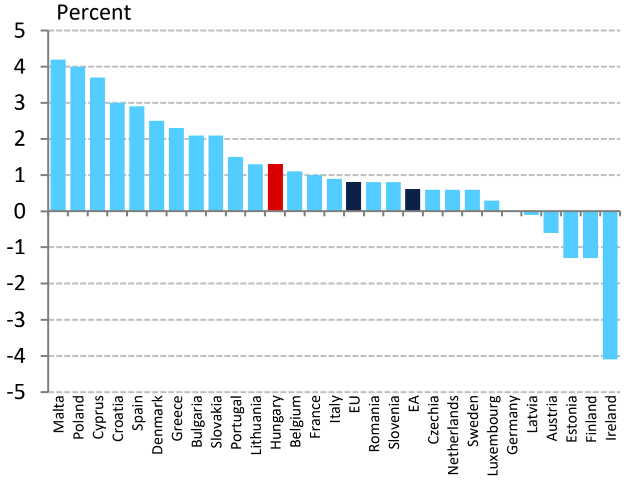
Developed market long bond yields declined, with the US 10-year yield falling by 55 basis points to nearly 3.7 percent, while the German 10-year yield dropped by 23 basis points to nearly 2.2 percent (Chart 3-7). The Japanese 10-year yield fell somewhat from the previous quarter to around 0.84 percent. Emerging market bond yields also moved lower during the period: in the region, the Polish 10-year yield fell by 50 basis points, the Czech 10-year by 42 basis points and the Romanian 10-year by 19 basis points. Meanwhile, the MSCI index of emerging market shares rose 0.4 percent. Against the US dollar, the euro and the pound sterling strengthened by 4 percent over the quarter, while the Swiss franc appreciated by 5 percent and the Japanese yen by 11 percent.

Based on market pricing, the Fed and the ECB may keep lowering their interest rates this year. The Fed and the ECB reduced interest rates at their policy meetings in the past quarter, and market pricing suggests that the Fed may cut its policy rates by 75 and the ECB by 40 basis points in the last quarter of the year.

3.2 Analysis of the production and expenditure side of GDP

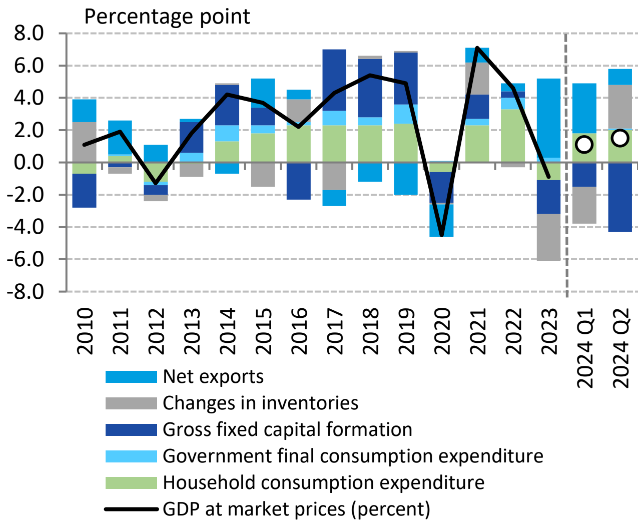
Based on raw data, Hungary's gross domestic product expanded at a year-on-year rate of 1.5 percent in 2024 Q2, while falling by 0.2 percent in a quarter-on-quarter comparison. Looking at production, among the main branches of the economy, services boosted GDP by 1.4 percentage points and construction by 0.3 percentage point on an annual basis, while industry and agriculture reduced GDP by 0.5 and 0.2 percentage point, respectively. In terms of expenditure, household consumption (+2.0 percentage points) and net exports (+1.0 percentage point) supported economic growth in the second quarter, while investment (-4.3 percentage points) dampened economic output. The contribution of the change in inventories was positive, improving GDP growth by 2.9 percentage points.

Chart 3-8: Annual GDP change in EU countries in 2024 Q2



Note: Seasonally and calendar adjusted data.
Source: Eurostat

Chart 3-9: Annual change in decomposition of expenditure-side GDP



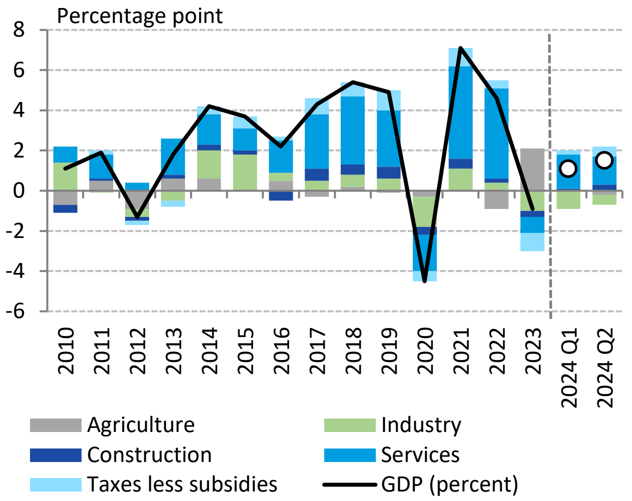
Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions. Changes in inventories includes acquisitions less disposals of valuables.
Source: HCSO, MNB

Based on raw data, gross domestic product grew by 1.5 percent year-on-year in 2024 Q2 but contracted by 0.2 percent quarter-on-quarter. According to data adjusted for seasonal and calendar effects used for international comparison, Hungary's economy expanded by 1.3 percent on an annual basis in the second quarter. GDP grew by 0.8 percent in the European Union and by 0.6 percent in the euro area in the second quarter (Chart 3-8), leaving Hungary with a positive growth margin.

Household consumption expenditure increased by 4.2 percent in 2024 Q2 compared to the same period of the previous year (Chart 3-9). Consumption increased in all product groups: the volume of durable goods rose by 9.1 percent and that of non-durable goods by 4.3 percent, while the volume of services increased by 3.6 percent and that of semi-durable goods by 2.0 percent. Government final consumption expenditure fell by 0.4 percent on an annual basis. In July 2024, retail sales were up 2.5 percent and the inflation-adjusted sales of online cash registers rose by 4.0 percent year-on-year. Online cash register sales differ from retail sales in that they include, for example, sales from food, taxi services and some accommodation services.

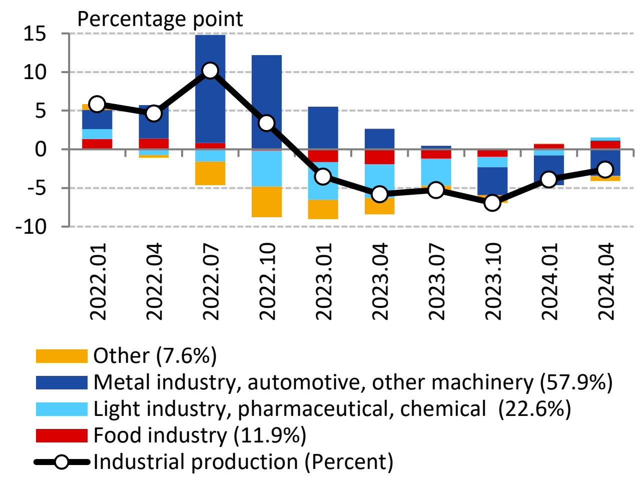
In 2024 Q2, gross fixed capital formation showed a significant decline of 15.4 percent relative to the same period of the previous year (Chart 3-9). The rate of decline accelerated in sectors producing for both domestic and export markets, while investment directly linked to the public sector and households rose. However, investments in the sectors indirectly related to the state (quasi-fiscal), which has a higher weight, decreased by 17.1 percent.. Construction projects shrank by 5.7 percent, and investment in machinery and equipment fell by 28.2 percent. The nominal investment rate was somewhat lower than in the previous quarter, at 25.2 percent, while four-quarter rolling average of the real investment rate was 21.6 percent. If we only take into account the data of the first half of this year, the investment rate calculated at 2015 prices was 18.9 percent. On a quarterly basis, gross fixed capital formation decreased by 6.7 percent.

Chart 3-10: Annual change in decomposition of production-side GDP



Source: HCSO

Chart 3-11: 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

Exports of goods decreased by 3.3 percent, while exports of services increased by 4.6 percent compared to the same period of the previous year (Chart 3-9). The balance of trade in goods showed a historically high surplus of EUR 3.9 billion in the second quarter. The terms of trade improved by 0.9 percent on an annual basis, still significantly supported by the correction in the price of mineral fuels. In July 2024, the trade surplus was EUR 203 million, with the value of goods exports in euros contracting by 2.3 percent and the nominal value of goods imports in euros expanding by 0.1 percent over a year. The balance deteriorated by EUR 921 million compared to the previous month and by EUR 362 million relative to the same period of the previous year.

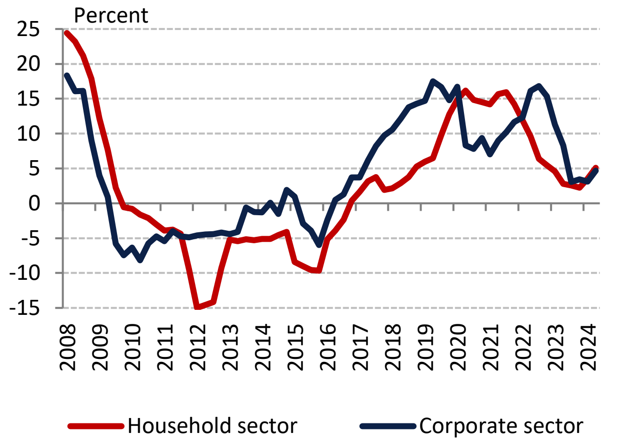
In terms of production, industrial output fell by 2.4 percent in 2024 Q2 compared to the same prior-year period, with manufacturing output down 3.7 percent (Chart 3-10). Of the manufacturing sectors, the largest contributors to the decline were the manufacture of electrical equipment and the production of road vehicles, while the output of the food industry increased (Chart 3-11).

Construction sector output rose by 6.2 percent versus the same period of the previous year (Chart 3-10). This is in line with investment in the real estate sector and the upturn in home loans. Construction of buildings increased by 5.2 percent and construction of other structures by 11.1 percent year-on-year in the second quarter. In July, the volume of construction contracts was 21.0 percent higher than in the same period of the previous year, while the volume of new contracts increased by 108.0 percent.

The value added of agriculture was 5.2 percent lower than in the same period of the previous year (Chart 3-10). The poor maize harvest, expected due to the drought at the end of the summer, will have an impact mainly in the third quarter.

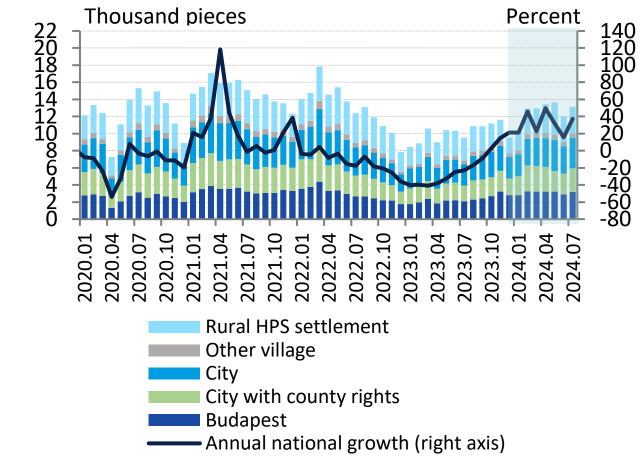
Overall, the value added of services increased by 2.4 percent in 2024 Q2 (Chart 3-10). The expansion was broad based, with the largest increase in accommodation and food services (+7.2 percent). In addition, the value added of arts, recreation and other services rose by 6.9 percent, information and communication by 3.3 percent and transport and storage by 3.2 percent. The value added of trade and the repair of motor vehicles, two major contributor sectors, increased by 2.0 percent. Services linked to the state (public administration, defence, compulsory social security, education, human health and social care) grew by 2.0 percent overall. Human health and social care grew by 4.7 percent and education by 3.0 percent, while the value added of public administration,

Chart 3-12: Annual change in lending to non-financial corporates and households



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

Chart 3-13: Number of housing market transactions by settlement type



Note: Only taking into account 50-percent and 100-percent private acquisitions. From October 2022 to December 2023, the data of 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 highlighted months.
Source: Housing market intermediary database, MNB, NTCA

defence and compulsory social security contracted by 0.2 percent year-on-year.

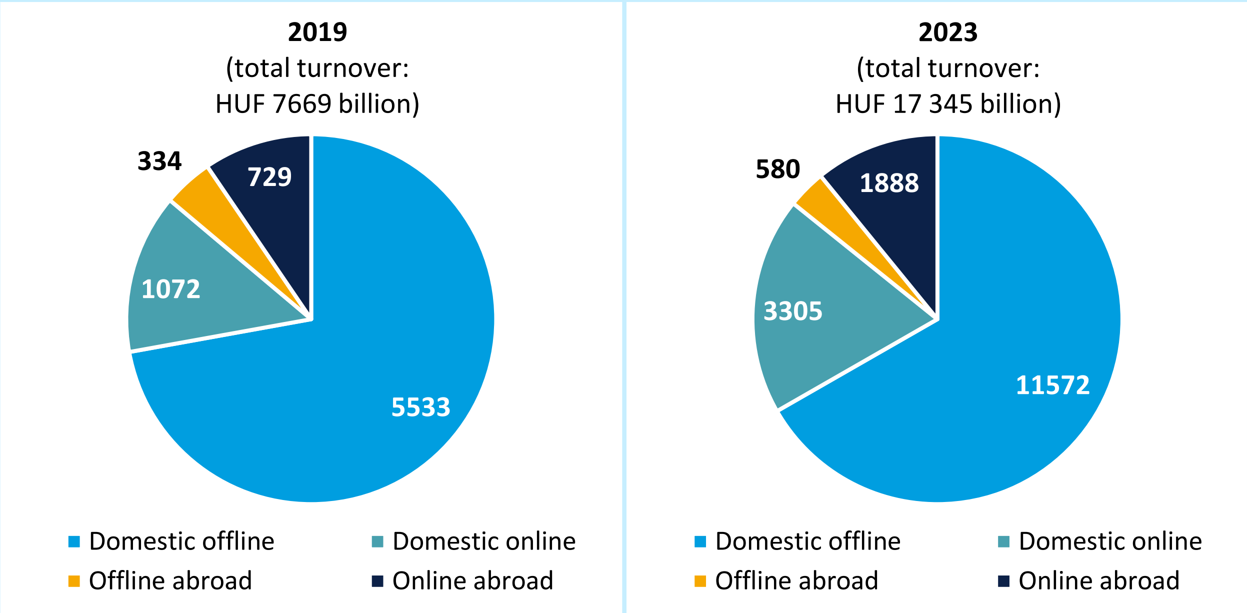
In 2024 Q2, banks saw a pick-up in loan demand in the market of loans to households, while a 'wait-and-see' attitude was experienced for corporate loans. Compared to the previous quarter, the annual growth rate of the total financial intermediation system's household and corporate lending accelerated by 1.5 and 1.6 percentage points, respectively, reaching 5.1 percent and 4.7 percent, respectively, at the end of June (Chart 3-12). In the corporate segment, the increase in the growth rate is attributable to individual large transactions, with the annual growth rate of SME loans, which are more in line with underlying developments, slowing by 1.8 percentage points to a mere 0.7 percentage point at the end of June. New contract signings in the household segment in the second quarter were 76 percent higher than the low base in the same quarter of the previous year, while the year-on-year value of new contracts in the corporate segment stagnated. Based on the responses to the lending survey, banks saw a pick-up in demand in the household segment in the second quarter, while no change in demand was observed in the corporate segment. Looking ahead to 2024 H2, however, a net 28 percent of banks expect a recovery in demand for corporate loans.

The number of sales in the housing market rose substantially year-on-year (Chart 3-13). In 2024 Q2, the number of private housing transactions reached 39,100 nationwide, up 32 percent from the very low number of transactions in the same period last year. In the second quarter, the number of housing market sales increased by 49 percent in Budapest, 35 percent in towns with county rights, 29 percent in other towns and 20 percent in villages eligible for the rural Home Purchase Subsidy Scheme for Families. According to the MNB's house price index, compared to the same period last year, nominal house prices rose by 7.5 percent in 2024 Q1 nationally, with Budapest seeing an increase of 5.6 percent, towns 7.0 percent on average and villages 8.9 percent. Preliminary data suggest that the annual growth rate of house prices may have moderated to 6.5 percent nationally in 2024 Q2 and accelerated to 7.0 percent in Budapest.

Box 3-1: Analysis of consumption abroad based on credit card data

Technological progress, the lifting of restrictions linked to the COVID-19 pandemic and changing social habits are also turning consumption into a cross-border economic activity to an increasing extent. Internationalisation applies to both physical and online forms of consumption. This trend has been boosted by the fact that the recent inflation shock has led to a shift in relative prices between countries. In a period like this the need to measure what is called shopping tourism arises, and the emergence of online commerce over the past decade has opened up the global market to consumers. Monitoring trends in these areas is made more difficult by the fact that it requires, in part, international data sources. However, there is one source of data that can cover almost the entire segment of online purchases and a significant share of cross-border offline purchases based on domestic data. These are data on the use of bankcards held by domestic residents. We use these data on payment services providers with a domestic headquarter or branch, available to the MNB in an aggregate form to analyse these trends.

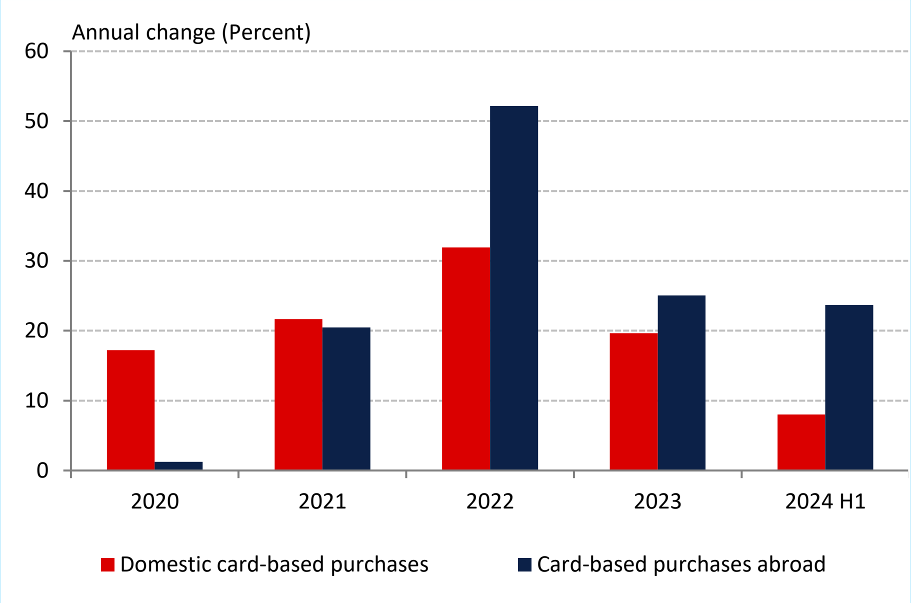
Chart 3-14: Distribution of domestic and foreign card-based purchases by domestic customers (billion HUF)



Note: Data on payment services providers with a seat or branch in Hungary.
Source: Collected by the MNB on the basis of bank card turnover data provided by banks

The share of transactions (both online and offline purchases) abroad made with bank cards issued in Hungary moderately increased from 13.9 percent to 14.2 percent between 2019 and 2023. In 2019, the last year before COVID-19, the total value of credit card-based shopping was HUF 7.8 billion, 13.9 percent of which were done abroad. The distribution of foreign and domestic transactions changed significantly during the pandemic due to travel restrictions. However, by 2023, as tourism picked up, consumption and payment patterns largely recovered and bounced back to pre-pandemic levels, and the share of purchases made abroad returned to the 2019 level: 14.2 percent of the total HUF 17.3 billion card-based transactions were made abroad. In 2023 the total value of transactions abroad increased by 132 percent compared with 2019, while domestic transactions increased by 125 percent. Within the purchases made abroad, a distinction can be made between offline purchases, i.e. those paid for in store, and online purchases. These are presented separately below.

Chart 3-15: Trends in domestic customers' card-based purchases at home and abroad



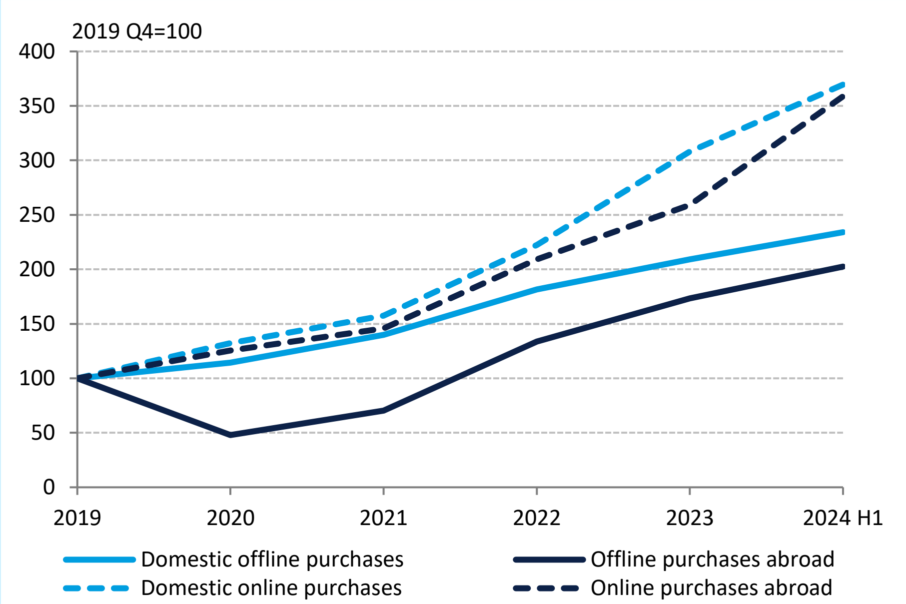
Note: Nominal change. Total value of offline and online purchases. Data on payment services providers with a seat or branch in Hungary.
Source: Collected by the MNB on the basis of bank card turnover data provided by banks.

In terms of offline purchases abroad, 4.8 percent of all card-based purchases by Hungarian customers were made abroad in 2023, a moderate decrease compared with 5.7 percent in 2019. In 2019, the total value of offline purchases abroad made with cards issued to domestic customers was HUF 334 billion, compared with domestic purchases amounting to HUF 5.5 billion. In subsequent years, the value of purchases abroad dropped significantly due to the effects of the pandemic, however, a substantial increase had occurred by 2023 again. Last year the total amount of transactions increased to HUF 579 billion, 1.7 times the 2019 amount. Simultaneously, the total amount of domestic purchases increased to HUF 11.6 billion, 2.1 times the amount in 2019. This means that 4.8 percent of domestic customers' card-based purchases paid for in store were made abroad in 2023, up from 5.7 percent in 2019.

For the other group of foreign transactions, i.e. online purchases, 36.4 percent of them was made by card owners registered abroad, somewhat lower than the corresponding figure in 2019 (40.5 percent). The total amount of online bank card turnover was HUF 1.8 trillion in 2019, of which roughly HUF 700 billion was generated in international online shops. Online card turnover had grown to HUF 5.2 billion by 2023. Most of the growth occurred in domestic online shops, thus, 36.4 percent of the total value of online sales in 2023, i.e. around HUF 1.9 billion, was generated abroad.

Overall, the share of purchases recorded abroad fell in respect of both offline and online transactions, while the share of the total purchases made abroad rose. This is due to a shift towards online purchases, with a significantly higher share of purchases recorded abroad.

Chart 3-16: Trends in domestic and foreign, online and offline purchases by domestic customers

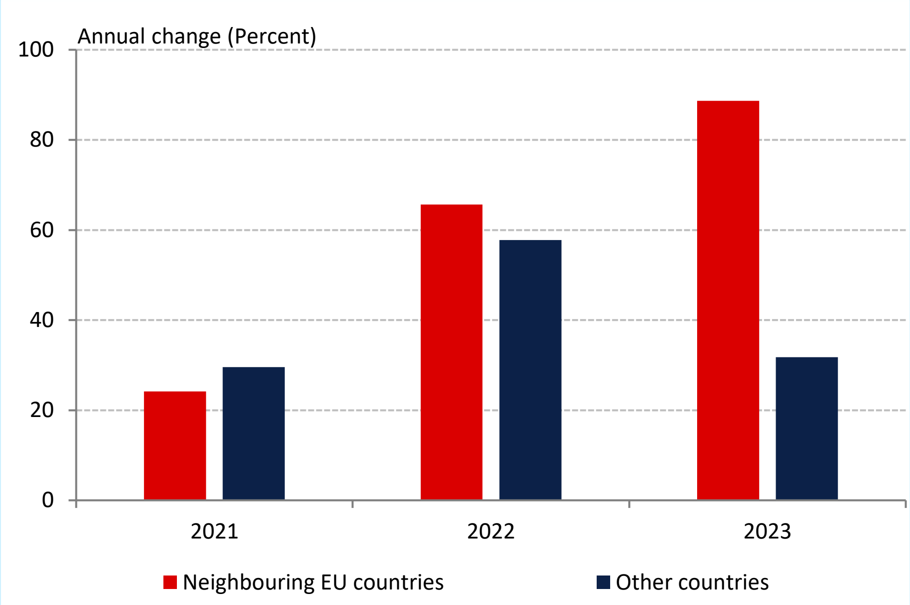


Note: Estimated values for 2024 based on the first half-year data are included. For statistical purposes, all card-based payments made at POS terminals are counted as in-store transactions. Online purchases made abroad also include card top-ups in respect of foreign payment services providers. Data on payment services providers with a seat or branch in Hungary.
Source: Collected by the MNB on the basis of bank card turnover data provided by banks.

In addition to the share of foreign and domestic purchases, the composition of card-based purchases abroad has also changed significantly. During the COVID-19 pandemic, trips abroad were difficult and few and far between; as a result, the value of purchases abroad dropped significantly. Simultaneously, online product orders, online services and software purchases became more popular. This led to a significant shift in the composition of international purchases, with a rise in the share of online transactions. From 2022 onwards, however, foreign tourism picked up again, increasing the share of offline purchases made abroad, despite the continued popularity of both foreign online marketplaces and online stores and foreign subscription-based services (e.g. streaming providers, music subscriptions). While in 2019 68.6 percent of purchases abroad were online transactions, in 2020 during the COVID-19 pandemic, it rose to 85.1 percent, and then fell to 76.5 percent in 2023.

In 2023, the use of domestic cards for shopping for groceries increased faster in neighbouring countries than in remote tourist regions. In 2022 purchases in grocery stores in the neighbouring EU countries accounted for 0.23 percent of domestic customers' card-based offline purchases, rising to 0.37 percent in 2023. A total of HUF 24.1 billion worth of card-based purchases were made by domestic customers in grocery stores in the neighbouring countries in 2022; this had almost doubled by 2023 and stood at HUF 45.5 billion. Simultaneously, food purchases in other, more distant countries increased by 32 percent (from HUF 46.4 billion to HUF 61.1 billion). Its share in total card-based in-store purchases by domestic customers increased from 0.44 percent to 0.5 percent.

Chart 3-17: Annual increase in purchases made with domestic cards in grocery stores in the individual country groups



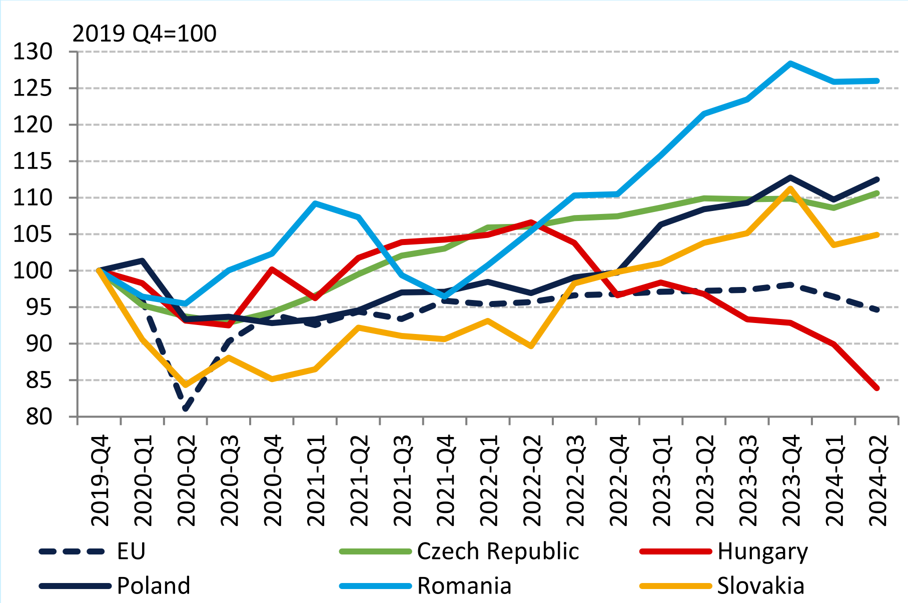
Note: Due to the methodology of data reporting serving as a data source, the neighbouring countries under survey are as follows: Austria, Croatia, Romania, Slovakia and Slovenia. Serbia and Ukraine have been classified as other countries.
Source: Data on payment services providers with a seat or branch in Hungary.

Box 3-2: Factors behind the fall in investment

In the 2010s, rising investment was a key driver of domestic growth. Between 2013 and 2019, gross fixed capital formation increased by 9.3 percent on average, supporting growth by 2.0 percentage points per year on average. Accordingly, the annual real investment rate, which is net of price effects, peaked in 2019 at 26.4 percent.

In parallel with the deteriorating business sentiment, a decrease was seen in the level of investment starting from mid-2022. The volume of investments fell from 2022 H2 following a downward trend, with the decline accelerating in 2024 H1. Compared to the same period of the previous year, gross fixed capital formation fell sharply, dropping by 15.4 percent in 2024 Q2, which slowed GDP growth on annual basis by 4.3 percentage points. For several quarters now, domestic investment compared to the pre-pandemic level has been below regional and EU averages (Chart 3-18).

Chart 3-18: Development of investments in the region and the EU

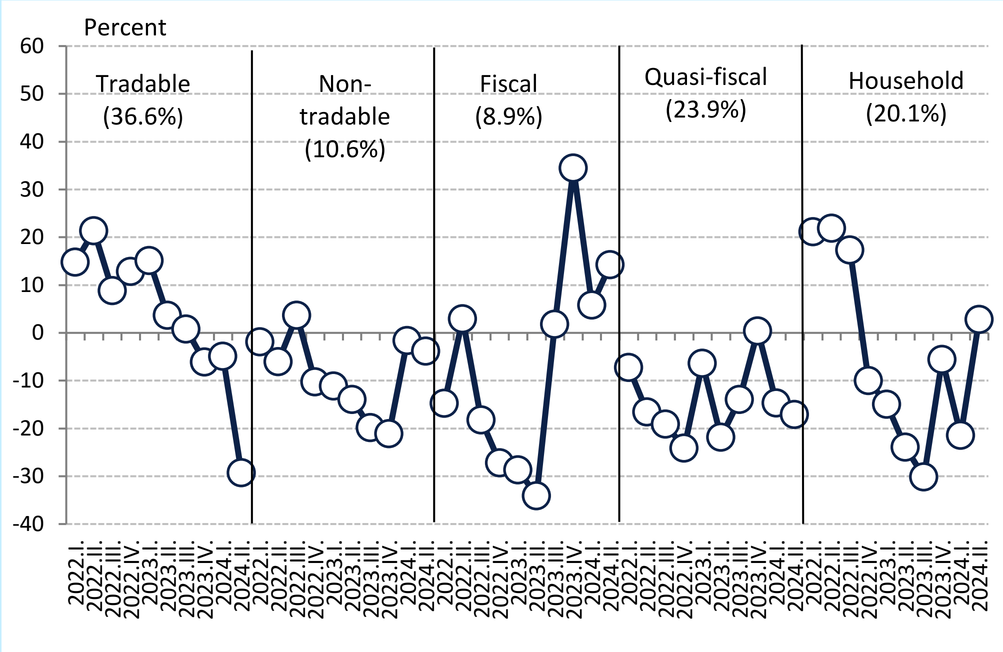


Note: National accounts adjusted data.

Source: HCSO, Eurostat

Detailed sectoral statistics show that both in the sector producing for the domestic market and in the sector producing for the export market the rate of decline increased, while investment directly linked to the public sector and households grew (Chart 3-19). Following a 4.9-percent fall in the previous quarter, investment in sectors producing for external markets dropped sharply, by 29.3 percent in 2024 Q2 relative to the same period of the previous year. Within this, investments in manufacturing, the largest contributor, shrank by 35.0 percent. The performance of the production and services sector supplying the domestic market fell by 3.8 percent year-on-year in 2024 Q2, following a 1.6-percent decline in the previous quarter. Investment in sectors indirectly linked to the public sector (quasi-fiscal) decreased by 17.1 percent. At the same time, investment in the public sector in the narrow sense (public administration, education, health) grew by 14.3 percent. Investment in the real estate sector, which is linked to household invetsments, increased for the first time since 2022 Q3, rising by 2.8 percent on an annual basis.

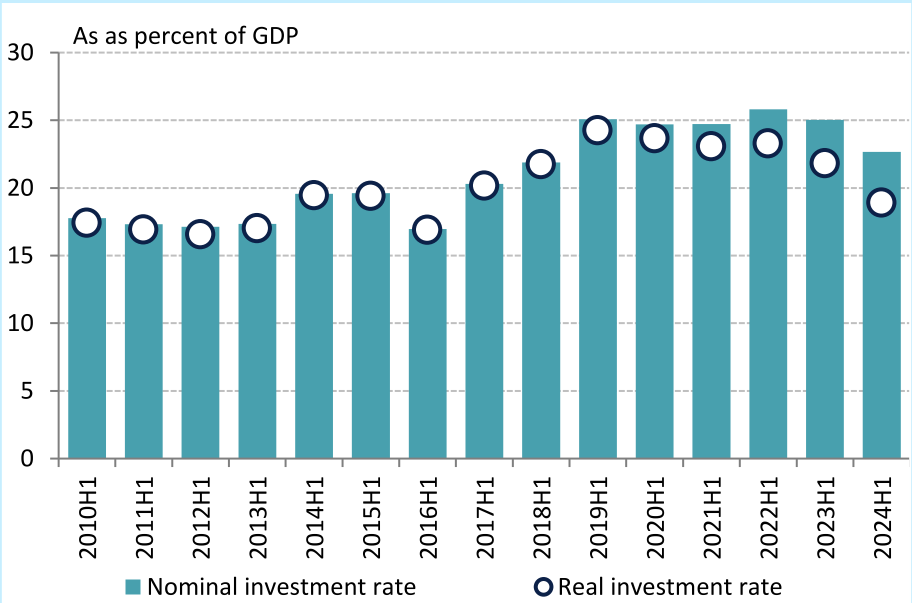
Chart 3-19: Development of investments by sector



Note: Based on the data on investment statistics. Annual change. In brackets, the weight of the sectors within total investment in 2023.
Source: HCSO

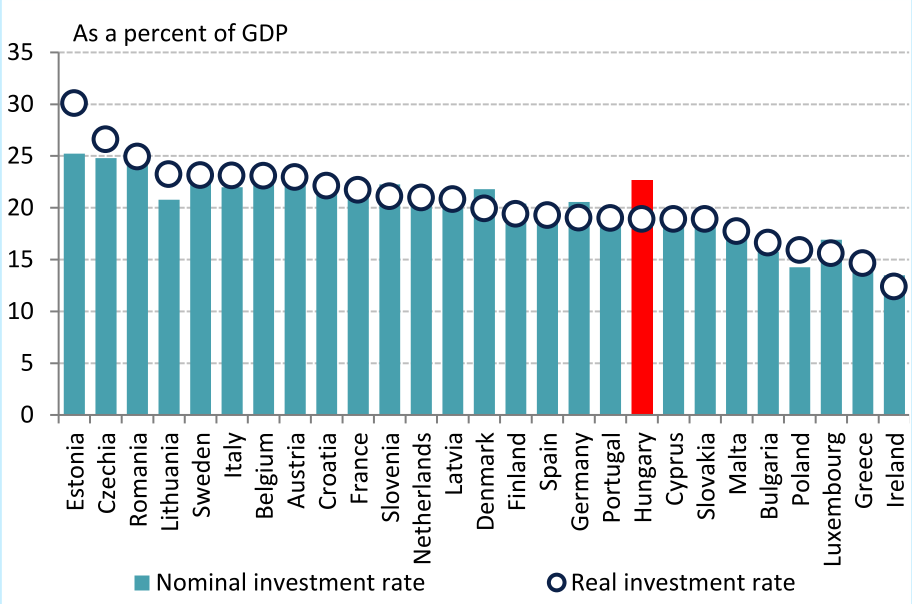
The real investment rate has been declining steadily since 2019 (Chart 3-20). In 2019 H1, the real investment rate amounted to 24.2 percent, ranked 4th highest in the EU, but it then slid to 18.9 percent by 2024 H1, leaving Hungary in 19th place. The nominal investment rate calculated for the first six months of the year, peaked at 25.8 percent in 2022. This is largely explained by the rise in the price of investment goods. In the first half of the current year, however, the nominal and real indicators both declined significantly (Chart 3-21).

Chart 3-20: Development of the domestic investment rate in H1



Note: The real investment rate is calculated at fixed 2015 prices.
Source: HCSO

Chart 3-21: Real and nominal investment rates in an international comparison in H1

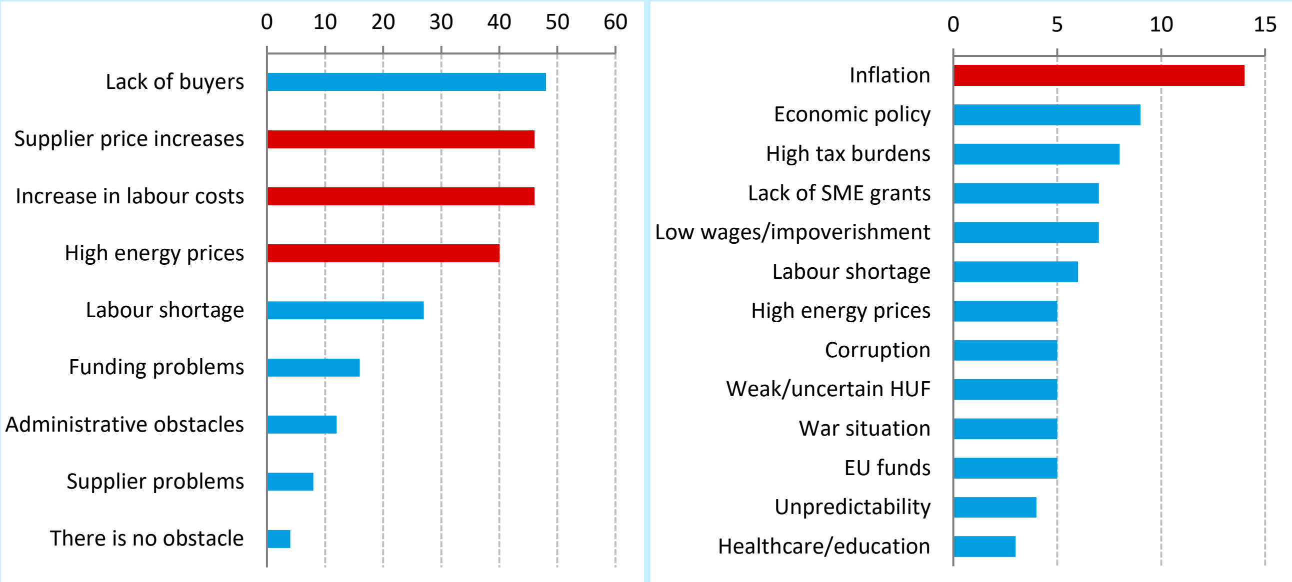


Note: The real investment rate is calculated at fixed 2015 prices.

Source: HCSO, MNB, Eurostat

Companies' business operations and investment continue to be hampered mainly by subdued external demand, the long shadow of inflation and uncertainty (Chart 3-22). According to the MNB's Business Sentiment Survey, the main constraints on companies' operations are the lack of customers, supplier price rises, rising labour costs and high energy prices. At the same time, a survey by the National Association of Entrepreneurs and Employers (VOSZ) shows that inflation remains the most important problem in connection with the country's economic situation, and companies did not list financial constraints among the main limiting factors. The business confidence indicator of the Research Institute of Economics and Enterprises (GKI) indicates weak business confidence, which has stagnated at a low level since end-2022 and is below the pre-pandemic level from end-2019. Subdued external demand and modest economic growth in Hungary's main export partners this year are also restraining domestic corporate sector performance. In particular, the sluggish recovery in European industry is a problem for companies producing for export: industrial production in Germany, the most important country for domestic industrial exports, fell by 5.2 percent overall in the first 7 month of this year. In this context, lower industrial capacity utilisation relative to pre-pandemic levels could hamper corporate developments. The cyclical position of the economy has been negative since the beginning of 2023 (see Chapter 3.4 for more details), which could dampen investment. In addition, the rescheduling of fiscal projects is also contributing to the fall in investment.

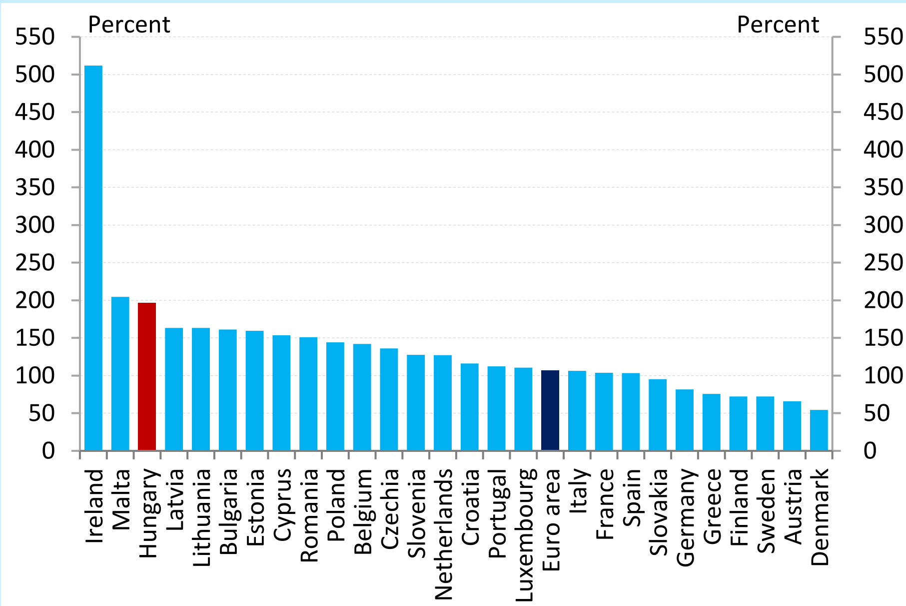
Chart 3-22: Factors complicating the activities of companies in August 2024 (left panel) and the most important problems related to the country's economic situation in 2024 Q2 (right panel)



Source: MNB (left panel), VOSZ (right panel)

The financial situation of companies is favourable, and accordingly the availability of funds is not an obstacle to investment. This is supported by the fact that the ratio of Hungarian companies' liquid assets to GDP remains above 30 percent, significantly exceeding the levels in other countries of the region. In addition, more than 40 percent of corporate assets are liquid financial assets that are easy to mobilise. The level of available funds is favourable not only in a regional comparison, but also when compared to the EU as a whole. In the EU, Hungarian companies rank third in terms of the ratio of liquid assets to loans from banks, following Ireland and Malta (Chart 3-23).

Chart 3-23: Corporate liquid assets as a share of loans from banks in international comparison in 2024 Q1



Source: ECB

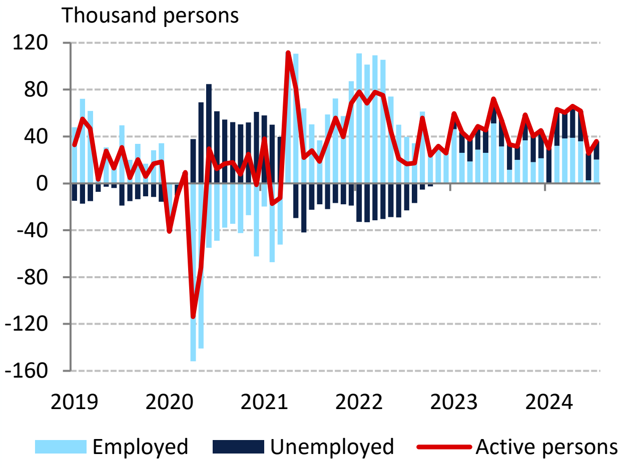
3.3 Labour market

Employment in the national economy remains high, with the unemployment rate dropping to 4.2 percent in July. The increase in labour market activity came to a halt in recent months, but is at historically high levels. The number of vacancies continues to fall, and thus the labour market tightness has eased recently. Average gross earnings in the private sector increased by 11.4 percent in June in year-on-year terms.

3.3.1 Employment and unemployment

Employment in the national economy remains at high levels. In July 2024, the number of employed persons aged 15–74 was 4,765,000, representing an increase of 20,000 versus the same period of the previous year (Chart 3-24). Based on seasonally adjusted data, the number of employed persons did not change significantly compared to the previous month.

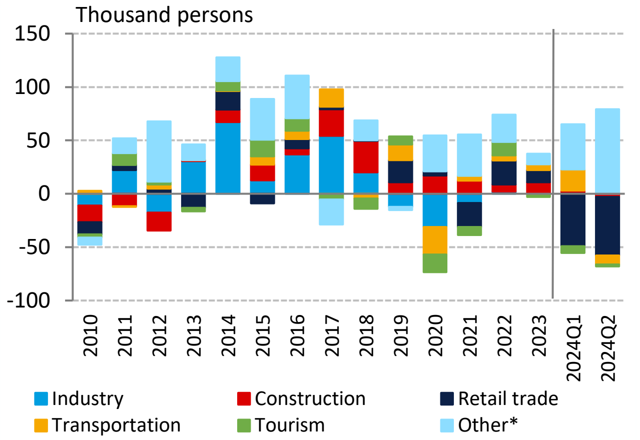
Chart 3-24: Decomposition of annual changes in the labour force participation



Source: HCSO

Employment is developing differently in individual sectors. Based on detailed sectoral data available on a quarterly basis, in the second quarter employment fell slightly in construction, but remained flat in manufacturing compared to the same period of the previous year. Market services saw an overall increase in employment, reflecting different developments at sectoral level. While employment decreased in trade, transportation and storage, and information and communication, it rose in administrative and support service activities, financial and insurance, as well as professional, scientific and technical activities (Chart 3-25). Within the public sector, employment stagnated in education, declined in public administration, and increased in health services on an annual basis. According to the seasonally adjusted data, the number of job vacancies continued to fall in the second quarter. The number of full-time equivalent (FTE) jobs rose again by 1.5 percent year-on-year after two quarters of decline.

Chart 3-25: Decomposition of annual changes in private sector employment

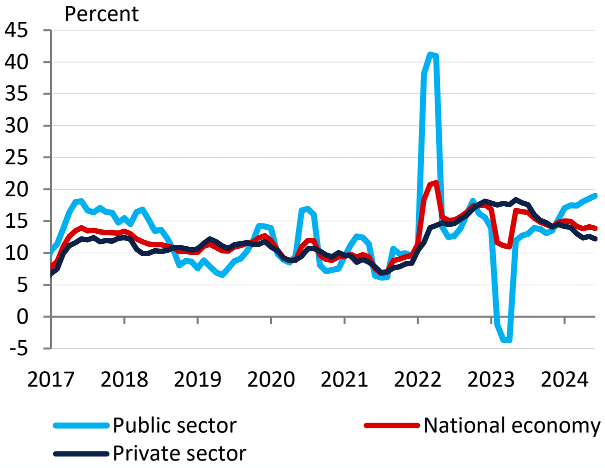


Note: *Agriculture, other industry and service sector branches.
Source: HCSO

Raw data show that the unemployment rate was 4.2 percent in July 2024. The unemployment rate, calculated with the HCSO methodology using a three-month moving average, also averaged 4.2 percent between May and July 2024. The domestic unemployment rate remains low in an international comparison.

The rise in labour market activity came to a halt in recent months. Based on seasonally adjusted data, the number of persons in the labour force has fallen slightly since April, as a result of a slight decrease in the number of the unemployed as well as a minor decline in employment in June. On an annual basis, however, we continue to see a significant increase in the level of the labour force, which was 36,000 persons higher in July 2024 compared to the same period last year.

Chart 3-26: Annual change in gross average wages in the national economy



Note: Quarterly moving averages.
Source: HCSO

3.3.2 Wages

Nominal wage growth decreased slightly in the private sector and increased in the public sector. In June 2024, average gross earnings in the private sector increased by 11.4 percent and regular earnings increased by 12.0 percent on an annual basis, while bonus payments fell short of last year, but were higher than in previous years. The wage increase on a monthly basis in June was lower than 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 in January and in healthcare in March) resulted in stronger gross average wage growth, which reached 18.8 percent in June. Looking at the national economy as a whole, gross average earnings rose by 13.3 percent (Chart 3-26).

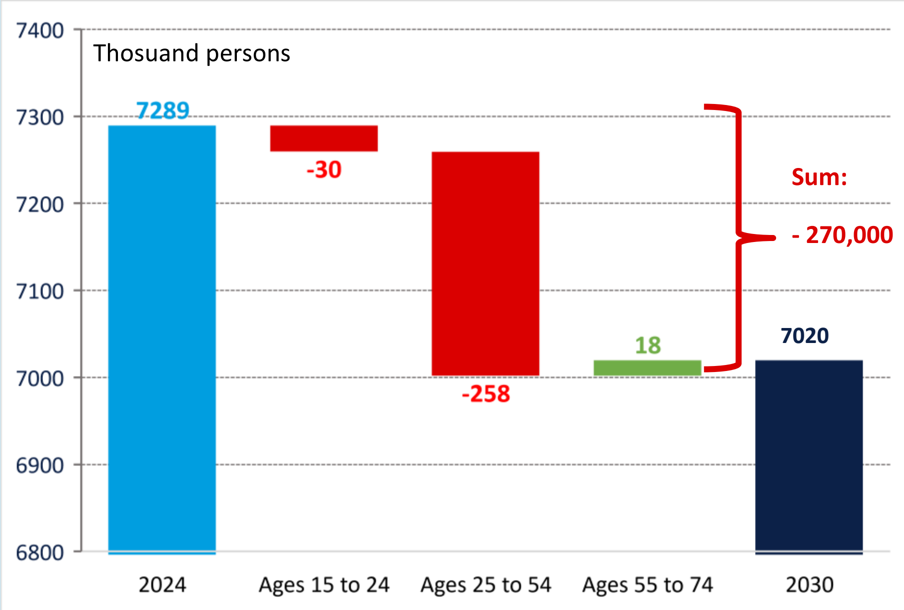
Among the countries in the region, nominal wage growth in Hungary was the second highest after Romania in June 2024. Earnings grew by 15.2 percent in Romania, 11.0 percent in Poland and 4.7 percent in Slovakia in year-on-year terms. For Czechia, wage data are only available at quarterly frequency, with average wages rising by 6.5 percent in the second quarter. Real wages in Romania and Hungary rose at the fastest pace in the region in June. Since the beginning of this year, real wages have increased in all countries of the region.

Box 3-3: Impact of demographic changes on the labour market

Since 2010, the number of people in employment has grown by more than 850,000 and now exceeds 4.7 million. The rise in employment took place against a background of a shrinking working-age population, made possible by an initially high inactivity rate. The number of people of working age (those aged 15–74 according to international statistics) fell from 7.7 million to 7.3 million during this period, i.e. by nearly 30,000 people annually. In addition, the number of people in employment may have increased because unemployment shrank from 470,000 to 200,000 over the same period, and the number of inactive people (of working age) dropped from 3.3 million to 2.4 million. The Hungarian activity rate amounted to 56.7 percent in 2010, the third lowest in the EU, but has since risen by more than 10 percentage points to exceed the EU average. As employment increased, the labour reserve of the unemployed and the inactive contracted significantly.

Demographic constraints on employment growth cause the declining labour supply to be increasingly effective. As in the previous decade, the ageing of society will continue in the years ahead, with the number of people leaving working age outstripping the number of people entering working age. The rate of the population decline will average about 50,000 people per year by the end of the decade, exceeding the average of the previous decade and a half. As a result, the domestic working-age population (15–74-year-olds) may decrease by nearly 300,000 by 2030. The problem is further compounded by the fact that the population decline will mostly affect the group of the best working age with the highest employment rate (25–54-year-olds), while the number of those in the older age group (55–74-year-olds) may also rise somewhat (Chart 3-26). The employment rate among older cohorts is still below that of the 25–54 age group, despite the increase in recent years, and thus the decline in employment may be proportionally larger. Overall, deteriorating demographic indicators, increasing labour market outflows and the erosion of activity reserves will increasingly check further employment growth.

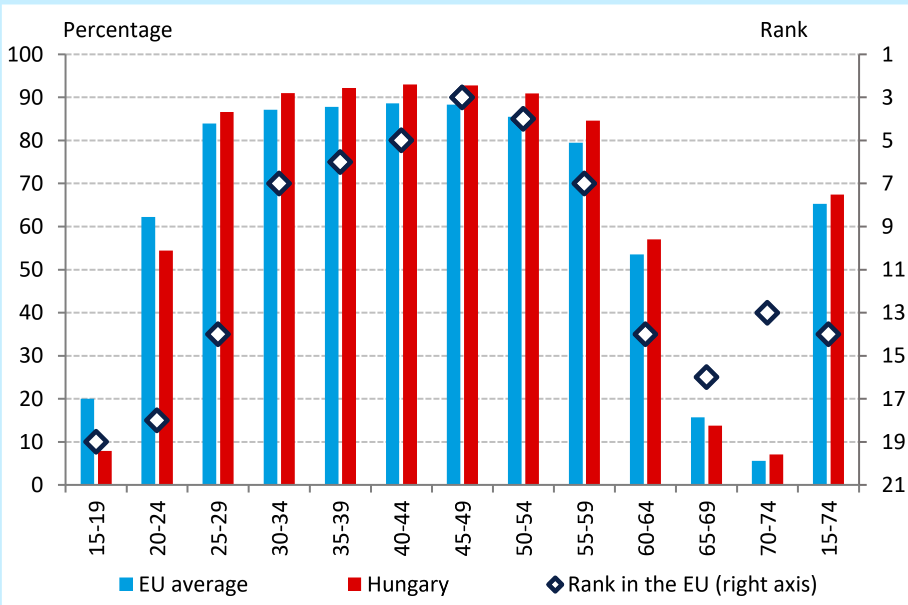
Chart 3-27: Working age population change between 2024 and 2030



Note: 2024 based in Q2 data.
Source: MNB calculation based on Eurostat and HSCO data

The activity rate has risen considerably since 2010 and is the highest among the countries of the region. While in 2010 Hungary's activity rate fell short of the EU average in almost all age groups, by 2023 it had improved across all age groups and, in several cases, the county ranks among the EU leaders. The activity rate is particularly high in the 30–59 age group, ranking among the top 10 in the EU, and among the top 5 in the EU in the 40–54 age group (Chart 3-27). However, the 15-24 age group and the 60+ age group remain in the lower half of the activity ranking. An MNB analysis (2024) suggests that employment in Hungary may only rise substantially by 2030 if employment rates in all age groups rank among the highest in the EU. Taking into account demographic constraints, the number of people in employment may increase by 200,000–250,000 by 2030 if employment rates rise to the level of the EU top 5 countries in all age groups. If the employment rate hovers around the EU average, the number of people in employment may fall as the population declines. Demographic constraints on further labour force growth mean that growth in productivity will play an increasingly important role in the convergence of the domestic economy in the future.

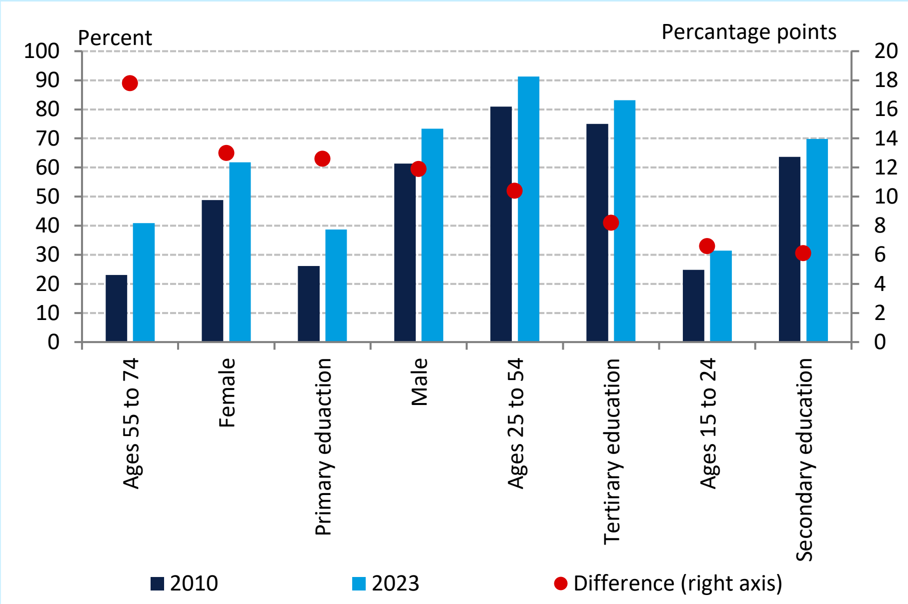
Chart 3-28: Activity rates by age group in 2023



Source: Eurostat

Since 2010, the increase in labour force participation was most significant among those over 55, women and those with a basic education. Analysing in detail the expansion of activity over the past decade, it can be seen that the activity rate has increased in all examined groups since 2010, but significant differences can be observed between these groups. By age, the largest increase was in the 55–74 years old age group at 17.8 percentage points, followed by the 25–54 years old age group at 10.4 percentage points, while it increased the least among young people who had the lowest activity rate at the beginning (15–24 years old) (6.6 percentage points). Among women (who started from a lower base), the expansion was slightly higher than among men (13.0 and 11.9 percentage points, respectively). In terms of education, the activity rate of those with a basic education increased most significantly (12.6 percentage points). The second largest increase was registered among those with higher education (8.2 percentage points), while among those with secondary education the rate of expansion was only 6.1 percentage points (Chart 3-28.).

Chart 3-29: Participation rate by population groups

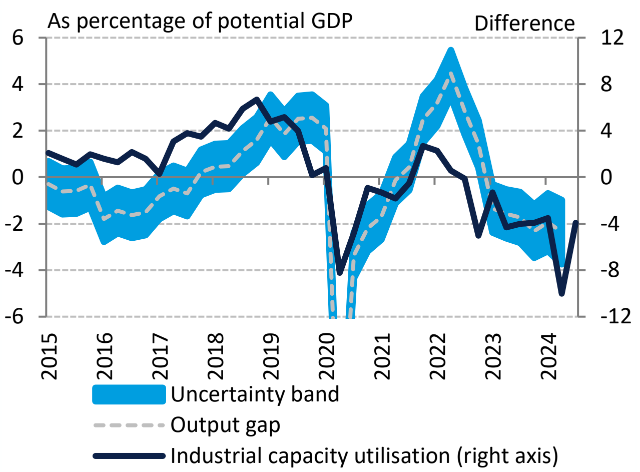


Source: Eurostat

3.4 The cyclical position of the economy

In 2024 Q2, the Hungarian economy grew by 1.5 percent year-on-year, but economic output declined by 0.2 percent in a quarter-on-quarter comparison. The subdued economic output in the past quarter was largely due to a negative contribution from industry. The cyclical position of the economy has been negative since the beginning of 2023 and has thus had a disinflationary effect. We estimate that GDP was below its potential level in 2024 H1. The capacity utilisation and the production expectations of manufacturing companies remain below their historical averages.

Chart 3-30: Uncertainty band of the output gap and the industrial capacity utilisation



Note: The estimation uncertainty band covers one standard deviation. Output gap excluding agriculture performance. In the case of industrial capacity utilisation, deviation from the historical average.
Source: ESI, HCSO, MNB estimation

The cyclical position of the economy is estimated to have been negative since the beginning of 2023 and has thus had a disinflationary effect (Chart 3-30). The output of the Hungarian economy declined by 0.2 percent in 2024 Q2 in a quarter-on-quarter comparison. In line with the moderate economic performance, the output gap excluding the performance of agriculture, remains in negative territory. The generally tense geopolitical situation and conservative growth prospects in Europe pose a risk to the external outlook. The external output gap – which has an effect on the Hungarian cyclical state – remains in negative territory as well.

According to questionnaire surveys, the capacity utilisation and production expectations of manufacturing companies remain below their historical averages. Production expectations for the coming months worsened somewhat in recent months

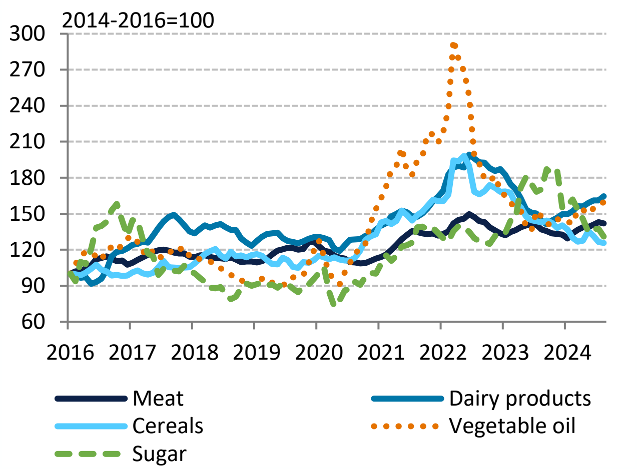
3.5 Costs and inflation

In August 2024, inflation returned to the tolerance band, as consumer prices rose by 3.4 percent year-on-year. Core inflation and core inflation excluding indirect tax effects both dropped to 4.6 percent. The consumer price index fell by 0.7 percentage point compared to the previous month, largely due to the decrease in the price dynamics of fuels. Our indicators capturing more persistent inflation trends remained broadly unchanged. On a monthly basis, the price of the total consumer basket remained unchanged, while the price of the core inflation basket rose by 0.2 percent. For both inflation and core inflation, the rate of price rises relative to the previous month exceeded the historical average for this time of the year.

3.5.1 Producer prices

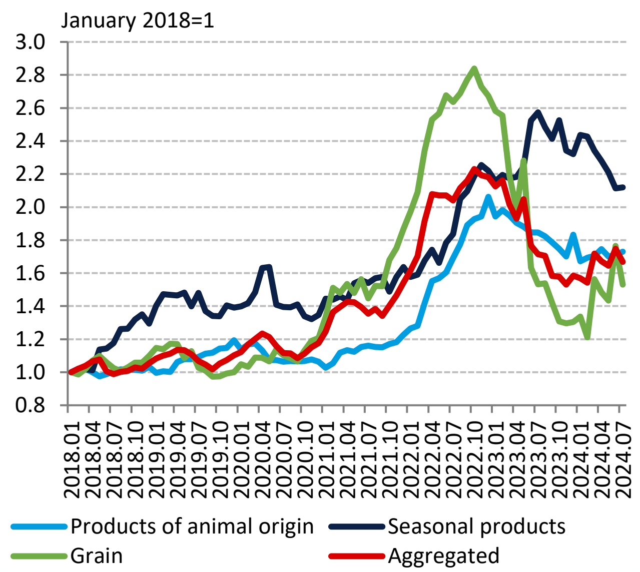
Global food prices fell by 0.3 percent in August. The rise in dairy product and vegetable oil prices was offset by a month-on-month decline in sugar, meat and grain prices. According to the FAO, food prices fell by 1.1 percent compared to August 2023, driven by a significant year-on-year drop in grain and sugar prices. Grain prices declined by 11.9 percent on an annual basis and by 0.5 percent on a monthly basis, mainly due to poor demand and strong competition. As a result, prices fell to nearly a four-year low. Vegetable oil prices rose by 8.1 percent year-on-year and by 0.8 percent on a monthly basis, with the price level reaching a 19-month high. The price increase in recent months was primarily explained by rising palm oil prices due to weaker output in Indonesia. Dairy products went up by 14.2 percent compared to the same period last year and by 2.2 percent relative to July. Meat prices were 3.7 percent higher than in August of last year and 0.7 percent lower than in July. World sugar prices dropped by 23.2 percent year-on-year, while they fell by 4.7 percent on a monthly basis. The monthly decrease was driven by more favourable production outlook in Thailand and India (Chart 3-31).

Chart 3-31: Development of world market prices of food



Source: FAO

Chart 3-32: Development of agricultural prices



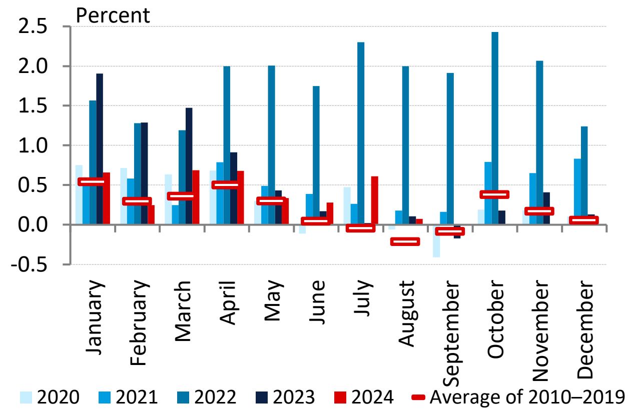
Note: Based on seasonally adjusted data.

Source: HCSO

In July, domestic agricultural producer prices decreased by 4.6 percent month-on-month, and thus prices were 2.7 percent lower than in the same period in 2023. Among the component items, the producer price of grains was unchanged on an annual basis. The year-on-year decline in the price level of animal products decelerated, with prices falling by 6.3 percent in July. Producer prices for seasonal products decreased by 17.6 percent over one year (Chart 3-32).

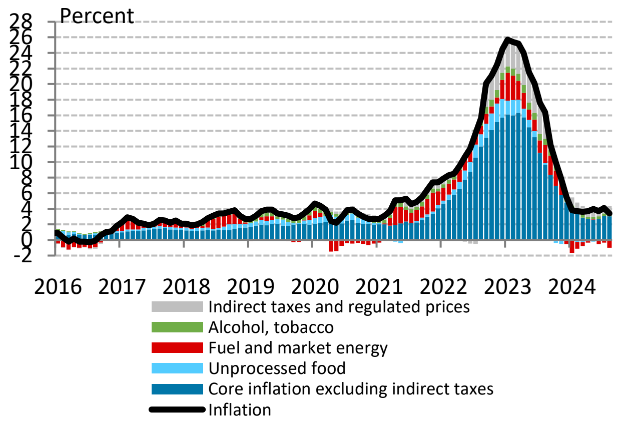
Producer prices for manufactured goods for domestic sale rose by 1.4 percent on an annual basis in July 2024. Domestic sales prices in the manufacturing sector increased by 2.8 percent compared to July last year. Producer prices were 2.1 percent lower in the energy sector and 1.5 percent lower in the food sector than in the same period of the previous year.

Chart 3-33: Monthly price changes of consumer prices excluding fuel and regulated prices



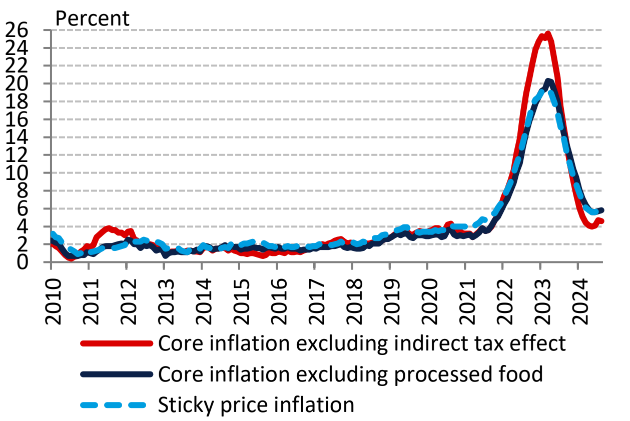
Note: Tax-adjusted, seasonally unadjusted monthly change.
Source: MNB calculation based on HCSO data

Chart 3-34: Decomposition of inflation



Source: MNB calculation

Chart 3-35: Underlying inflation indicators



Note: Core inflation excluding processed foods with unchanged content is equivalent with the earlier demand sensitive inflation. The new name is justified by the fact that the previous name might be ambiguous in a period of significant cost shocks with general effects.
Source: MNB calculation based on HCSO data

3.5.2 Consumer prices

Inflation returned to the tolerance band, as consumer prices rose by 3.4 percent year-on-year in August. The consumer price index dropped by 0.7 percentage point compared to the previous month. The fall in the annual consumer price index was largely due to the decrease in the price dynamics of fuels, which declined by 0.5 percentage point, mainly resulting from the base effect (Chart 3-33). On a monthly basis, the price of the total consumer basket remained unchanged, while the price of the core inflation basket rose by 0.2 percent (Chart 3-34). Month-on-month core inflation excluding processed food, which better reflects the underlying trends, amounted to 0.2 percent.

Core inflation and core inflation excluding indirect tax effects both declined to 4.6 percent. Both indicators decreased by 0.1 percentage point, driven by the decline in the price dynamics of processed foods. Indicators capturing more persistent inflation trends remained broadly unchanged in August (Chart 3-35). On a shorter basis (annualised 3-month-on-3-month), core inflation and inflation fell. The rate of price increases relative to the previous month was higher than the historical average for both inflation and core inflation.

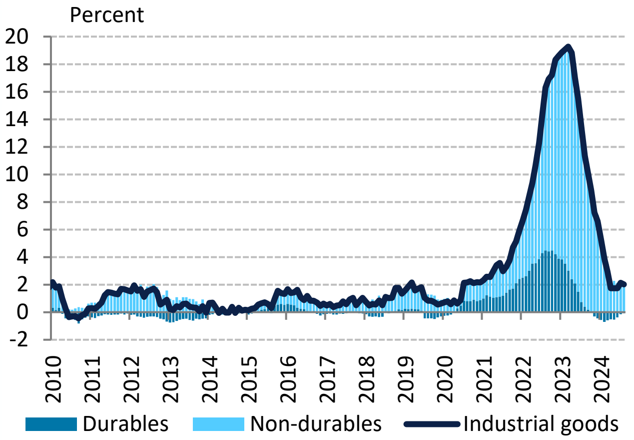
Annual inflation of tradables fell to 2.0 percent in August. On a monthly basis, the price of this product group dropped by 0.2 percent (Chart 3-36 and Chart 3-37). Durables prices rose by 0.1 percent, while non-durables prices were down by 0.3 percent. The latter was primarily explained by changes in the prices of clothing and non-alcoholic beverages.

The annual price index of market services rose to 9.6 percent. On a monthly basis, prices increased by 0.5 percent, which was mainly explained by the rise in rents and the price of accommodation and food services (Chart 3-38).

Inflation for alcohol and tobacco products was 3.9 percent. Compared to July, the price of this product group decreased by 0.1 percent.

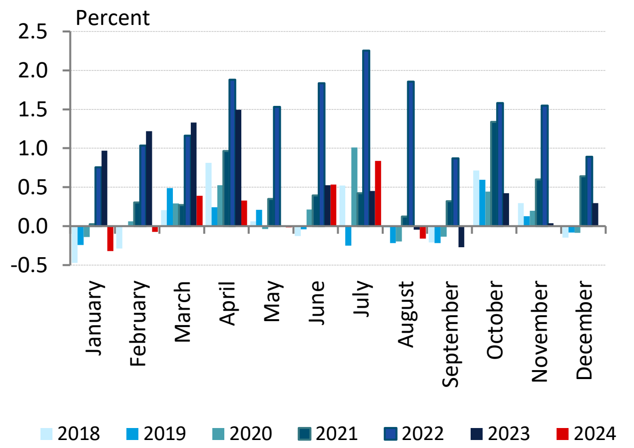
Food inflation according to the MNB's classification amounted to 0.3 percent in August. Within this product group, unprocessed food inflation was 0.7 percent, while the annual price index for processed food was 0.1 percent. According to the data released by the Hungarian Central Statistical Office, food prices increased by 2.4 percent, which includes a rise of 8.0 percent in restaurant meal prices. Compared to July, the prices of unprocessed food fell by 0.6 percent as a result of the decreases in potatoes and

Chart 3-36: Inflation of industrial goods



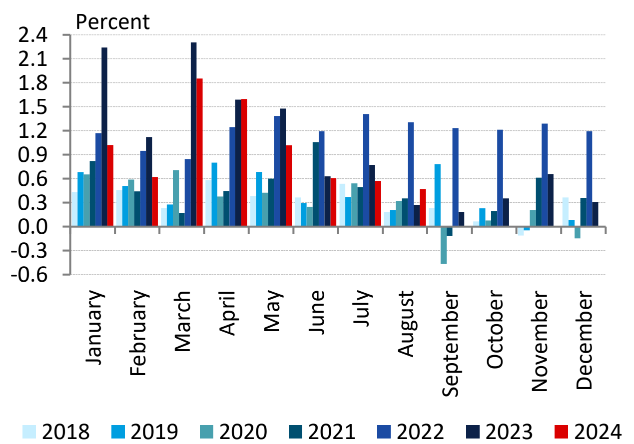
Note: Year-on-year change, excluding the effect of indirect taxes.
Source: MNB calculation based on HCSO data

Chart 3-37: Monthly price changes of traded goods



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

Chart 3-38: Monthly price change of market services



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

fresh vegetables prices. Processed food prices were up by 0.2 percent, which was primarily fuelled by pastry prices.

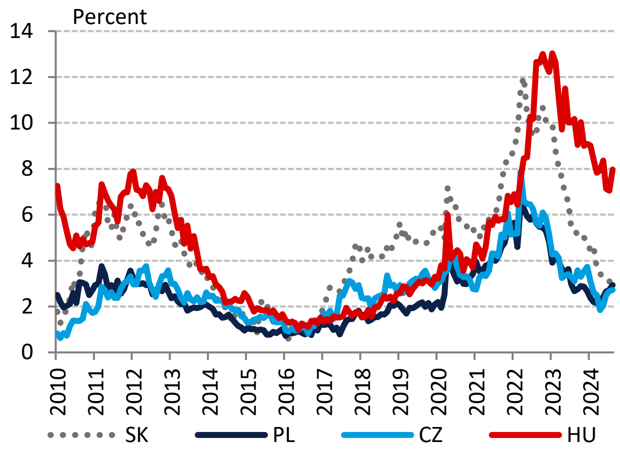
Fuel prices fell by 0.8 percent month-on-month in August as a result of lower global oil prices. Due in part to favourable base effects, prices decreased by 2.9 percent on a yearly basis.

August inflation was in the middle of the projected range of the June Inflation Report. Core inflation was also in the middle of the projected range.

3.5.3 Inflation expectations

Inflation expectations have been on a downward trend since the beginning of last year, with higher than usual volatility. Similarly to Hungary, Slovakia also sees easing inflation expectations with considerable volatility, while in Poland and Czechia, inflation expectations rose in recent months (Chart 3-39).

Chart 3-39: Inflation expectations in the region



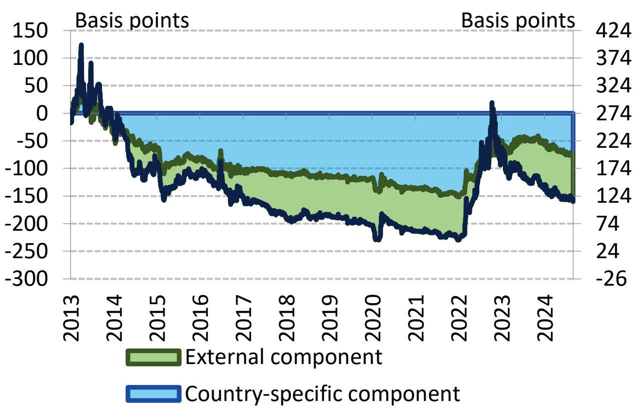
Source: MNB calculations based on European Commission data

4 Financial markets and interest rates

4.1 Domestic financial market developments

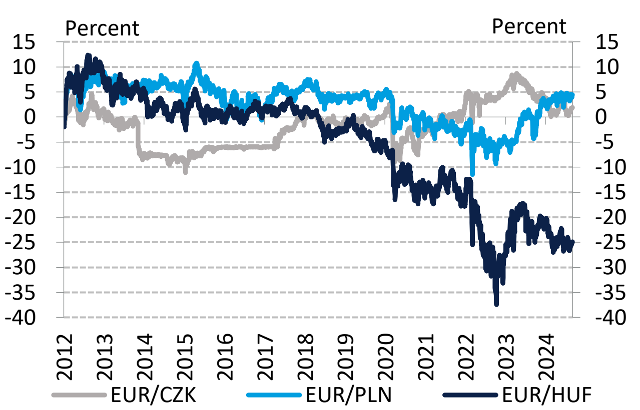
Investor sentiment was mostly unfavourable in the past quarter, due to developments in the financial market in early August and the global growth outlook. In addition, geopolitical conflicts continue to pose significant risks, especially in relation to the energy sector. The Japanese central bank's interest rate hike at the beginning of August and worse-than-expected US macro data caused volatility to flare up briefly in the financial markets, with some risk indicators rising sharply. Except for a volatile period in early August, asset price developments in international markets in the past period were mainly driven by expectations about the interest rate policies of central banks in developed markets. The entire market interest rate path shifted downwards in response to decisions by major central bank policymakers and macroeconomic data; thus, the Fed and the ECB are also likely to further cut their policy rates a number of times this year. The forint weakened temporarily as global sentiments deteriorated and then appreciated, and government bond yields moderated in the past quarter.

Chart 4-1: Components of the 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 edge lower over the period. The premium declined consistently and falling by 9 basis points overall to 113 basis points in the past quarter (Chart 4-1), supported by a combination of international and country-specific factors.

4.1.2 Foreign exchange market trends

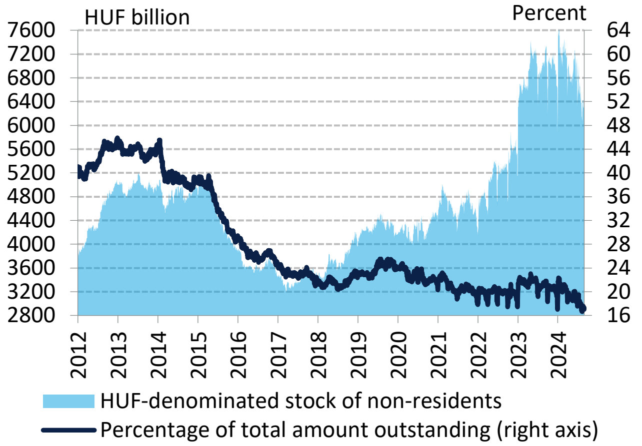
The forint strengthened by 0.7 percent against the euro in the period as a whole, underpinned by the Hungarian central bank's cautious and patient interest rate cuts, which were well received by the market. The forint weakened at the beginning of the period and then, following some financial market turbulence in early August, strengthened again, which was also supported by the market reception of the August interest rate decision. In the region, the Polish zloty appreciated by around 1.2 percent, while the Czech koruna depreciated slightly and the Romanian leu remained broadly unchanged over the period (Chart 4-2). The forint and the Polish zloty strengthened by 4.7 and 5.3 percent, respectively, while the Czech koruna and the Romanian leu appreciated 3.4 and 4.1 percent, respectively, against the US dollar.

4.1.3 Government securities market and changes in yields

Non-residents' holdings of government securities fell during the past quarter (Chart 4-3). Non-residents' holdings of HUF government securities decreased by HUF 806 billion to HUF 6,343 billion in the period. The share of the forint in government bonds also declined in the last quarter to around 17.5 percent.

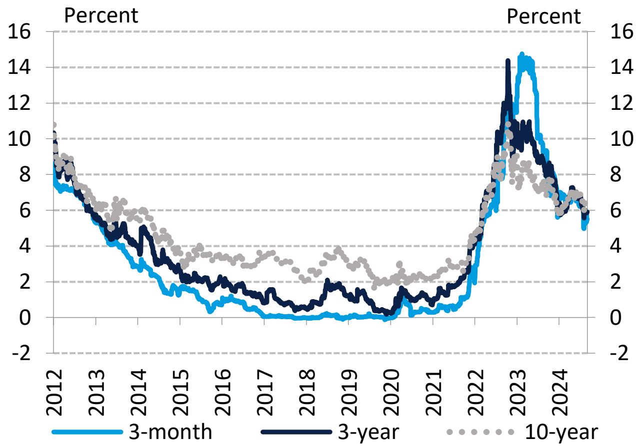
Demand at discount treasury bill auctions was mostly weak in the last quarter. By contrast, bids for government

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



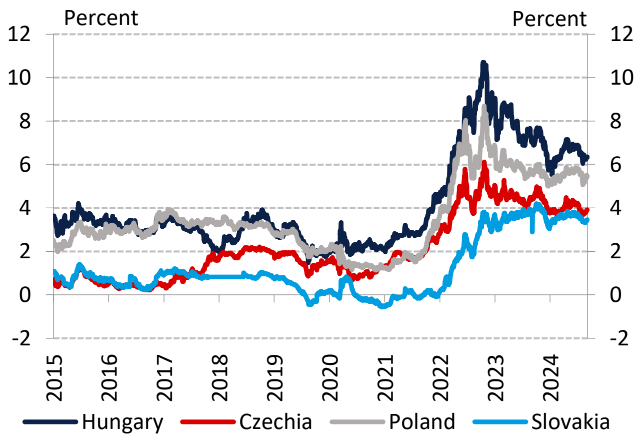
Note: The chart shows the stock of T-bills and T-bonds.
Source: MNB

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

bonds, on average nearly 1.5 times higher than the planned issuance, were accepted at government bond auctions. Average bond yields also fell in the last quarter. Average yields fell by 80 basis points at the three-month T-bill auction, and by 45 basis points at the 10-year auction.

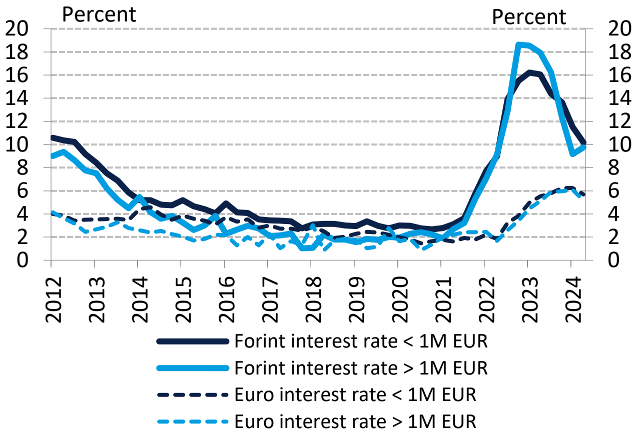
The government bond market yield curve as a whole shifted downwards in the period (Chart 4-4). Overall, the five-year yield declined by 81 basis points and the ten-year yield by 44 basis points in the past quarter. Regarding interbank yields, the 3-month BUBOR decreased by 42 basis points to 6.45 percent.

Long-term benchmark yields in the region declined in the past quarter (Chart 4-5). Czech, Polish and Slovak ten-year yields fell by 42, 51 and 25 basis points, respectively.

4.2 Credit conditions of the financial intermediary system

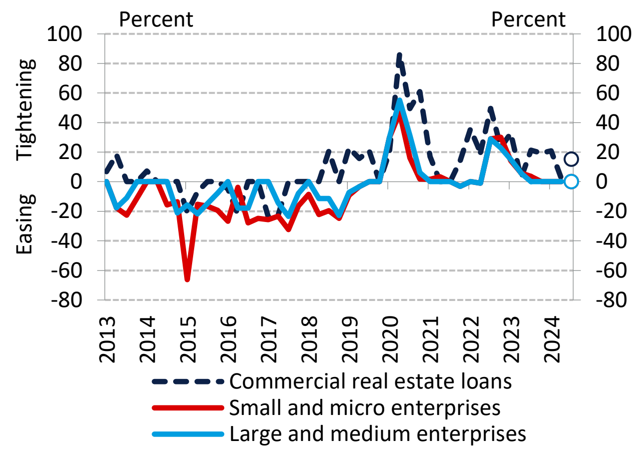
In 2024 Q2, banks left credit conditions for corporate loans broadly unchanged, and looking ahead to 2024 H2 banks do not intend to change them significantly. In the second quarter of the year, banks reported growing demand for corporate foreign currency and short-term loans, and they expect a further pick-up in demand in the second half of the year as well. By contrast, demand for long-term loans was reported to have been broadly flat, with no recovery expected looking ahead. Banks' lending capacity remains high. Banks eased their standards for housing loans; however, a net 8 percent of the banks tightened the conditions for consumer loans. Looking ahead to the next six months, terms for housing loans are expected to be eased further while those of consumer loans are likely to be tightened further. Banks reported a pick-up in demand for both housing and consumer loans in the second quarter of the year. Banks do not expect any further pick-up in demand for housing loans in 2024 H2, in contrast to consumer loans, while 81 percent expect a further increase in demand for consumer loans. Due to a fall in borrowing costs, and partly due to regulatory measures affecting interest rates, the average financing cost of newly contracted corporate HUF loans and the average cost of newly contracted fixed-rate long-term housing loans both declined during the period under review.

Chart 4-6: 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 4-7: Changes in credit conditions in corporate sub-segments



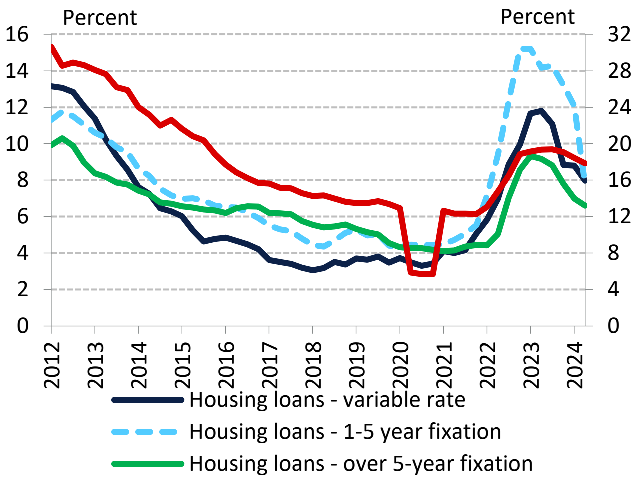
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Forecast for 2024 H2.
Source: MNB, based on banks' responses

4.2.1 Corporate credit conditions

In 2024 Q2, HUF lending rates fell below 10 percent in conjunction with the decline in borrowing costs. Net of money market transactions, the average interest on newly contracted, mostly market-based corporate HUF loans with variable interest rates within a 12-month period decreased by 1.3 percentage points for low-amount loans, and increased by 0.6 percentage point for large-amount loans relative to the previous quarter. The average interest rate on contracted corporate HUF loans fell below 10 percent overall and stood at 9.6 percent at end-June (Chart 4-6), partly due to lower borrowing costs and partly due to regulatory requirements for loan interest rates and the initial mark-ups applied. Supported by a decline in euro area interbank interest rates, interest on low-amount EUR loans fell by 55 basis points and that on large-amount EUR loans by 92 basis points in the second quarter of the year. The average cost of financing corporate EUR-denominated loans stood at 5.2 percent at the end of June.

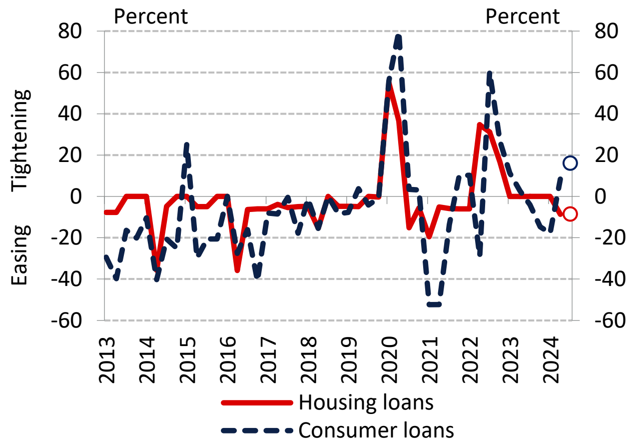
In 2024 Q2, banks left overall corporate lending conditions unchanged across all company size categories and they do not intend to change these conditions in 2024 H2. Overall, banks did not change their standards for commercial real estate loans significantly, but 37 percent of them tightened financing conditions for office buildings, due to the negative prospects for this segment. Banks' lending capacity remains high. Banks do not plan to make significant changes to corporate lending standards in any size category in the next six months, but 15 percent and 58 percent of the banks, respectively, envisaged tightening financing conditions for logistics centres and office buildings, due to the change in risk tolerance (Chart 4-7). In terms of loan demand, institutions reported broadly unchanged corporate loan demand in 2024 Q2, while 38 and 19 percent of the banks perceived a pick-up in demand for foreign currency loans

Chart 4-8: 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 4-9: 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 H2.
Source: MNB, based on banks' responses

and short-term loans, respectively, due to rising demand for inventory financing. With declining investment activity, a net 14 and 15 percent of the banks, respectively, experienced a decline in demand for HUF loans and for long-term loans. Looking ahead to the next six months, one third of the banks expect demand for foreign currency loans and short-term loans to continue to pick up, and around one quarter also expect demand for HUF loans to increase as the general interest rate environment improves; however, demand for long-term loans may be characterised by a 'wait-and-see' approach.

4.2.2 Household credit conditions

The average interest rate on long-term fixed-rate housing loans continued to fall during the quarter. The average APR of housing loan contracts signed in 2024 Q2 regarding for loans with fixed interest rates for a term of over 5 years, covering the majority of market-based loans, reached 6.6 percent in June 2024, relative to 7.0 percent in March 2024 (Chart 4-8). The application of a voluntary APR ceiling by the majority of the banks between 9 October 2023 and 30 June 2024 may also have contributed to the reduction. The level of the APR ceiling has fallen from an initial 8.5 percent, to 7.3 percent since January 2024.[1] In 2024 Q2, the volume of Certified Consumer-friendly Housing Loans (CCHL) with an interest-rate period of at least 5 years accounted for 27 percent of newly disbursed housing loans, while the share of loans with a fixed term of at least 10 years was 72 percent. The average smoothed APR for personal loans decreased by 59 basis points to 17.8 percent at the end of the period under review.

Regarding housing loans, in response to increasing competition, banks eased price terms, but with the expiration of the APR ceiling, this may be followed by tightening in the latter half of the year. Based on the responses to the Lending Survey, in 2024 Q2 a narrow range of banks, around a net of 9 percent, eased their credit standards for housing loans, while 45 and 57 percent, respectively, reduced their spreads on housing loans and the premium on riskier loans as a result of voluntary compliance with the APR ceiling and increased market competition. With regard to consumer loans, 8 percent of the banks have tightened standards (Chart 4-9). Looking ahead to 2024 H2, a net 9 percent of the responding banks considered a further easing for housing loan conditions. Easing in price terms projected for the second quarter of the year is likely to be followed by tightening at around half of the banks in the second half of the year after the expiration of the voluntary APR cap. A broader range of banks, around 16 percent, expect a further tightening of consumer credit conditions, while a net 34 percent would continue to reduce spreads to increase market share. All institutions surveyed reported a recovery in demand for housing loans in the second quarter, with no further recovery expected in the latter half of the year. A net 58 percent of the institutions surveyed experienced a pick-up in demand for consumer loans, with 81 percent expecting a further increase in the next six months.

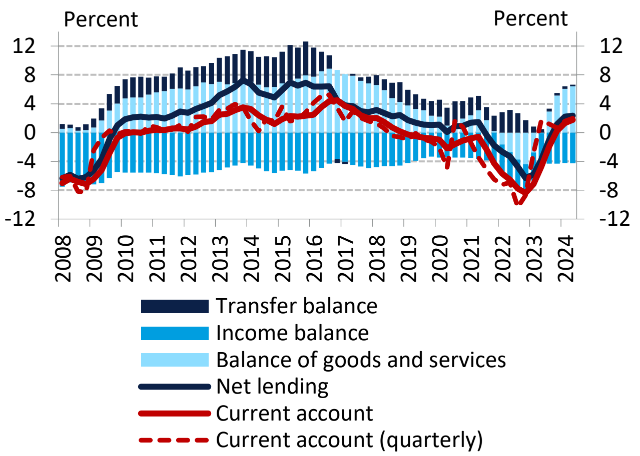
[1] For a more detailed analysis of the effects of the APR ceiling, see Box 3 in the May 2024 Financial Stability Report.

5 Balance position of the economy

5.1 External balance and financing

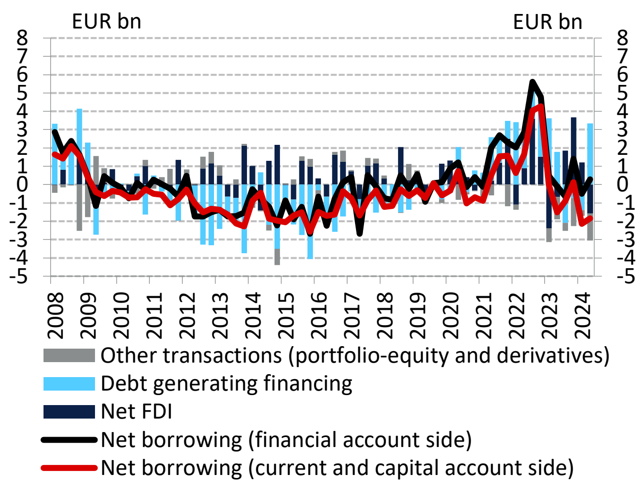
According to preliminary monthly data, the current account surplus grew to 1.8 percent of GDP in 2024 Q2, while net lending reached 2.3 percent of GDP. Improvement in the external balance continued to be driven by an increase in the goods balance, linked to a fall in imports. In terms of financing, the quarter saw a net outflow of FDI, mainly related to the buyback of Budapest Airport, accompanied by an increase in the country's debt liabilities. In the first quarter, gross external debt stood at 63.9 percent of GDP, while the net ratio fell below 10 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

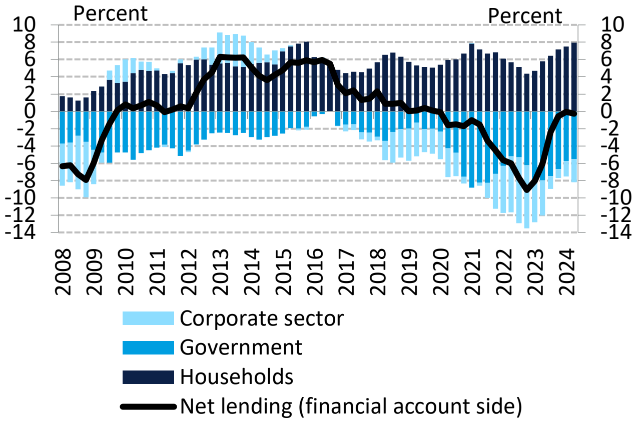
The current account balance and net lending continued to improve in 2024 Q2 (Chart 5-1). Based on preliminary monthly data, this was entirely driven by the external trade balance, including the goods balance. The decline in the energy balance (albeit now at a slower pace) and low investment activity both contributed to a fall in imports, which was only partly offset by the mounting demand for imports triggered by rising consumption. At the same time, the services surplus as a share of GDP remained stable at close to 5 percent. The transfer balance fell to 0.2 percent of GDP, down substantially from a year ago, reflecting the moderate use of EU transfers and the settlement of the fine imposed by the Court of Justice of the European Union.

5.1.2 Developments in financing

In 2024 Q2, a one-off effect led to a net outflow of FDI, while debt liabilities increased substantially (Chart 5-2). In 2024 Q2, domestic FDI declined significantly, mainly due to the buyback of Budapest Airport; in addition, it was also reduced by ordinary dividend payments. The quarter saw resident investors buy a significant amount of foreign shares and stocks. The buyback of Budapest Airport increased the government's net external debt, while the maturity of the MNB's short bonds worked in the opposite direction. In parallel with the fall in the use of central bank assets, the banking system's ratio rose, with the net external debt of businesses also increasing moderately.

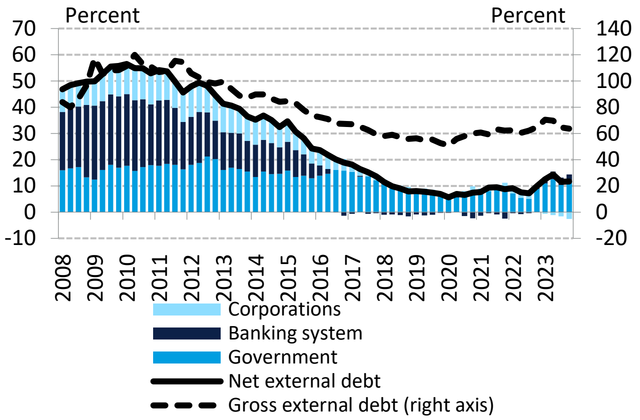
In 2024 Q2, government net borrowing was nearly offset by net financial savings in the private sector (Chart 5-3). The net borrowing of the general government continued to ease, thanks to substantially lower public investment and higher tax revenues from labour. In addition, taxes on consumption rose at a rate higher than before, which could lead to a further decline in net borrowing. Net financial savings in the private sector shrank to a small degree, but remain high. Household net savings rose to 7.9 percent of GDP, reflecting the slow unwinding of precautionary motives in the household sector. By contrast, net borrowing

Chart 5-3: Decomposition of net lending by sectors



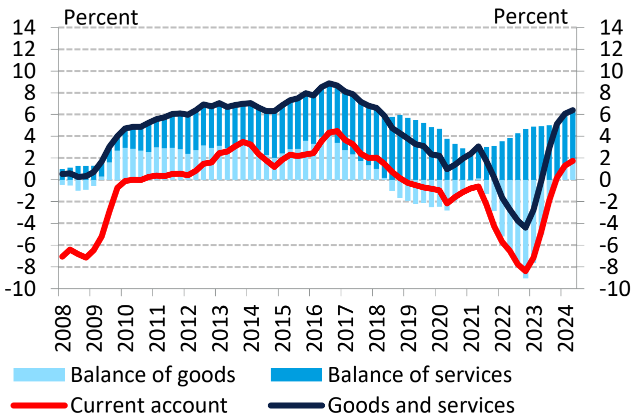
Note: Four-quarter cumulation, as a percentage of GDP.
Source: MNB

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

Chart 5-5: Changes in the balance of goods and services



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

by companies started to climb again after a steady decline, as high profitability diminished.

At the end of March 2024, the economy's net external debt fell to 9.8 percent of GDP (Chart 5-4). The substantial decline in the indicator was partly due to the downward effect of transactions in the first quarter and partly to the effect of revaluation. The decline in net external debt was primarily attributable to the general government, while the ratio of banks and companies increased moderately. The country's gross external debt stood at 63.9 percent of GDP at the end of the quarter.

The balance of services is playing an increasingly important role in the external trade balance and consequently in the current account as well (Chart 5-9). Traditional services (tourism, labour, transport services) were gradually joined by IT, financial and business services in the aftermath of the financial crisis, with the services balance contributing markedly to the current account surplus in the mid-2010s. The balance of services had risen to 5 percent of GDP by the end of the decade, but the pandemic temporarily hampered trade in services as well, similarly to the export of commodities. The surplus in services, however, returned to its growth trajectory in 2021, which, in 2022, helped dampen the external balance eroding impact of the dramatic deterioration in the goods balance which had been driven by an energy price hike. The impact of declining exports in recent quarters in an uncertain global economic environment has also been mitigated by the fact that imports have also fallen, reflecting the high import content of exports, and so thanks to stable terms of trade the risks to the external balance remain limited. The services balance was close to its historical peak at mid-2024, contributing significantly to the current account surplus.

5.2 Forecast for Hungary's net lending position

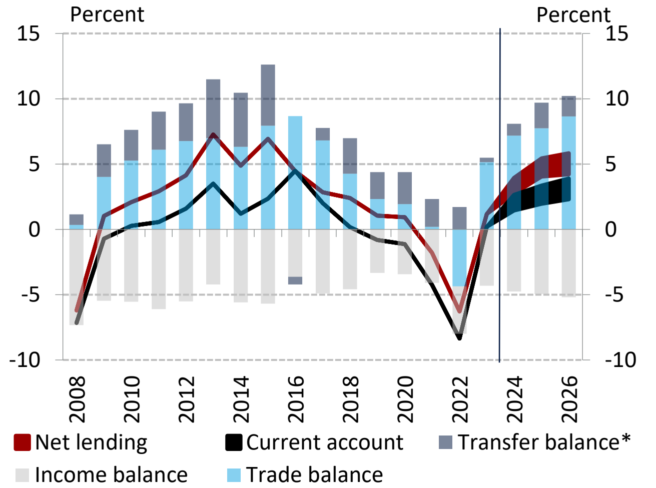
The current account balance will improve gradually over the forecast horizon, driven mainly by an increase in the foreign trade balance. This will be supported by improving terms of trade in 2024, thanks to low energy prices and lower investment dynamics. Improvement in export growth is expected to materialise from 2025 onwards as new export capacity will be put in operation. Simultaneously, growth in household consumption this year and in investments in the coming years will lead to growth in imports, which, in turn, will slow down the improvement in net lending. Based on trends in sector's financing, the external balance will improve with general government deficit gradually shrinking, and private sector financial savings stabilising at a high level.

Improvement in the external trade balance is reflected in better external balance indicators (Chart 5-5). The current account balance, which showed a modest surplus in 2023, will improve markedly this year, thanks to a continued rise in foreign trade surplus. This is due mainly to the slightly improved terms of trade and a rising goods balance surplus, which reflects falling imports owing to lower investment. Later, from 2025, the increasing export market share may be reflected in the acceleration of exports. The deficit on the income balance will rise gradually in response to the prolonged effect of higher interest rates, and windfall tax will reduce profits generated by foreign companies substantially in 2024 and 2025. Overall, the current account surplus will grow gradually over the forecast horizon, and so will net lending in line with the utilisation of a growing number of EU transfers.

The energy balance deficit will shrink substantially in 2024, but from 2025 onwards only a slight improvement is expected. The combination of falling gas prices and subdued energy demand is reflected in the shrinking energy deficit in 2024 H1. The surplus on the balance of other goods is set to rise significantly this year, on the back of subdued investment activity, and to increase further during the rest of the forecast horizon as export momentum picks up in response to recovery in external demand. The surplus on the balance of services will stabilise at above 5 percent of GDP in the coming years (Table 5-1).

Based on sectoral financing approach, in parallel with the moderation in the fiscal deficit, the private sector net position remains high (Chart 5-7). The lower fiscal deficit is attributable to rising tax revenues in 2024, falling investment growth and lower energy expenditures over the outlook horizon, as well as declining interest expenditure from 2025 onwards. As households' caution eases slowly, the amount of net financial savings may reach high levels this year, but will start to decline slowly from 2025 onwards as consumption picks up again. The outlook for moderation in profit will increase the net borrowing of firms in 2024, but this will then begin to decline again as exports recover in response to an external recovery and due to the utilisation of higher EU transfers.

Chart 5-6: Evolution of net lending



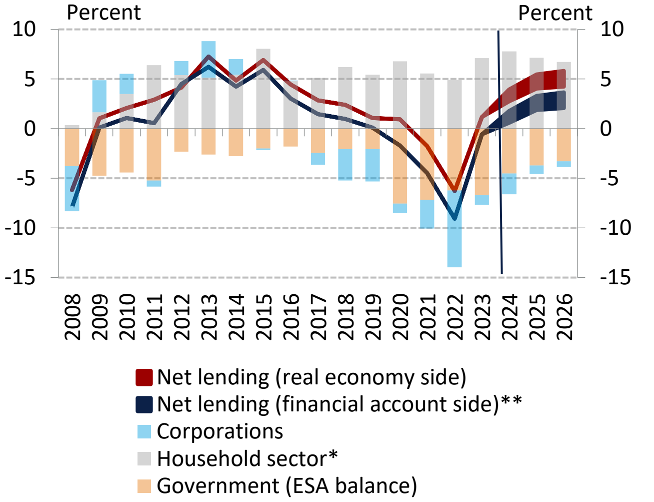
Note: As a percentage of GDP* The sum of the balance of the current transfers and the capital account balance.
Source: MNB

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

	2023	2024	2025	2026
Balance of goods	0.1	2.1	2.3	3.3
Balance of energy	-4.4	-3.1	-3.1	-2.7
Balance of other goods	4.6	5.2	5.4	6.0
Balance of services	5.0	5.1	5.4	5.4
Trade balance	**5.1**	**7.2**	**7.7**	**8.7**

Source: HCSO, MNB

Chart 5-7: 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

5.3 Fiscal developments

The budget deficit-to-GDP ratio is projected to be 4.3–4.7 percent in 2024, 3.2–4.2 percent in 2025 and 2.8–3.8 percent in 2026, depending on macroeconomic developments and the degree of fiscal discipline. Based on the preliminary fiscal accounts data, the accrual deficit amounted to 3.9 percent of the half-year GDP in 2024 H1. Compared to the 6.7-percent figure for 2023, the 2024 reduction in the budget deficit is supported by lower energy expenditure due to the stabilisation of energy prices, the decreasing public investment expenditure and the fiscal measures announced at the beginning of July 2024. Achieving the deficit target, which was revised up to 4.5 percent of GDP, is made difficult by high government interest expenditure and tax revenues falling short of the budget appropriation; therefore, it is necessary to maintain control over expenditures for the rest of the year. Continued reduction in the government debt-to-GDP ratio in 2024 and improvement in domestic risk perception require that the deficit targets be achieved in a credible manner.

5.3.1 Main balance indicators and the fiscal impulse

According to our forecast, the government sector's accrual deficit-to-GDP ratio may amount to 4.3–4.7 percent in 2024 (Table 5-2). In addition to the decline in energy prices and the decrease in public investment expenditure, the consolidation measures announced in July 2024 will facilitate the reduction in fiscal deficit in 2024 compared to the previous year and help achieve the revised budget deficit target of 4.5 percent of GDP. With the significant rise in government interest expenditure driven by the high inflation in the past two years, and tax revenues falling short of the appropriation, achieving the deficit target requires maintaining control over expenditures during the rest of the year.

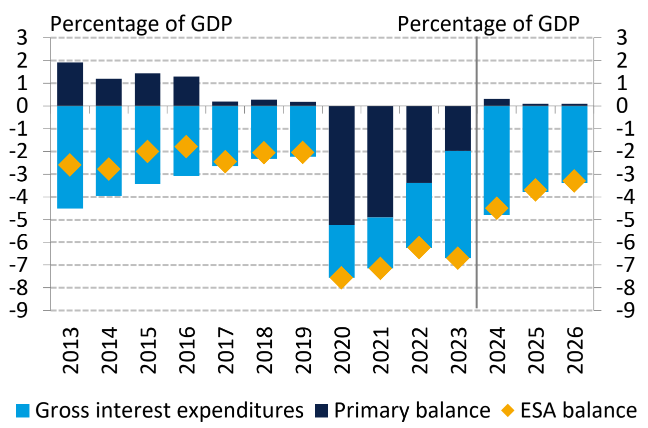
Table 5-2: General government balance indicators

	2023	2024	2025	2026
ESA balance	-6.7	(-4.7)-(-4.3)	(-4.2)-(-3.2)	(-3.8)-(-2.8)
Primary ESA balance (point estimate)	-2.0	0.3	0.1	0.1
Gross interest expenditures	4.7	4.8	3.8	3.4

Source: HCSO, MNB

The deficit is expected to continue declining to a range of 3.2–4.2 percent in 2025 and 2.8–3.8 percent in 2026. In the absence of adopted budgets, based on the current macroeconomic and fiscal base, as well as taking into account the measures announced at the beginning of July, according to our forecast, the deficit-to-GDP ratio will gradually fall and it may approach 3 percent of GDP in 2026 (Chart 5-8).

Chart 5-8: Changes in the fiscal balance and government interest expenditures



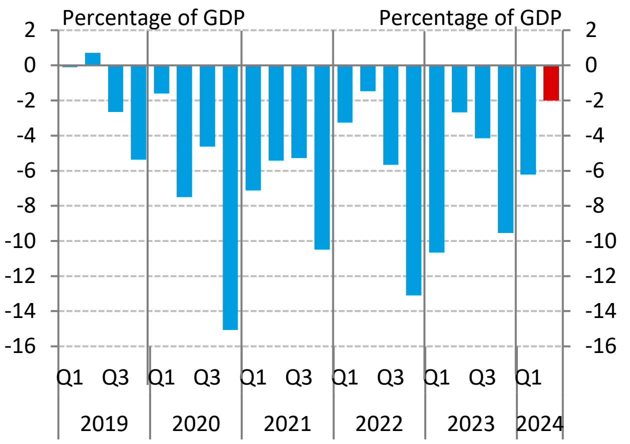
Note: The time series of the ESA balance and the primary ESA balance after 2023 are point estimates, which are consistent with the midpoint of the ESA balance forecast bands.
Source: HCSO, MNB

5.3.2 Budget balance in 2024

We forecast the budget deficit at 4.3–4.7 percent of GDP in 2024. Based on the general government data from the preliminary fiscal accounts released by the MNB, the first half-year accrual-based budget deficit amounted to 3.9 percent of the half-year GDP (Chart 5-9). The budget's cash deficit amounted to HUF 2,858 billion at end-August, accounting for 72 percent of the EDP report's cash deficit target of approximately HUF 4,000 billion.

In order for the budget deficit target to be met in 2024, a package of balance correction measures (Table 5-3) amounting to around 0.6 percent of GDP was announced in July 2024. Most of the measures concern the revenue side: for the financial transaction levy (FTL), the tax rates and the upper limit of levy and the exemption from the levy for

Chart 5-9: Accrual balance of the general government sector



Note: The data show the net lending capacity of the general government as reported in the preliminary financial accounts published by the MNB.
Source: MNB

Table 5-3: Budgetary impact on revenues and expenditures of the new measures announced in July 2024 (HUF billion)

	2024	2025
Tax revenues	**146**	**606**
Financial transaction levy	92	230
Windfall tax on financial institutions	40	140
Retail tax	0	130
Income tax on energy providers	14	83
Airline tax	0	-37
Insurance tax	0	60
Other revenue measures	**17**	**70**
Inflation adjustment of electronic road toll	0	22
Job Protection Action Plan	2	8
Tax and administrative fines	15	40
Expenditures	**343**	**-53**
Postponement of prenatal baby support deadlines	-26	-53
Rearrangement of expenditures	369	0
Total	**506**	**623**
As a percentage of GDP	**0.6**	**0.7**

Source: Government announcements, MNB calculations

households also rose with effect from 1 August 2024. Furthermore, tax and administrative fines were also raised with effect from the same date. As regards windfall tax on financial institutions tax relief on the purchase of government securities has been tightened and regarding the income tax on energy providers the tax relief on (Brent-Ural) oil price spread difference has been reduced. An additional financial transaction levy on foreign exchange conversion transactions will be introduced on 1 October. As part of the measure aimed at spending savings, direct investment and capital formation expenses were transferred to the Central Residual Settlement Fund. The final fiscal impact of the expenditure saving measures depends on the expenditure measures taken during the rest of the year and on how control over expenditures is maintained. The extension of the childbirth pledge deadline until 1 July 2026 for families who took out prenatal baby support loans between July 2019 and June 2021 will help families.

Despite the above consolidation measures, revenues in 2024 may continue to fall significantly short of the appropriations in the Budget Act, due mainly to a shortfall in value added tax revenues. Nevertheless, the general government's revenues from tax and contributions showed an increase in the first eight month compared to the same period in 2023 (Chart 5-10). The revenues from taxes and contributions on labour and other consumption taxes with revenue measures are likely to be in line with or higher than the budget appropriations. Revenues from social security contributions correspond to the wage bill and are in line with labour market trends (Chart 5-11). By contrast, corporate tax revenues are expected to be slightly lower.

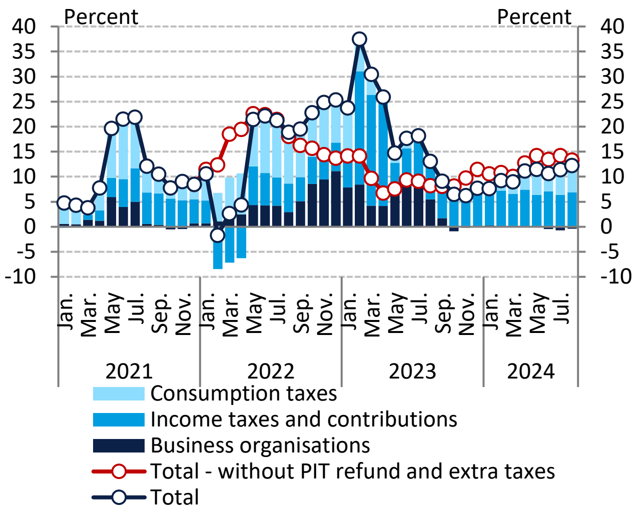
In addition to the shortfall in tax revenues, rising government interest expenditure in the wake of the high inflation seen in the past two years will increase the deficit in 2024; however, interest expenditure is expected to start declining from 2025, due to the decline in inflation.

5.3.3 Budget balance for 2025 and 2026

Our forecast for the accrual deficit-to-GDP ratio is 3.2-4.2 percent in 2025 and 2.8–3.8 percent in 2026. In the absence of available budget appropriations, we make technical projections for 2025 and 2026, according to which, based on the expected macroeconomic path, lower energy expenditure, falling interest expenditure and public investment, and the announced measures will further decrease the deficit.

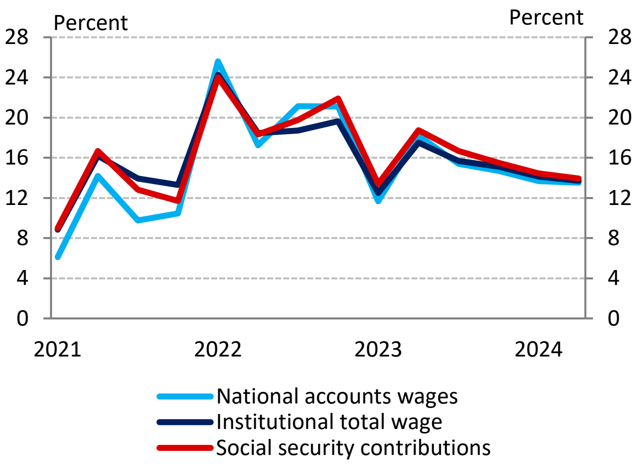
The package of measures announced in early July 2024 may lead to an improvement of around 0.7 percent of GDP in the

Chart 5-10: Evolution of tax and contribution revenues in 2021–2024, yoy, 3-month moving average



Source: HST, MNB

Chart 5-11: Annual changes in national account and institutional total wage, and social security contributions revenue



Source: Eurostat, HCSO, HST, MNB calculations

budget balance in 2025. In essence, the measures only affect the revenue side: in addition to the fiscal impact of the measures announced for 2024, according to the government's announcement the windfall tax on financial institutions, the insurance tax and the income tax on energy providers and retail tax, which were originally planned to be phased out, will remain in force in 2025 and will improve budget balance. Electronic road tolls will be adjusted for inflation from next year. In addition, it was announced that the airline tax would be scrapped from January 2025.

In the absence of a Budget Act, based on the government's forecast for 2025 and 2026, the fiscal deficit is expected to decline further. The government plans to keep the deficit below the Maastricht threshold of 3 percent in 2026. Based our forecast, this target can be achieved through strict control over fiscal expenditures and growth in revenues.

5.3.4 Risks surrounding the baseline scenario

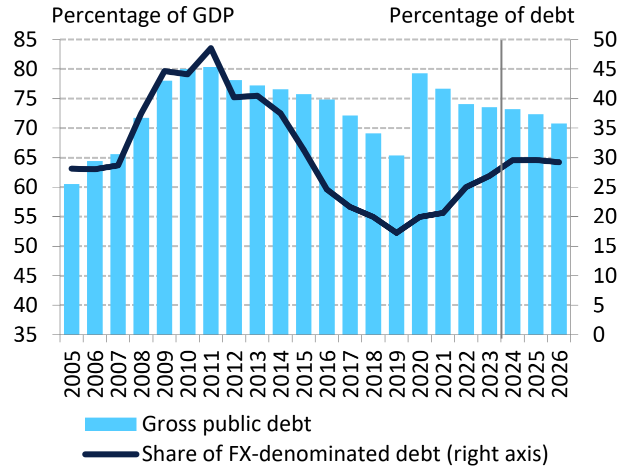
The macroeconomic environment has a significant impact on tax revenues. The budget balance is exposed to risks posed by trends in revenues from consumption taxes.

The final fiscal impact of the savings measures on the expenditure side will depend on the expenditure decisions made in the rest of the year. Part of the expenditures have already been used, which related to the public investment and capital formation transferred to the Central Residual Settlement Fund in July 2024. Improvement in the budget balance from the remaining transferred amount depends on the expenditure measures to be taken during the rest of the year, and whether control over expenditures can be maintained.

The fiscal impact of doubling the family tax allowance has not been included in our forecast, as the details of this measure are not yet known. If the allowance per child were to be raised to an amount twice the current allowance, budget revenues from personal income tax and employee contributions may be lower than our current forecast. The yearly additional income that would be allocated to families is estimated to be 0.3 per cent of GDP; however, the spending of such additional income would boost other tax revenues.

The limited access to EU funds continues to create considerable uncertainty for the budget. 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 and Resilience Facility (RRF) and cohesion funds representing an amount of nearly EUR 20 billion, which is linked to the implementation of the 27 super-milestones defined by the Commission. Based on H1 budget data,

Chart 5-12: Gross public debt forecast



Note: The time series for 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

expenditures and revenues related to EU funds remain substantially below what can be expected on the basis of appropriations and this is likely to be interconnected to restrictions on access to EU funds. This points to few advance payments on and a low level of the absorption of funds. 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 trends in public debt

According to the preliminary fiscal accounts data, the gross public debt-to-GDP ratio was 76.1 percent at the end of 2024 Q2. The debt ratio increased by 0.9 percentage point compared to the same period of the previous year and by 2.6 percentage points from its value at the end of 2023. The rise in government debt was driven by high net issuance, which suggests that most of the annual issuance was already realised in the first half of the year.

We forecast that the gross public debt-to-GDP ratio will decrease slightly to 73.2 percent by the end of 2024, if the deficit target is met. However, the continued decline of the debt ratio in 2024 is surrounded by risks. Achieving this decline will require net issuance consistent with the cash term deficit forecast from the April EDP report, an adequate increase in nominal GDP and a low level of central and non-central debt issuances in the second half of the year (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 is. A HUF 10 change in the EUR/HUF exchange rate alters the public debt-to-GDP ratio by about 0.6 percentage point. The share of foreign currency dominated debt in central debt increased as a result of significant foreign currency issuances during the year.

6 Special topic: Focus: Sources and use of household income since the wake of the inflation shock

The fact that the dynamics of retail trade did not follow the rapid rise of real wages aroused keen interest among the professional community during the spring and summer months. Analyses strove to find where surplus income unspent in retail trade went. In the past period, more detailed data on household sector income and its use for H1 2024 became available. Below, with the help of these data we are looking for the answer to how much the real income of families has increased and how it has been used or saved.

The consumption dynamics reflected in the data disclosed in the detailed national accounts is more consistent with the real value of income than retail turnover. Furthermore, consumption expenditure of household is broadly in line with international trends, although it has been more volatile than in other countries in the region.

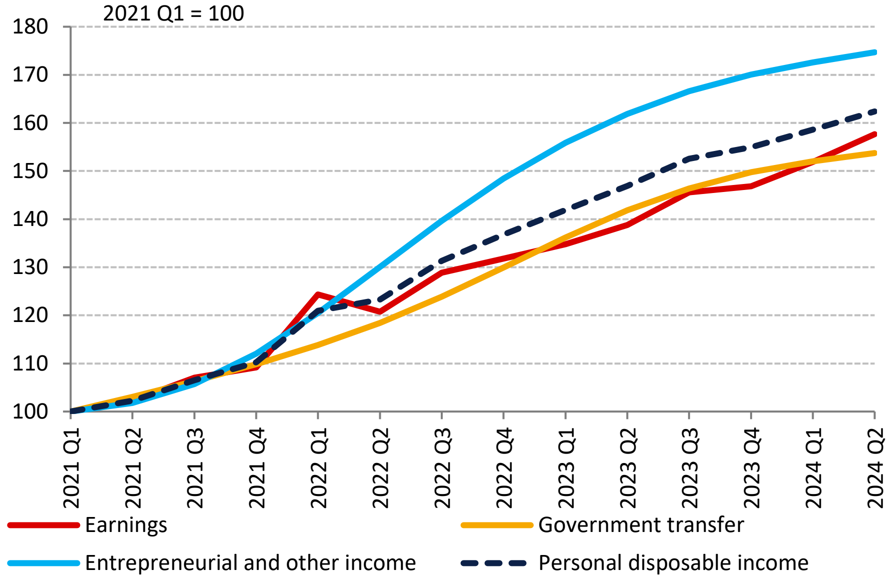
Savings have also grown faster than consumption due to an increased willingness to save also attributable to income structure and economic psychological effects. Households with higher incomes and a greater willingness to save have seen both their nominal and real income grow more than those with lower incomes. Nevertheless, since the top two income quintiles account for almost sixty percent of consumption, consumption in this income bracket has been able to expand significantly despite the lower marginal rate of consumption. Another good indicator of the rise in consumption in the top income brackets is above-average growth in the purchase of services and durable goods, the demand for which tends to grow in line with income. Savings were also increased by the fact that, as a result of high inflation and uncertain economic prospects, families set aside an increasing share of their income in order to eke out and thus preserve the real value of their savings.

Since the increase in savings is a decisive factor in the development of the domestic economy's macroeconomic trajectory, we have also examined the structure of savings. The share of foreign assets approached 40 percent at the end of 2022, after which it stabilized at around 20 percent. However, the share of foreign assets is still almost twice what we registered at the beginning of 2021.

Generation of household incomes

At macroeconomic level, other (entrepreneurial and mixed) income increased more compared to Q1 2021 than labour income from employment and government transfers (pensions, family allowances, etc.). In addition to wages, the income of the residential sector is made up of a high proportion of government transfers (e.g. pensions) and entrepreneurial and other incomes. Within household incomes, overall, entrepreneurial and other incomes have risen the most in recent years. Between the beginning of 2021 and 2024 Q1, the net national income of the economy grew by 57.7 percent in nominal terms. Social benefits in cash provided by the state increased by almost the same amount in forint terms, i.e. by 53.7 percent in the same period. Mixed income, which includes entrepreneurial income and interest earned on savings, has shown the largest expansion over the past quarters, rising by nearly 75 percent. This trend is consistent with the observation that, in the upward phase of inflation, the increase in corporate profits partly accelerated the rise in consumer prices. Based on these, profit inflation was also an observable phenomenon among sole proprietors, the so-called "mixed incomes". Revenues of the budget from tax on labour moved in line with the increase seen in the wage statistics, suggesting that there is no significant whitening effect behind the wage increase (Section 5.3 Budgetary trends).

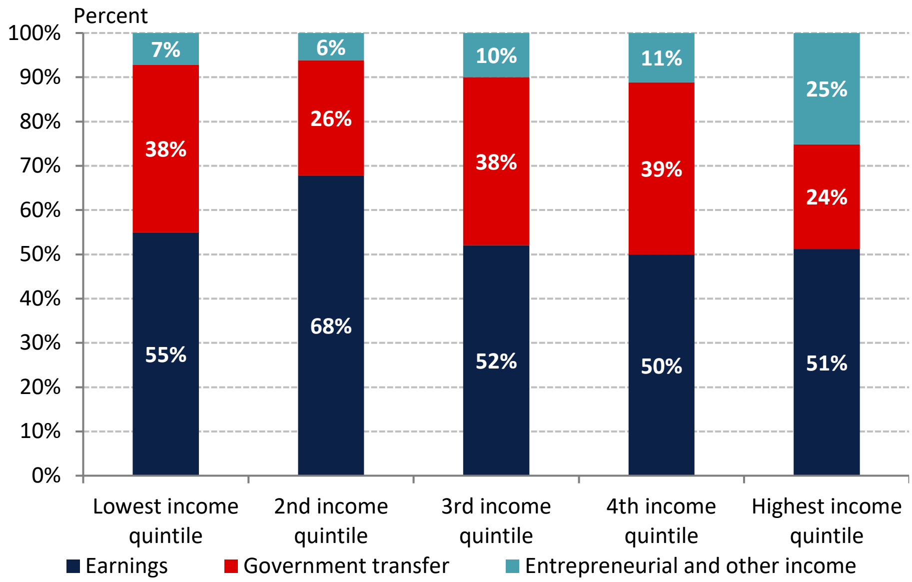
Chart 6-1: Development of the sources of disposable income



Note: Nominal data. Hike in average wages in February 2022 was driven primarily by the armed forces and law enforcement personnel service allowance (the so-called 'arms money') equivalent to six months' salary. Other income includes entrepreneurial and capital income.
Source: HCSO, MNB calculations

There are significant differences in the income structure of families with different incomes. Both the amount and the structure of income are different as is revealed when households are divided into 5 equal groups (quintiles) according to their per capita income. Families in the lower income quintile earned an average annual per capita income of HUF 1.2 million in 2022, while in the highest income bracket it was five times higher at HUF 6.0 million. The HCSO's Household Budget Survey (HBS) statistics are based on a questionnaire survey and provide an approximate picture of the income structure of different income groups of the population. However, a limitation of this statistical survey is that high-income earners and entrepreneurs are under-represented in it, and, hence, the proportion of entrepreneurial and other income may, in fact, be higher than that in the survey. According to the survey, overall wages account for over half of incomes, and their share is higher in the lower income groups. Combined, public transfers (pensions and other social transfers) account for 38–39 percent of total net income in the first, third and fourth income quintiles, and around 25 percent in the other two. Typically, the higher is the total income of a household, the higher is the share of entrepreneurial, proprietor and other income. Its weight is significant only in the highest income quintile (25 percent), and it may be even higher if the survey limitations mentioned above are taken into account, which further supports our findings presented later.

Chart 6-2: Income structure of households by income quintiles (2022)



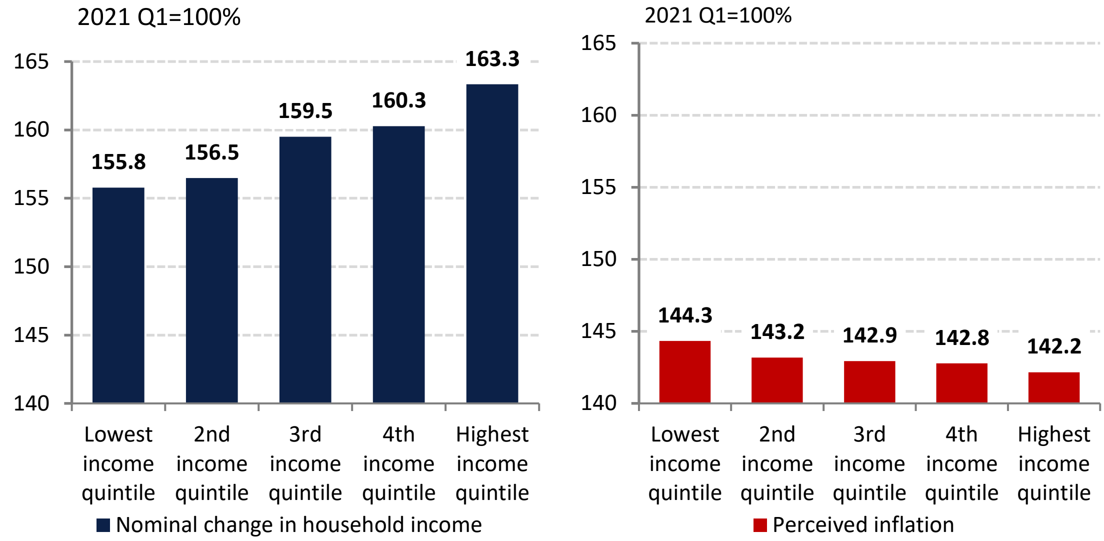
Note: Ratios calculated with net incomes.

Source: HCSO, HKF, MNB-estimates

Due to the structure of incomes, higher income households have seen their incomes rise at a higher pace. Due to the fact that the share of transfers is highest in the bottom quintile and that of entrepreneurial income is highest in the top quintile, households in the top quintile have experienced the largest cumulative nominal income growth, while growth was the lowest in the bottom quintile, based on our estimate using HKF data. The more affluent groups, i.e. those with higher savings rates, benefited more from yields. The difference in income growth between successive quintiles is cumulative over three years, ranging from 1 to 3 percentage points, and between the bottom and top quintiles, it is close to 8 percentage points.

Inequality in real income growth was further exacerbated by the fact that different consumption structures led to different inflation perceptions in different income categories. In the consumption of households with lower incomes, food items that are rising in price at the highest rate have a greater weight, so they perceived a slightly higher price increase than those with higher incomes. Households in the bottom income quintile and those in the top one experienced an average increase of 44.3 and 42.2 percent, respectively, between 2021 Q1 and 2024 Q2.

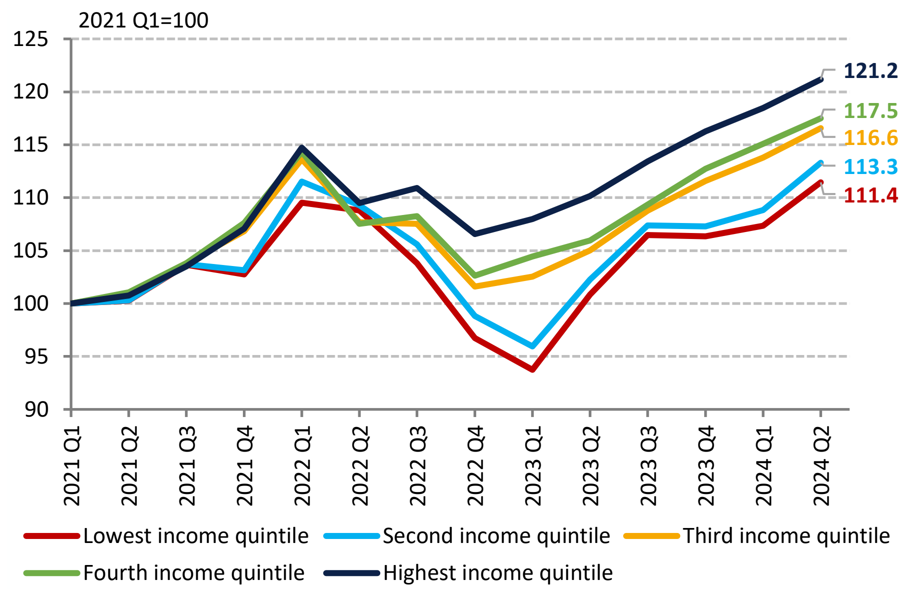
Chart 6-3: Nominal change in household income (left chart) and trends in consumer prices perception by income quintiles (right chart) (2024 Q2)



Note: MNB calculation.
Source: HCSO, HKF, MNB-estimates

The combined effect of these was that the real income of households in the top income quintile rose by 21.4 percent, while the price-adjusted income of households in the bottom income quintile rose by 11.4 percent in the period surveyed. Chart 6-4 reveals clearly that real income suffered the largest fall in the bottom two income quintiles in the inflationary wave followed by a protracted recovery. Real income in the poorest households caught up with its level in 2022 H1 in 2024 Q2.

Chart 6-4: Development of real incomes by income quintiles

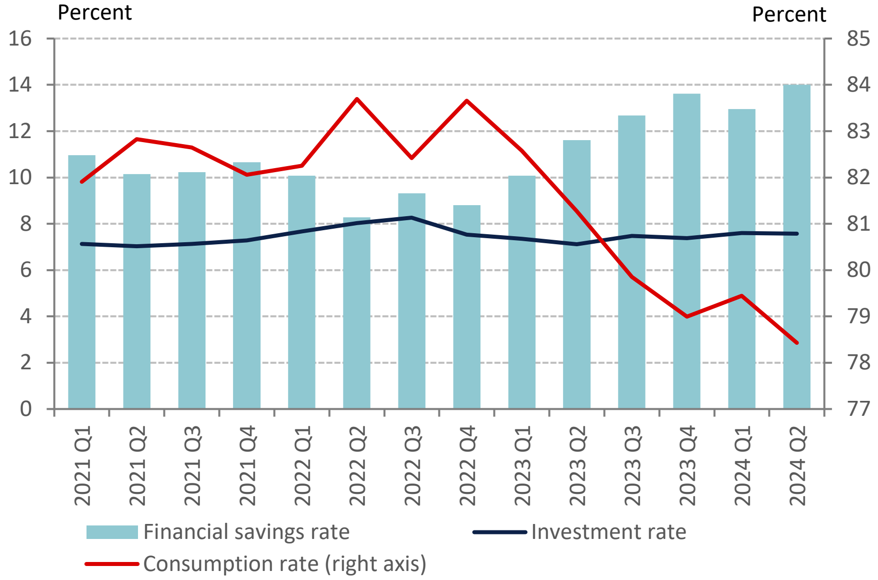


Note: Real income calculated with inflation as perceived by the income quintiles.
Source: HCSO, HKF, MNB-estimates.

Trends in and structure of the use of household income

Statistically, families spend their income on consumption, investment and savings. The sum of these necessarily gives the total of their incomes. Therefore, income not used for consumption and investment (housing) increases savings in some form. Between 2021 Q1 and 2024 Q2, the share of savings in the use of income increased from 11 percent to 14 percent, while that of consumption decreased from 82 percent to 78 percent. The amount spent on household investment changed moderately, hovering around 7–8 percent of income in the period as a whole.

Chart 6-5: Trends in the rate of household consumption, investment and savings as a proportion of disposable income

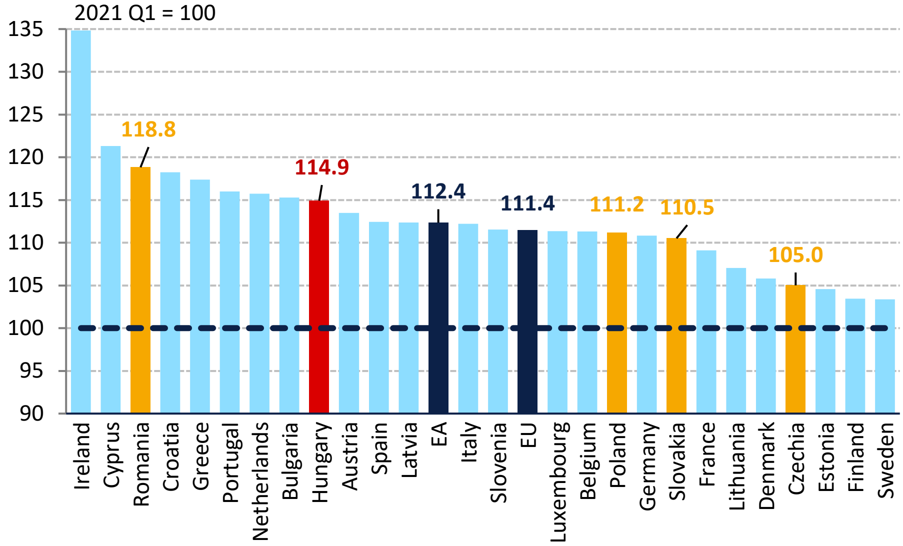


Note: Nominal, seasonally adjusted data
Source: HCSO, MNB-estimates

Household consumption trends

In 2024 Q2, household consumption expenditure was 14.9 percent higher than in 2021 Q1, placing Hungary in the top third of the European ranking. Consumption in each Member State of the European Union exceeded the level of three years ago, with the Visegrad countries showing a smaller increase than Hungary on average (Chart 6-6). In Poland and Slovakia the increase was 11.2 and 10.5 percent respectively. Romania and the Czech Republic represent the two extremes among the countries of the region: while Romanian household consumption grew by nearly 19 percent, Czech consumption increased by only 5 percent in the first quarter compared with the level at the beginning of 2021. Overall, compared to the base at the beginning of 2021, the expansion of domestic household consumption is in the top third of the region and the EU.

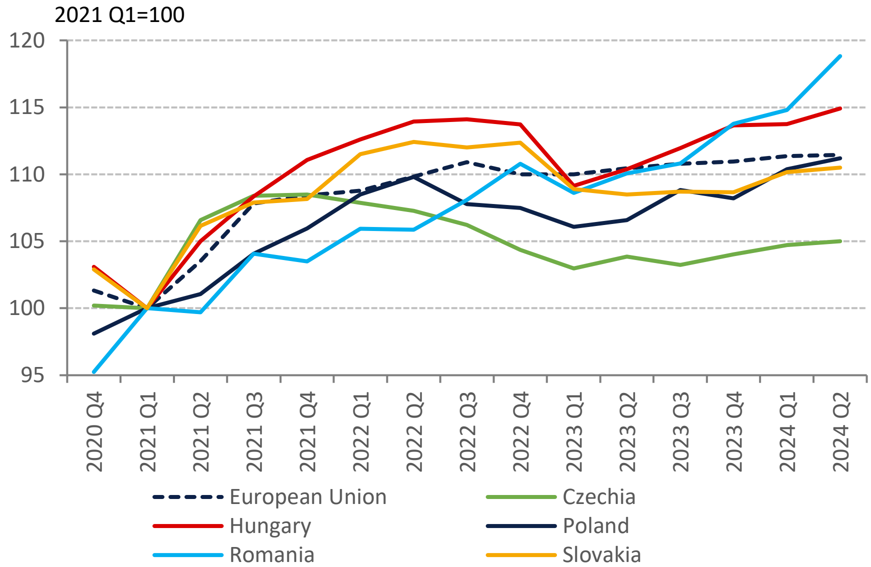
Chart 6-6: Household consumption in 2024 Q2



Note: Household consumption expenditure includes social transfers in kind from NPI's. Data adjusted for seasonality and calendar effects. KSH data for Hungary. No data are available for Malta.
Source: Eurostat

Domestic consumption has shown considerable volatility in the recent period (Chart 6-7). We saw major cumulative growth from 2021 to 2022 Q1 during the recovery after the COVID-19 pandemic. Domestic consumption growth exceeded the regional average substantially in this period. Subsequently, from mid-2022 onwards, stagnation followed by a decline set in. Household consumption reached a trough in early 2023, followed by a gradual recovery.

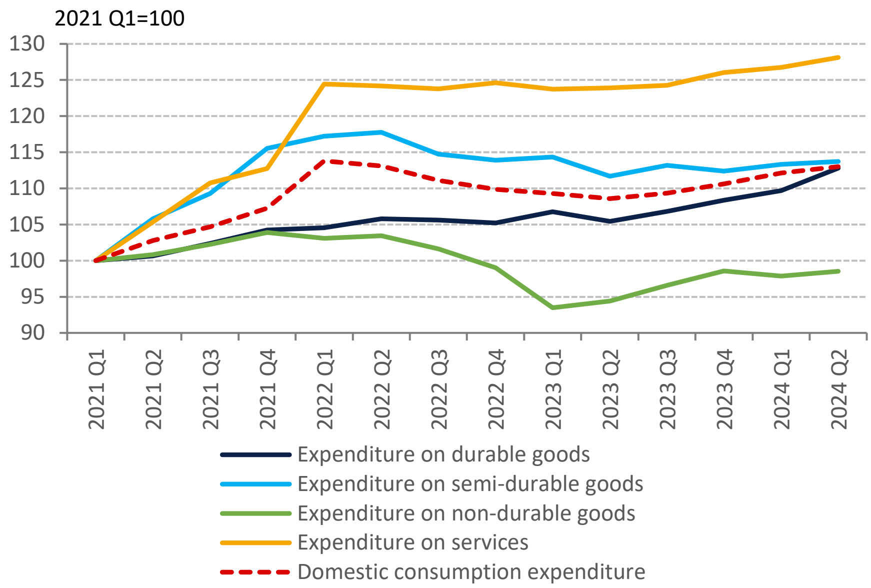
Chart 6-7: Trends in the level of household consumption expenditures



Note: Household consumption expenditure includes social transfers in kind from NPI's. Data adjusted for seasonality and calendar effects.
Source: Eurostat

There is considerable variation in the different consumption categories in Hungary: compared with the beginning of 2021, it was the consumption of services grew most dynamically, by almost 30 percent, while the consumption of non-durable goods fell significantly. The consumption of durable goods (home furnishings, major technical goods and vehicles) increased by 12.8 percent and that of semi-durable goods (clothing, electronic goods, hobbies and sports goods) by 13.7 percent compared with 2021 Q1, while non-durable goods (food, fuel, medicine and utilities) were the only category whose consumption moderately decreased by 1.5 percent (Chart 6-8). We have examined trends in consumption abroad based on credit card data which do not suggest that this has significantly distorted domestic consumption trends. We present our findings in a separate box (Box 3-1).

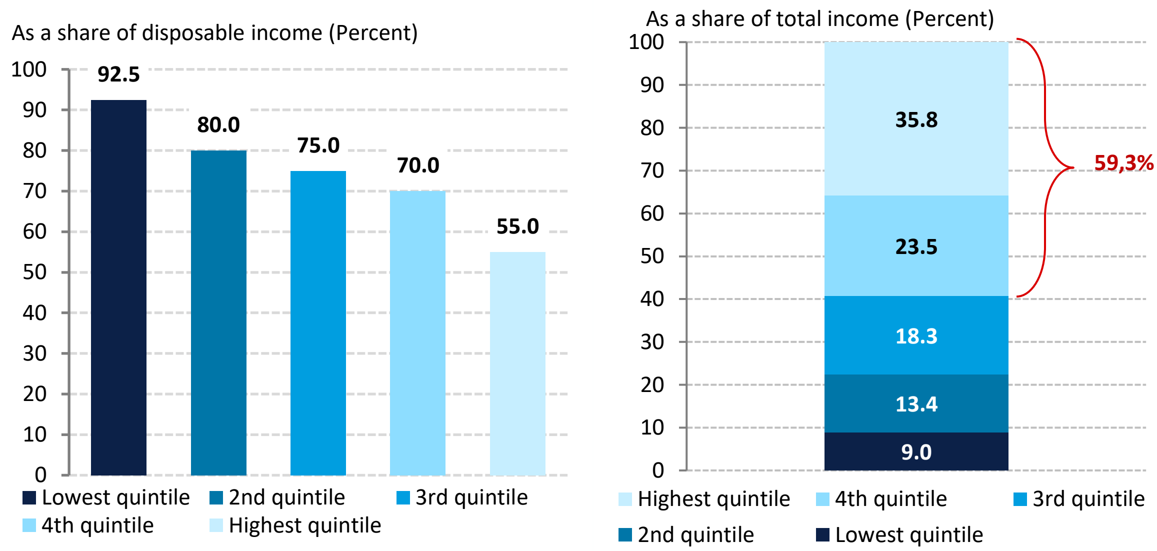
Chart 6-8: Trends in the level of household consumption expenditures



Note: Data adjusted for seasonality and calendar effects.
Source: HCSO

The favourable relative consumption trajectory, which is favourable by international comparison, is driven by higher household income. While low-income households have reduced their consumption of non-durable goods due to high inflation, high-income households have been able to increase their consumption, and this is reflected in the higher consumption of income elastic consumption items – services and durable goods. The trend seems to be contradicted by the fact that the rate of marginal consumption declines as income rises (Chart 6-9, left), yet the share of the top two income quintiles in total consumption is dominant, accounting for almost 60 percent (Chart 6-9, right).

Chart 6-9: Rate of marginal consumption by income quintiles (left chart) and the distribution of consumption across income quintiles (right chart)



Note: Rates calculated with gross incomes. Based on 2022 data. Marginal consumption rate based on 2019 data.
Source: HCSO, HKF, MNB-estimates

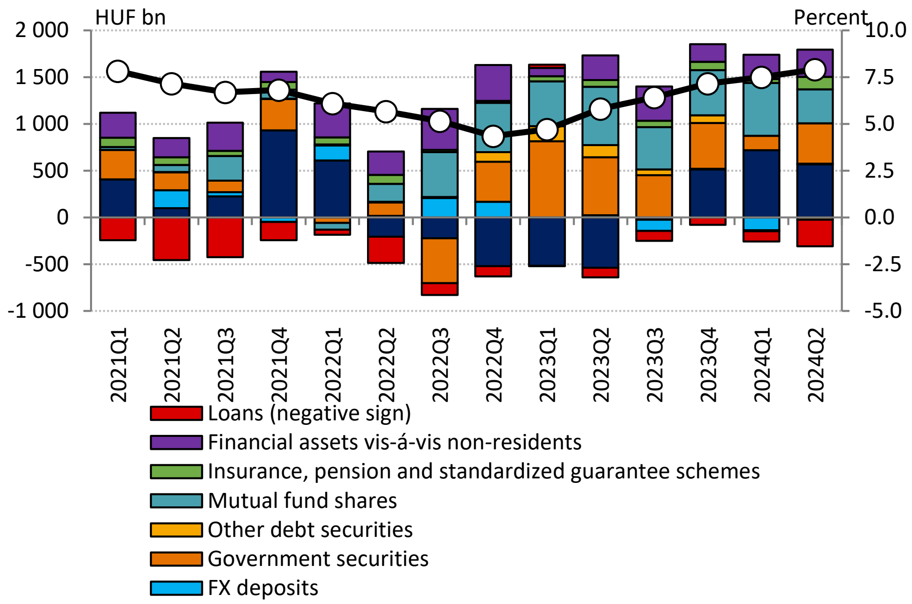
Structure of household savings

As the rate of savings was rising, so the amount of savings was outpacing than consumption. Variation in income generation also contributed to the high savings rate: households in the top income quintile save almost half (45 percent) of their income growth due to their low marginal consumption rate, so the significant real wage growth of recent years has also boosted their savings, contributing to the recovery of record high household financial savings.

Responding to a surge in inflation, families increased the proportion of their income that they save, especially from the beginning of 2023. Although in the 2010's savings by Hungarian households grew at a remarkable pace, their real value was reduced significantly by inflation in 2022 and 2023. After bottoming out in early 2023the value of real household financial assets at end-2024 Q2 was still lagging behind the end-2021 value. High inflation and uncertain economic prospects urged families to set aside an increasing share of their income in order to eke out and thus protect the real value of their savings. However, household savings are also likely to be kept high by caution that only eases up slowly: only 10–20 percent of households expect their real income to rise in the coming year (depending on the income group they belong to), and uncertainty caused by the war in a neighbouring country may also contribute to the persistence of caution. Savings are also boosted by accrued interest not yet paid (for example, interest on the PMÁP (Premium Hungarian Government Bond), amounting to around HUF 100 billion per month).

Dwindling inflation was accompanied by growing holdings of HUF deposits in 2024 H1. Purchases of government bonds and investment fund shares remained dynamic. During the period of high inflation, households reduced their HUF deposits – primarily their demand deposits with near zero interest rates – and increased their holdings of government securities and investment units. As inflation was easing, so the holdings of HUF deposits was starting to grow again from end-2023. Government securities and investment fund shares remained popular forms of investment. After the initial rate of interest on inflation-linked PMÁP, the most popular retail government bond had been lowered FixMÁP, which pays fixed quarterly interest, took over Bond funds (made up of mainly short-term bonds) used to be the most popular investment funds; mixed funds, derivatives and equity funds have become increasingly popular since the beginning of 2024. Increase in net savings was offset somewhat by a pick-up in lending.

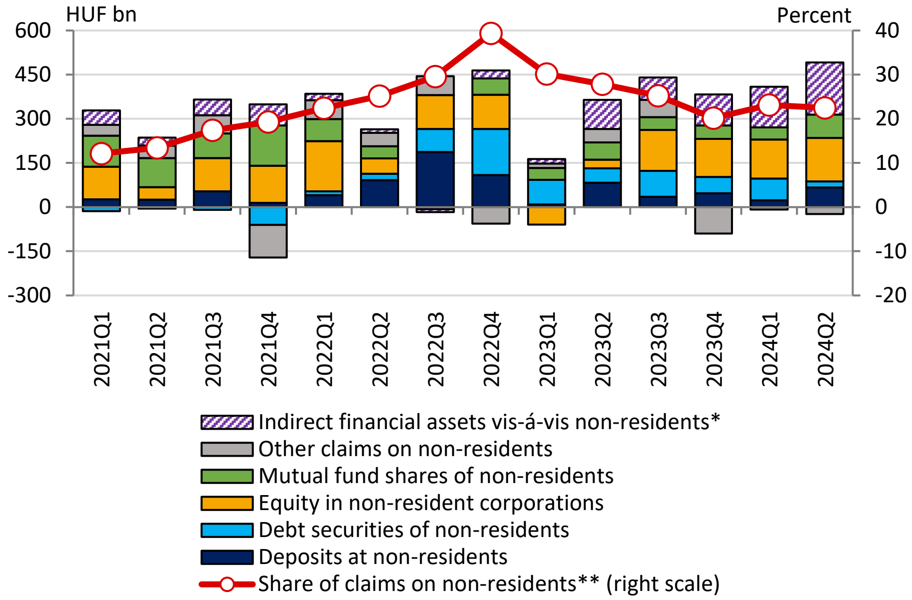
Chart 6-10: Household transactions of main financial assets and liabilties



Note: *In proportion to rolling four-quarter GDP.
Source: MNB

The share of foreign assets in total savings has declined compared with the share recorded in 2022 H2, yet, it is still significantly above the level of early 2021. Simultaneously, the HUF exchange rates stabilised and inflation declined. The growth of the holdings of direct financial assets vis-à-vis the rest of the world also contracted in nominal terms, due mainly to a decline in the placement of deposits. At the same time, savings in indirect foreign assets, through domestic investment, insurance and mutual funds, increased; as a result, in 2024 Q2, the growth rate of the holdings of households' foreign assets also exceeded the rate recorded at end-2022. The sharp increase in indirect foreign assets is due, in part, to high inflows into investment and insurance funds, and, in part, to the growing popularity of funds with a higher foreign exposure.

Chart 6-11: Household transactions of financial assets vis-á-vis non-residents directly and indirectly



Note: * Via mutual fund shares, insurance companies and pension funds, estimate.
** Direct and indirect together, rolling four-quarter data in proportion to total transactions of financial assets.
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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