MACROECONOMIC AND FINANCIAL MARKET DEVELOPMENTS

BACKGROUND MATERIAL

TO THE ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING

OF 23 APRIL 2024

APRIL

2024

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

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

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

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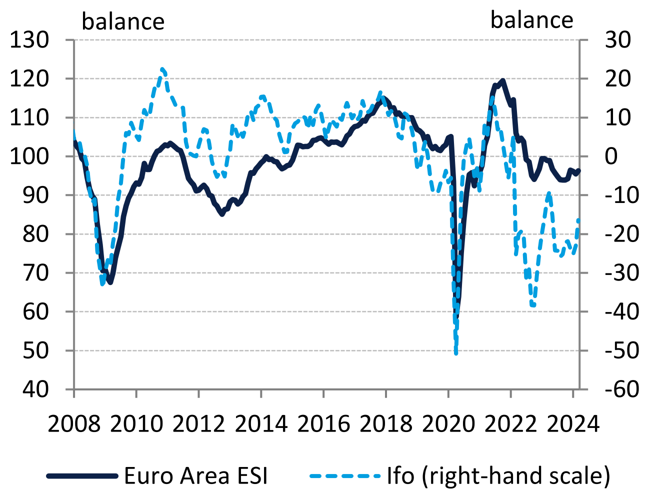
1. Macroeconomic developments

1.1. Global macroeconomic environment

In 2023 Q4, GDP grew faster year-on-year in the United States and China, whereas it increased at a slower pace in the European Union. Monthly industrial production fell in the euro area and the US, while it rose in China. In March, the Purchasing Managers' Index for manufacturing improved in China, while it dropped in the United States and the euro area. The volume of retail sales expanded in both the US and China, but shrank in the euro area. Annual inflation in the United States rose again to a higher-than-expected 3.5 percent in March, up from 3.2 percent in February. In China, consumer prices moved up by 0.1 percent on an annual basis in March, following a 0.7 percent rise in February. Inflation in the euro area was below analysts' expectations with consumer prices rising by 2.4 percent year-on-year and core inflation falling to 2.9 percent in March. Disinflation slowed down, as inflation increased or became stagnant in 14 EU countries in March.

GDP expanded by 3.1 percent in the United States and by 0.2 percent in the European Union, while GDP in the euro area was flat on an annual basis in the last quarter of 2023. In China, the 2023 end-of-year growth of 5.2 percent was followed by an increase of 5.3 percent in 2024 Q1. Within the EU, GDP grew in 15 Member States on an annual basis with the highest annual increases in Croatia and Malta (+4.3 percent), while the largest decrease was recorded in Ireland (–9.1 percent). Our largest trading partner, Germany, contracted by 0.2 percent. In the region, GDP also grew in Poland (1.7 percent), Slovakia (1.3 percent), Romania (3.0 percent) and the Czech Republic (0.2 percent).

Chart 1 Business climate indices in Hungary's export markets



Source: European Commission, Ifo

Industrial production fell by 0.2 percent in the US in February and by 6.7 percent in the euro area in January. China recorded an overall expansion of 7.0 percent in January and February.

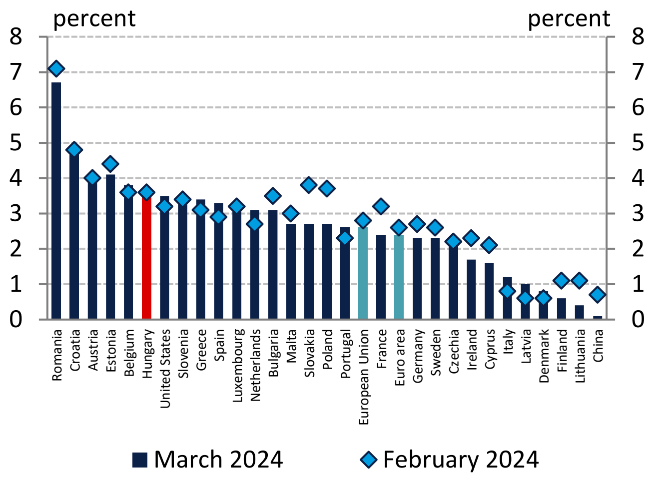
In March, the Purchasing Managers' Index for manufacturing was above the expansion threshold in both China and the US but below it in the euro area, according to seasonally adjusted data. The euro area's Economic Sentiment Indicator (ESI) rose by 0.8 points in March (Chart 1).

International labour market developments were favourable in March, too. In the United States, the unemployment rate moderately fell to 3.8 percent in March from 3.9 percent in February, and thus remained historically low. The number of employees in the non-agricultural sector grew by 303 thousand in March, at a greater extent than expected. Similarly to the January figure, the unemployment rate in the euro area stood at 6.5 percent in February.

Retail sales went up by 1.5 percent in the US and dropped by 0.7 percent in the euro area in February, while China recorded a 5.5 percent increase in January and February.

Increasing to 3.5 percent in March from 3.2 percent in February, **annual inflation in the United States exceeded**

Chart 2 Developments in the international inflation environment



Note: HICP rates.
Source: Eurostat

expectations. **In China, consumer prices rose by 0.1 percent year-on-year in March**, following a 0.7 percent climb in February. **Euro area inflation declined to 2.4 percent year-on-year and core inflation to 2.9 percent in March,** both **failing analysts' expectations**.

Inflation in Hungary was in the middle range of the region in March. Inflation was 6.7 percent in Romania, 4.1 percent in Austria, 2.7 percent in Slovakia and Poland, and 2.2 percent in the Czech Republic, according to Eurostat data (Chart 2).

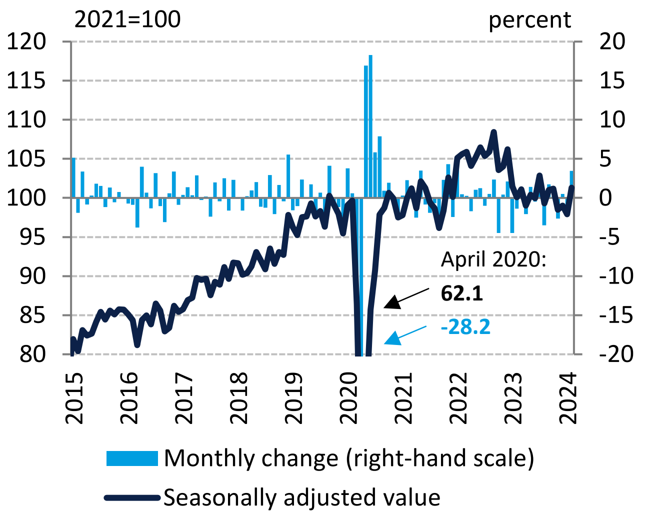
1.2. Domestic real economy developments

Industrial production expanded by 1.8 percent in February 2024, breaking the trend of a 13-month annual decline. Construction output grew by 3.2 percent, while retail sales increased by 1.1 percent on an annual basis. According to preliminary data, the balance of trade in goods for February showed a record surplus of 1.7 billion euros. The average number of persons in employment aged between 15 and 74 amounted to 4 million 723 thousand which, in seasonally adjusted terms, is 10 thousand more compared to January. The unemployment rate stood at 4.6 percent in February.

1.2.1 Economic growth

Gross domestic product stagnated in 2023 Q4 compared with the same period of the previous year. Based on balanced data adjusted for seasonal and calendar effects, output rose by 0.5 percent on an annual basis. Economic performance also remained unchanged relative to the previous quarter. On the production side, added value in agriculture rose in the fourth quarter by 80.9 percent, starting from a low base after the drought in 2022. Added value in industry, in particular manufacturing, both fell by 6.3 percent on an annual basis, while added value in construction was 7.4 percent lower than in the same period of the previous year. Added value in services in general dropped by 0.9 percent in 2023 Q4, while government-related services (public administration, defence; compulsory social security, education, human health care, social care) grew by 2.3 percent overall. On the consumption side, household final consumption expenditure moved up by 0.3 percent year-on-year, whereas the added value of gross fixed capital formation decreased by 2.8 percent. Community consumption fell by 5.1 percent on an annual basis, and the contribution of change in inventories was essentially negative, holding back growth by 3.5 percentage points. The volume of imports decreased to a greater extent (–8.4 percent) than that of exports (–4.1 percent).

Chart 3 Developments in industrial production



Note: From January 2024, seasonally adjusted value is based on the monthly averages of 2021.

Source: MNB calculation based on HCSO data

Industrial production grew by 1.8 percent year-on-year in February 2024, interrupting a 13-month decline. Adjusted for seasonal and calendar effects, production expanded by 1.3 percent compared with February 2023 (Chart 3). Domestic industrial sales dropped, while export sales rose again in February. The manufacturing sub-sectors saw mixed performance, with motor vehicles, pharmaceuticals, basic metals, and food, beverages and tobacco manufacturing expanding from February 2023 levels, while the manufacture of electrical equipment and computers, electronic and optical products declined. The total volume of new orders in manufacturing was 24.3 percent higher than in February 2023. New domestic orders grew by 1.0 percent and new export orders by 28.4 percent. At the end of February, unfilled orders in manufacturing were 19.6 percent below the year-earlier level.

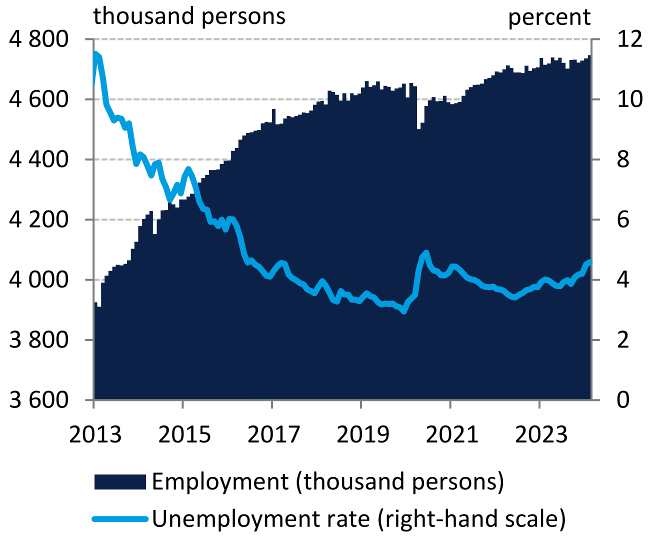
Construction output increased by 3.2 percent year-on-year in February 2024. Construction of buildings and other construction grew by 2.8 percent and 4.4 percent, respectively, year-on-year. Based on seasonally and workday-adjusted data, total construction output fell by 8.5 percent compared to January 2024. The volume of new contracts signed rose by 84.1 percent in February. In particular, the volume of contracts for the construction of buildings increased by 30.1 percent and for the construction of other structures by 150.9 percent, relative to the previous year. The significant rise in the latter was attributable to a low base and new contracts for road development. The end-of-February volume of contracts in the construction sector fell by 7.6 percent. In particular, contracts for the construction of buildings and of other structures were down by 8.7 percent and 6.6 percent, respectively, compared with the same period of the previous year.

Retail sales grew by 1.1 percent on an annual basis in February 2024. Data adjusted for calendar effects suggest that retail trade excluding fuel sales stagnated in February, ending the downward trend that continued since July 2022. In February, retail sales decreased by 0.6 percent on a monthly basis. The annual turnover of petrol stations went up by 3.9 percent. Retail food trade rose by 2.7 percent on an annual basis in February. In addition, the sales of pharmaceuticals, medicinal products and perfumes, fragrances (+6.9 percent), and miscellaneous industrial goods (+1.8 percent) also grew. Sales declined in the product groups of parcel delivery (–1.0 percent), textiles, clothing and footwear (–2.8 percent), books and computers (–4.3 percent), and furniture, hardware and ironware (–10.1 percent).

Preliminary data for February 2024 show that the trade balance recorded a surplus of EUR 1.7 billion, the largest surplus seen since the start of data reporting in 1995. The balance improved by EUR 1.1 billion compared with the previous month and with the same period of the year before, mainly due to imports. The balance adjusted for VAT residents was EUR 1.0 billion higher than a year earlier, showing a surplus of EUR 988 million. In February, the value of exports in euros fell by 2.4 percent on an annual basis. The nominal value of imports in euros shrank by 11.6 percent over a year, as energy prices fell and domestic demand weakened. According to seasonally adjusted data, exports increased by 1.9 percent, while imports decreased by 1.5 percent compared with January.

Based on online cash register data, nominal turnover moved up by 7.5 percent, while real turnover adjusted for inflation grew by 3.7 percent year-on-year in February.

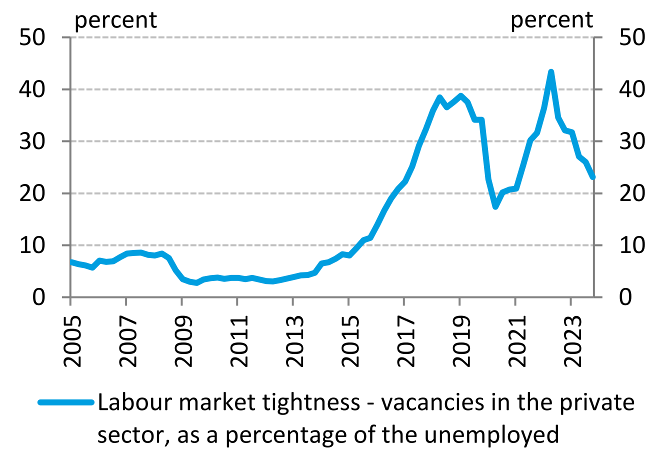
Chart 4 Number of persons employed and the unemployment rate



Note: Employment based on seasonally adjusted data.

Source: HCSO

Chart 5 Labour market tightness indicator



Note: Seasonally adjusted quarterly data.

Source: HCSO, MNB calculation

Freight traffic (+8.9 percent) and air passenger traffic (+10.4 percent) expanded, while road passenger traffic (–13.1 percent) contracted. Electricity load fell by 2.8 percent. Cinema admissions increased by 50.7 percent and catering turnover grew by 12.7 percent. The number of Google searches for the term “unemployment benefit” rose in March.

1.2.2. Employment

According to the Labour Force Survey, the average number of workers aged 15–74 equalled 4,723,000 in February 2024, which, seasonally adjusted, is 10,000 higher than in January. Over the period from December 2023 to February 2024, the average number of persons in employment stood at 4 million 721 thousand, 31 thousand more than in the same period of the previous year. In the same period, the average number of people employed in the primary labour market increased by 30 thousand, the number of people working at a business unit abroad rose by 5 thousand, while the number of people in fostered employment decreased by 4 thousand relative to the same period in the preceding year.

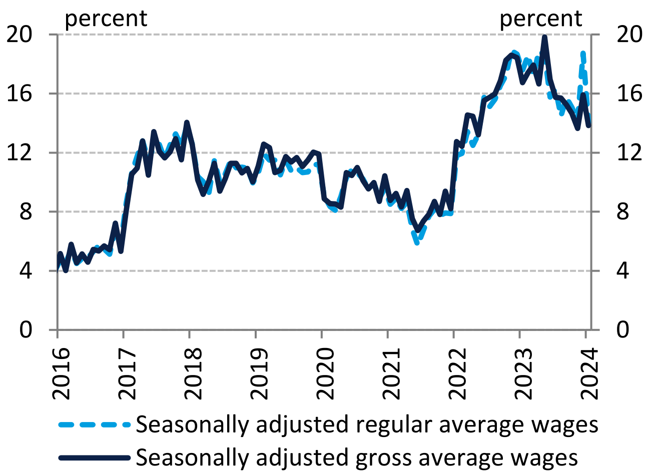
The number of unemployed persons amounted to 227 thousand in February, 31 thousand more than in the same period of the year before. Thus, the overall unemployment rate stood at 4.6 percent (Chart 4). As per seasonally adjusted data, basically, the number of the unemployed did not change from January to February. According to raw data from the National Employment Service (NFSZ), there were 235,000 registered jobseekers in Hungary in February and 236,000 in March 2024. This represents a decrease of 10 thousand and 8 thousand, respectively, relative to the same period of the previous year. Seasonally adjusted data show practically no change in the number of registered jobseekers in March 2024 compared with February; however, it continues to be lower than in the months before the outbreak of the coronavirus pandemic.

The labour market has become less tight in recent months (Chart 5). In 2023 Q4, there were 49,000 vacancies in the private sector, down by 16.3 percent year-on-year and 8.7 percent lower than in the previous quarter. Labour demand in both manufacturing and market services fell compared with the previous quarter. In manufacturing, there were 2.6 thousand fewer job vacancies than in the third quarter. The market services sector had 30.3 thousand job vacancies in 2023 Q4, 1.5 thousand fewer than in the previous quarter. In the public sector, labour demand increased moderately relative to the previous quarter.

1.3. Inflation and wages

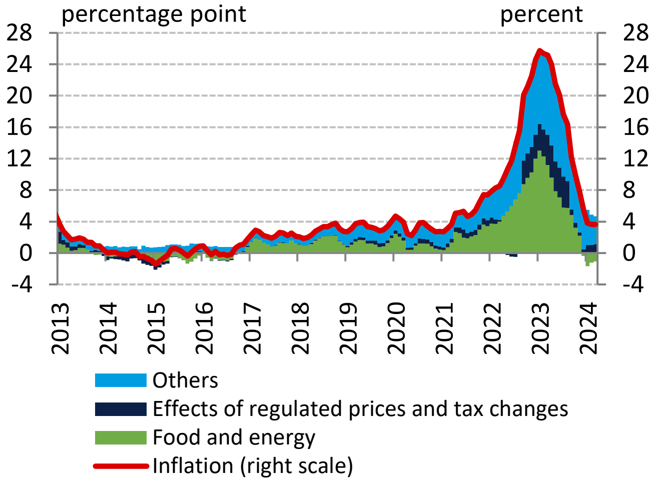
Domestic inflation continued to decline in March 2024, with consumer prices rising by 3.6 percent year-on-year. Both core inflation and core inflation excluding indirect tax effects dropped to 4.4 percent, in line with analysts' expectations. Average regular earnings (excluding bonuses) in the national economy and in the private sector rose by 15 percent and 14.1 percent, respectively, in January 2024, on an annual basis.

Chart 6 Dynamics of average earnings in the private sector



Source: MNB calculation based on HCSO data

Chart 7 Decomposition of inflation



Source: MNB calculation based on HCSO data

1.3.1. Wage setting

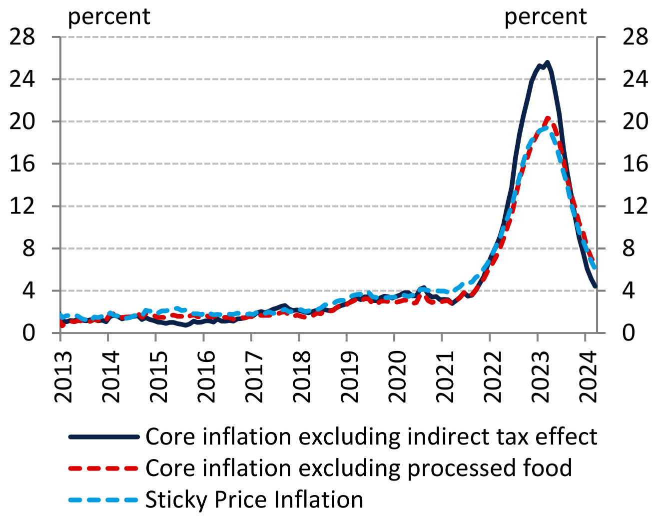
In January 2024, average gross earnings in the private sector grew by 13.6 percent compared with the same period last year. Regular earnings went up by 1.1 percent on a monthly basis, by much less than in the previous two years, also because the minimum wage had been already increased in December. The level of bonus payments was somewhat lower than in the preceding few years. Average regular earnings (excluding bonuses) rose by 15 percent in annual terms in the national economy and by 14.1 percent in the private sector. Total (raw) average earnings in the national economy expanded by 14.7 percent on an annual basis, beating analysts' expectations of 14 percent.

Based on seasonally adjusted data, the dynamics of both gross average wages and regular average wages decelerated in the private sector compared to the previous month (Chart 6). In the private sector, wage dynamics in manufacturing exceeded the dynamics observed in market services. Raw data indicate that in manufacturing, wages were 13.7 percent higher in January compared with the same period last year. With regard to market services, the Hungarian Central Statistical Office registered an increase of 13.1 percent. As for the sectors of the national economy, wages in construction grew by 15.5 percent, by 13.5 percent in tourism and by 13.2 percent in trade compared with the same period of the previous year.

1.3.2. Inflation developments

Domestic inflation continued to fall in March 2024, with consumer prices rising by 3.6 percent year-on-year (Chart 7). Both core inflation and core inflation net of indirect taxes fell to 4.4 percent. In monthly terms, the price of the representative consumer basket and core inflation both rose by 0.8 percent. The annualised consumer price index decreased by 0.1 percentage points relative to the previous month. The contribution of industrial goods (–0.3 percentage points), food (–0.2 percentage points) and market services (–0.1 percentage points) to disinflation was largely offset by the upward impact of fuels (+0.3 percentage points) and goods and services with regulated prices (+0.2 percentage points). Annual core inflation eased by 0.7 percentage points, with disinflation being general. The annual inflation rate for industrial goods fell to 2.9

Chart 8 Measures of underlying inflation indicators



Source: MNB calculation based on HCSO data

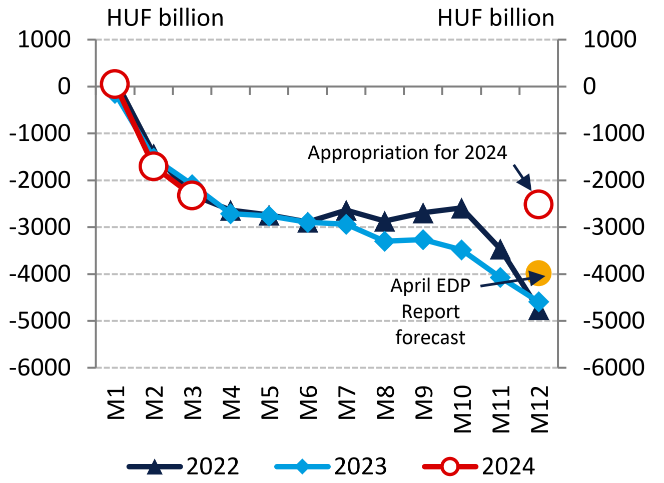
percent, while the annual price index for market services dropped to 10.2 percent. Among food products, the annual price index for processed food decreased to –3.4 percent and for unprocessed food to –2.0 percent. Fuel inflation stood at 2.3 percent on an annual basis. The annual price index for goods and services with regulated prices was 3.8 percent. Incoming data were essentially consistent with analysts' expectations. The median equalled 3.5 percent with expectations ranging from 3.2 to 3.9 percent.

The MNB's annual indicators, which capture more persistent inflation trends, also declined in March. The inflation of sticky-price goods and the annual increase in core inflation excluding processed food were both 0.7 percentage points lower than in the previous month (Chart 8).

1.4. Fiscal and external balance trends

In March, the central sub-sector of the general government recorded a higher deficit than a year ago, adding to the budget deficit accumulated since the beginning of the year. The current account surplus reached a historically high level of EUR 958 million in February 2024, mainly due to a record surplus of the goods balance.

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



Source: 2024 Budget Act, Hungarian State Treasury, HCSO

1.4.1. Fiscal trends

The central sub-sector of the general government ended March with a budget deficit of HUF 617 billion, HUF 53 billion higher than the deficit in the third month of a year earlier. This brought the deficit of the first quarter up to HUF 2,321 billion (Chart 9). The Hungarian Central Statistical Office published the EDP Report on 2 April, which showed an accrual budget deficit of 6.7 percent of GDP and a gross public debt ratio of 73.5 percent in 2023. According to the Report, the ESA deficit in 2024 equals 4.5 percent of GDP, and the cash deficit of the central government is expected to reach HUF 3,982 billion in 2024.

Central sub-sector revenues increased by HUF 76 billion on an annual basis in March, mainly driven by a HUF 102 billion rise in labour taxes and contributions, HUF 57 billion higher VAT receipts and HUF 32 billion higher excise duties. At the same time, EU revenues decreased significantly, and were around HUF 280 billion less than in March last year.

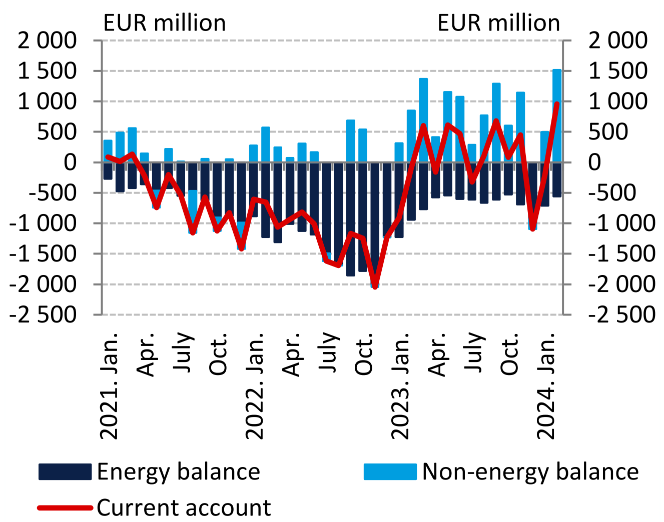
Budget expenditure in March was HUF 129 billion higher than in the same period of the previous year. The increase is mainly due to a HUF 173 billion rise in expenditure on public transport and utilities and a HUF 126 billion growth in net interest expenses. Higher spending was partly offset by the fact that EU payments were nearly HUF 200 billion lower than in March last year.

1.4.2. External balance developments

The current account surplus reached EUR 958 million in February 2024, and net lending equaled EUR 1,054 million (Chart 10). The increase of the current account balance to a historic high was driven by the balance on goods reaching a record surplus. Exports remained subdued amid the weak European economy but recovered somewhat compared to January, while imports continued to fall significantly in annual terms. In February, the services surplus remained roughly at the same level as a year earlier. The deficit on the income account narrowed relative to January, whereas the balance on transfers expanded, with EU funds rising.

Based on the financial account, net direct investment in February was broadly neutral in terms of financing, as the level of outflows during the month and foreign investment in Hungary both amounted to around EUR 0.3 billion. The increase of EUR 0.4 billion in net external debt resulting from transactions was linked to the banking system, while government and corporate indices both declined.

Chart 10 Developments in current account and energy balance



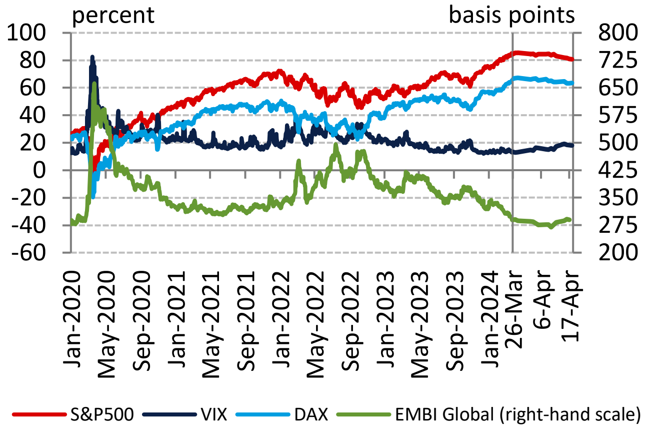
Note: The last monthly value of the energy balance is an estimate.
Source: MNB, HCSO

2. Financial markets

2.1. International financial markets

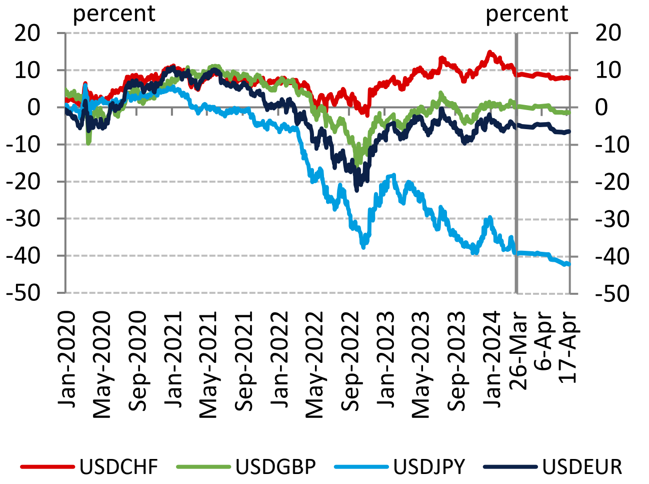
Global risk appetite weakened over the latest period. Market participants focused on expectations regarding the interest rate policies of world's leading central banks and the escalation of the conflict in the Middle East. Developed market equity indices fell, while long-term government bond yields rose since the last interest rate decision.

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



Source: Bloomberg

Chart 12 Evolution of developed market foreign exchange rates compared to January 1, 2019



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

Source: Bloomberg

Among risk indicators, the VIX index, a measure of US equity market volatility, rose by 5 percentage points and thus stands at 18 percent. Regarding the emerging markets, the EMBI global spread also increased, by 2 basis points to 291 basis points (Chart 11).

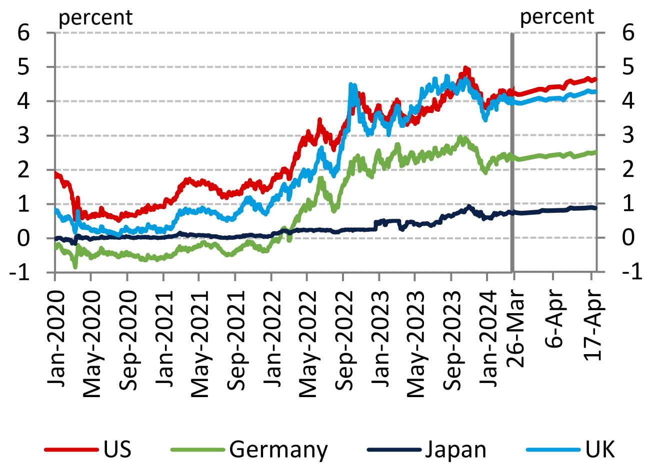
Developed market stock indexes fell over the period. The US Dow Jones fell by 3.8 percent, the S&P 500 index dropped by 2.9 percent and the Nasdaq 100 decreased by 2.7 percent. As for Europe's leading stock market indexes, the German DAX index moved down by 3.4 percent and the French CAC 40 index by 3.1 percent. Of the Asian indexes, the Shanghai stock index fell by 0.8 percent, the Japanese Nikkei by 4.8 percent and the Hang Seng by 2.2 percent since the previous interest rate decision. Overall, the MSCI Developed Market Index went down by 3.5 percent and the Emerging Market Index by 2.9 percent over the period.

The dollar appreciated against major currencies (Chart 12). The US currency appreciated by 1.9 percent against the euro to around 1.065, by 1.6 percent against the British pound, by 1.0 percent against the Swiss franc and by 2.1 percent against the Japanese yen.

Developed market long yields increased significantly since the last interest rate decision (Chart 13). The US ten-year yield increased by 44 basis points to 4.67 percent since the previous interest rate decision. The German long yield rose by 14 basis points to 2.49 percent, and yields in the Mediterranean countries moved up by 15 to 30 basis points. The Japanese 10-year yield also rose by 13 basis points to 0.87 percent. With regard to the ten-year government bond yields in the region, Romania is up 30 basis points, Poland 31, the Czech Republic 55 and Hungary 56.

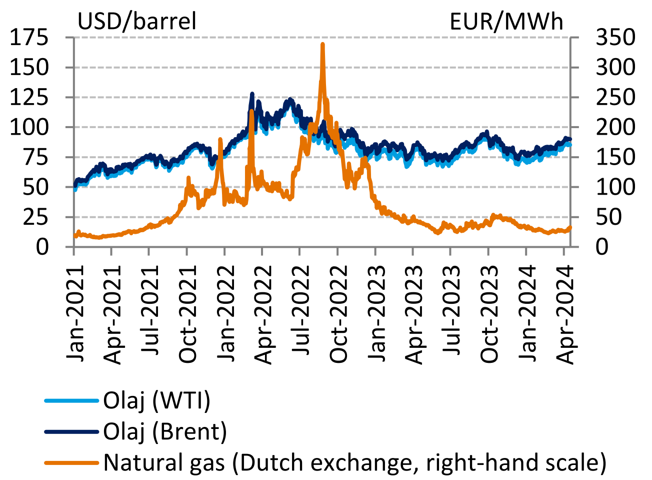
Commodity prices rose considerably since the previous interest rate decision (Chart 14). The price of North Sea Brent crude oil per barrel rose by 4 percent from around USD 86 at the end of March to around USD 90, while the price of the US benchmark, the WTI barrel increased by a similar degree to USD 85 over the period under review. The main driver behind the rise in oil prices is the escalation of geopolitical tensions, with the outbreak of the Israel-Iran conflict in particular pushing up prices. Gas prices in Europe moved up too since the last interest rate decision, the

Chart 13 Yields on developed market long-term bonds



Source: Bloomberg

Chart 14 Developments in oil and gas prices since January 2021



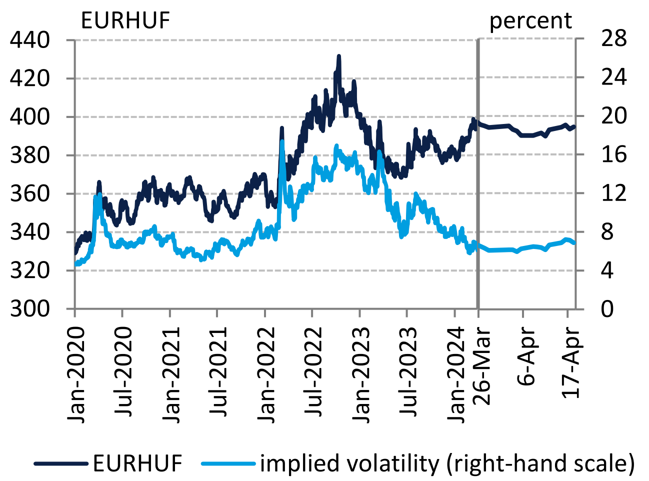
Source: Bloomberg

benchmark gas price increased from EUR 27/MWh to EUR 32.7/MWh, also because of the conflict in the Middle East. Although stocks in European countries remained high thanks to the mild winter, and industry used fewer raw materials than expected, the market may well face severer supply disruptions. If Iran were to close the Strait of Hormuz, that would make nearly 20 percent of the liquefied gas trade insecure. The Dow Jones Commodity Index, which covers a large part of the commodity market, also rose.

2.2. Developments in domestic money market indicators

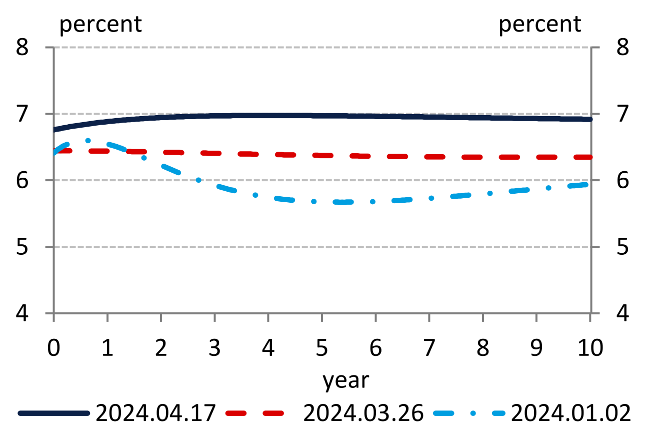
Overall, the forint appreciated somewhat against the euro since the March interest rate decision. The yield curve for government bonds shifted upwards. The 3-month BUBOR fell by 27 basis points to 7.69 percent.

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



Source: Bloomberg

Chart 16 Shifts in the spot government yield curve



Source: Bloomberg

Overall, the forint appreciated slightly against the euro since the March interest rate decision (Chart 15). On the day of the March rate decision, the forint strengthened somewhat, by 0.3 percent. Between the end of March and the second week of April, the forint appreciated against the euro to 388.5, driven by an interest rate decision that met analysts' expectations and by other country-specific factors. Subsequently, however, the upward shift in rate paths expected from the major central banks and the strengthening of the US dollar continued to weaken the domestic currency. Overall, the forint appreciated by 0.3 percent against the euro over the period. Regional currencies developed variably over the period, with the Czech koruna strengthening by 0.1 percent, while the Polish zloty weakened by 1.2 percent and the Romanian leu by 0.1 percent against the euro.

The 3-month BUBOR, which is relevant for monetary transmission, fell by 27 basis points since the previous interest rate decision to 7.69 percent.

Since the last rate decision, the entire yield curve of the government bond market shifted upwards (Chart 16). The inter-year section of the yield curve moved up by 31 to 44 basis points and the section outside the year rose by 44 to 60 basis points.

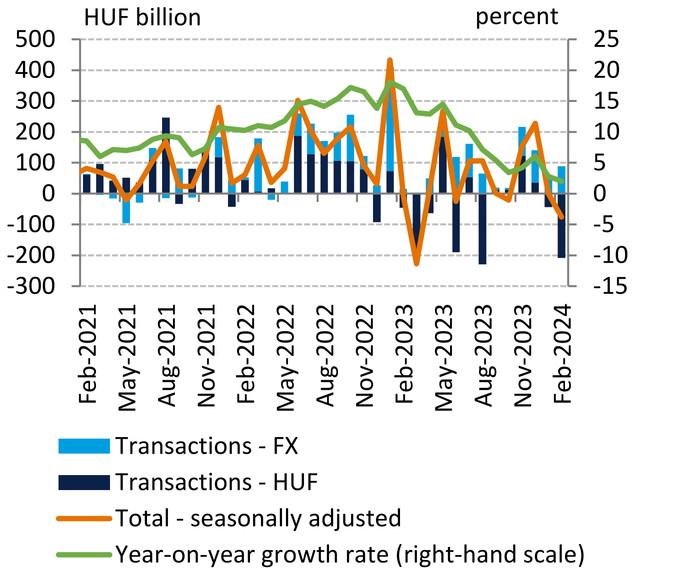
Since the previous interest rate decision, demand at treasury bill auctions was low but high at government bond auctions. In the period under review, the Government Debt Management Agency accepted bids at treasury bill auctions below the pre-advertised quantity in all cases but one. Demand at bond auctions was, however, high for all maturities, thus for the majority of the auctions, the GDMA accepted more bids than announced.

Non-residents' holdings of forint government securities decreased. Holdings owned by non-residents shrank by HUF 141 billion to HUF 6,798 billion. The market share of forint government securities held by foreigners thus stood at 19.0 percent.

3. Trends in lending

Non-financial corporations' loans outstanding declined in February 2024, pushing down the year-on-year growth rate of their loans outstanding from credit institutions. Outstanding household loans continued to grow at a faster pace compared to the corporate sector. Smoothed interest rate spreads on forint corporate loans rose moderately.

Chart 17 Net borrowing by non-financial corporations



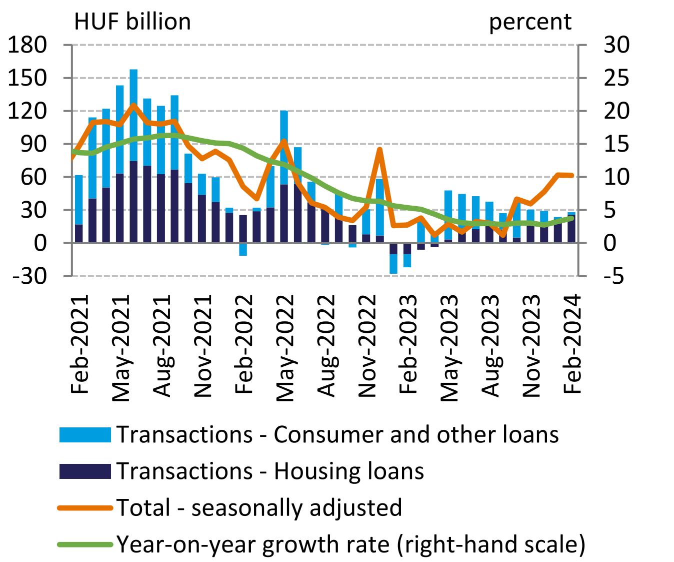
Source: MNB

Corporate loans contracted by HUF 120 billion in February 2024 due to a HUF 208 billion decline in forint loans and a HUF 88 billion increase in foreign currency loans. **The annual growth rate of loans dropped to 2.0 percent** from 2.7 percent in January (Chart 17). The last time the growth rate was this low was in 2016. Credit institutions contracted new non-overdraft loans in an amount of HUF 158 billion during the month, which is 19 percent lower than in the same period last year.

Household lending increased by HUF 28 billion in February, raising the annual growth rate of outstanding loans by 0.5 percentage points to 3.8 percent compared with January (Chart 18). Due to the low base, the HUF 185 billion volume of new household loan contracts was 89 percent higher than in the same period of the previous year, while the value of newly contracted housing loans was one and a half times higher year-on-year compared with the last February. Around 500 contracts were signed in February under the HPS Plus programme, which has been available since January.

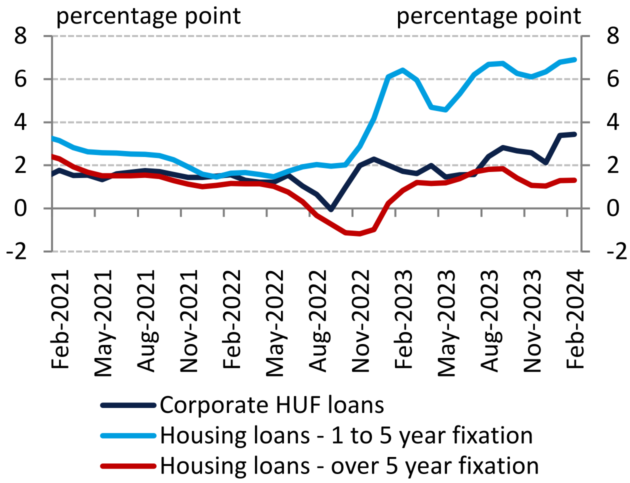
The smoothed interest rate spread on corporate forint loans increasedslightly by 6 basis points from the previous month, and amounted to 3.44 percentage points in February 2024 (Chart 19). As for housing loans, the spread on products with an interest rate fixation period longer than 5 years remained essentially unchanged, and stood at 1.30 percentage points at the end of the period under review.

Chart 18 Net borrowing by households



Source: MNB

Chart 19 Developments in corporate and household credit spreads



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

Source: MNB