MACROECONOMIC AND FINANCIAL MARKET DEVELOPMENTS

BACKGROUND MATERIAL

TO THE ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING

OF 26 MARCH 2024

MARCH

2024

Time of publication: 2 p.m. on 10 April 2024

The background material 'Macroeconomic and financial market developments' is based on information available until 21 March 2024.

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

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

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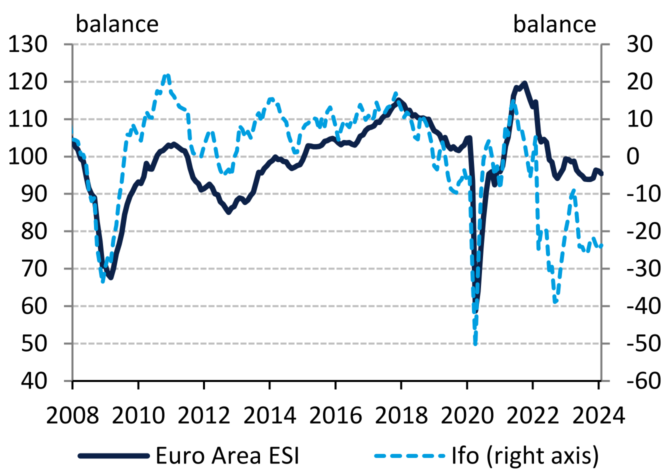
1. Macroeconomic developments

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 February, the Purchasing Managers' Index for manufacturing rose in the United States and the euro area, while it stagnated in China. While retail sales volumes increased in both the US and China, they fell in the euro area. Annualised inflation in the United States rose in February, once again slightly above expectations. In China, consumer prices rose slightly on an annual basis in February after moderating in January. Euro-area inflation and core inflation fell year-on-year in February, yet both still remained above analysts' expectations. Disinflation continued across a wide range of countries.

GDP grew by 3.1 percent year-on-year in the United States, 5.2 percent in China, 0.2 percent in the European Union and 0.1 percent in the euro area. Within the EU, GDP grew in 18 Member States on an annual basis, with the highest annual increases in Croatia and Malta (+4.3%), while the largest decrease was recorded in Ireland (–9.1%). Our largest trading partner, Germany, contracted by 0.2 percent. Among the countries in the region, GDP also grew in Poland (+1.7%), Slovakia (+1.3%), Romania (+1.1%) and the Czech Republic (+0.2%).

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.

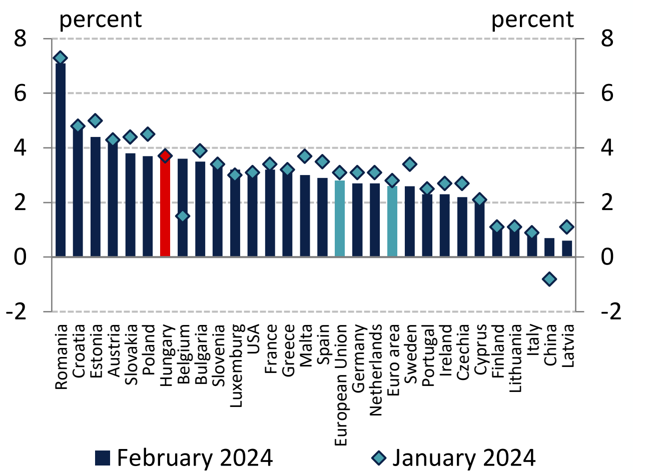
The Purchasing Managers' Index for manufacturing was below the expansion threshold in the euro area, while it was above the threshold value in China and the US. The euro area's Economic Sentiment Indicator (ESI) fell by 0.7 points in February (Chart 1).

International labour market trends have as yet shown no signs of a significant slowdown. In the United States, while the unemployment rate rose slightly, reaching 3.9 percent in February, from 3.7 percent in January, it has remained historically low. Non-agricultural employment grew by a larger-than-expected 275 thousand in February. The unemployment rate in the euro area stood at 6.4 percent in January.

Retail sales rose by 1.5 percent in the US in February, by 5.5 percent in China in January - February and decreased by 1.0 percent in the euro area in the first month of the year.

Annualised inflation in the United States rose to 3.2 percent in February from 3.1 percent in January. **In China, consumer prices rose by 0.7 percent on an annual basis in February**, following a 0.8 percent decline in January. **Euro area inflation fell to 2.6 percent year-on-year, while core**

Chart 2 Developments in the international inflation environment



Note: HICP rates.

Source: Eurostat

inflation dropped to 3.1 percent in February; however, both figures were above analysts' expectations.

February inflation in Hungary corresponded to the average for the Visegrad countries. Inflation was 7.1 percent in Romania, 3.8 percent in Slovakia, 3.7 percent in Poland and 2.2 percent in the Czech Republic, according to the Harmonised Index of Consumer Prices (HICP) (Chart 2).

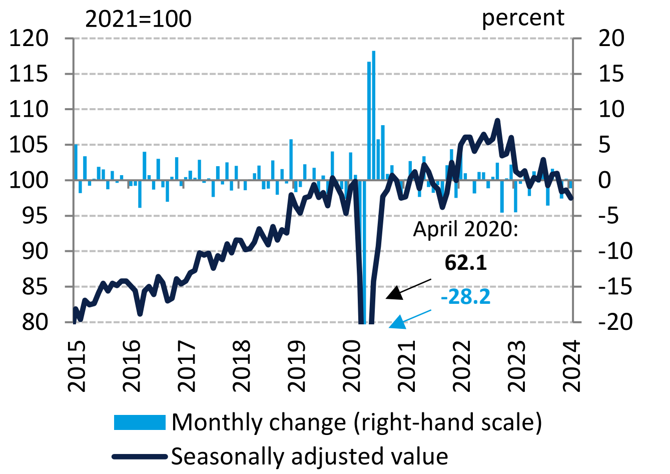
1.2. Real economic trends in Hungary

In January 2024, industrial production fell, while construction grew. The volume of retail sales increased on an annual basis, breaking a thirteen-month trend of annualised decline. In January 2024, preliminary figures show a surplus of €497 million in external trade. In January 2024, the average number of employed persons aged 15-74 was 4 million 699 thousand, the same as in January the previous year. The unemployment rate stood at 4.5 percent in January.

1.2.1. Economic growth

Gross domestic product stagnated in 2023 Q4 compared to 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 was also unchanged compared with the previous quarter. On the production side, added value in agriculture rose 81.1 percent in the fourth quarter, from a low base following the drought of 2022. Added value in industry, in particular manufacturing, both fell by 6.4 percent on an annual basis, while added value in construction was 7.4 percent lower than in the equivalent period of the previous year. Added value in services in general dropped by 1.0 percent in 2023 Q4, while government-related services (public administration, defence; compulsory social security, education, human health, social work) grew by 2.3 percent overall. On the consumption side, household final consumption expenditure decreased by 0.2 percent year-on-year, while the added value of gross fixed capital formation fell by 3.0 percent. Community consumption fell by 3.8 percent on an annual basis, while the contribution of the change in inventories was substantially negative, curbing growth by 3.4 percentage points. The volume of imports decreased to a greater extent (–9.0 percent) than that of exports (–4.7 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

In January 2024, industrial production fell by 3.6 percent year-on-year, marking thirteen months of year-on-year contraction. The level of production fell by 1.1 percent compared to the previous month (Chart 3). Both domestic industrial sales and export sales declined in January. Production fell in most manufacturing sub-sectors, while output increased in coke manufacturing, petroleum refining and the food industry. The total volume of new orders in manufacturing were 5.1 percent lower than in January 2023. New domestic orders fell by 4.7 percent, while new export orders by 5.1 percent.

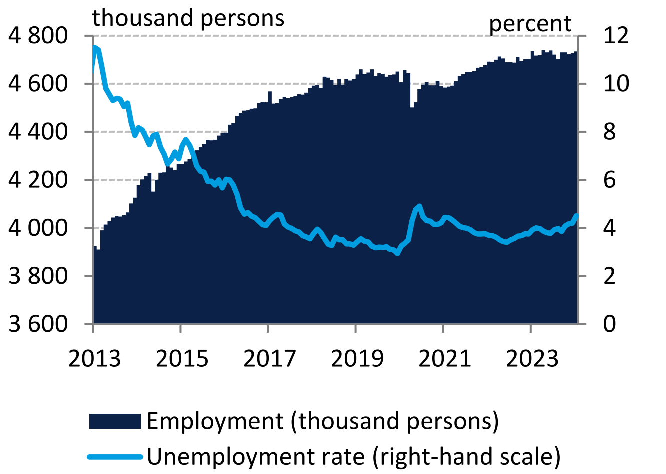
The volume of construction output grew by 17.2 percent year-on-year in January 2024. The construction of buildings increased by 20.5 percent, while the construction of other structures rose by 11.6 percent on an annual basis. The total construction output was 10.2 percent higher than in December 2023, based on seasonally and working-day adjusted data. The volume of new contracts increased by 21.5 percent. In particular, the volume of contracts for the construction of buildings increased by 31.5 percent, while the contracts for the construction of other structures were 19.8 percent down from a year earlier. The volume of contracts in the construction sector fell by 14.9 percent at the end of January. In particular, contracts for the construction of buildings were 9.1 percent down compared to the same period of the previous year, while contracts for other construction were 20.5 percent lower.

In January 2024, retail sales volume grew by 0.6 percent year-on-year, breaking a thirteen-month trend of annualised decline. Retail trade excluding fuel sales, on the other hand, fell by 0.2 percent in January, continuing the downward trend since July 2022, according to calendar-adjusted data. On a monthly basis, the volume of retail sales remained unchanged in January. Sales volumes were close to December 2022 levels, based on seasonally and calendar-adjusted data. The annual volume of sales at filling stations increased by 4.6 percent. Food retail trade increased slightly on an annual basis in January (+0.2%). In addition, turnover in pharmaceuticals, medical products and perfumes (+8.0 percent) and mail order businesses (+4.3 percent) also increased. Sales declined in books and computers (-5.5 percent), mixed industrial goods (-6.4 percent), textiles, clothing and footwear (-8.1 percent) and furniture, hardware and ironmongery (-8.2 percent).

According to preliminary data, the external trade balance showed a surplus of EUR 497 million in January 2024, after a deficit in the previous month. The balance improved by EUR 767 million compared to the previous month and by EUR 900 million compared to the equivalent period of the previous year. The VAT-adjusted balance was EUR 796 million better than a year ago, with a deficit of EUR 63 million. In January, the value of goods exports in euro fell by 7.4 percent on an annual basis. The nominal value of imports in euro terms shrank by 14.3 percent over a year, as energy prices fell and domestic demand slowed down. According to seasonally adjusted data, exports decreased by 4.7 percent and imports by 13.0 percent from their levels in December.

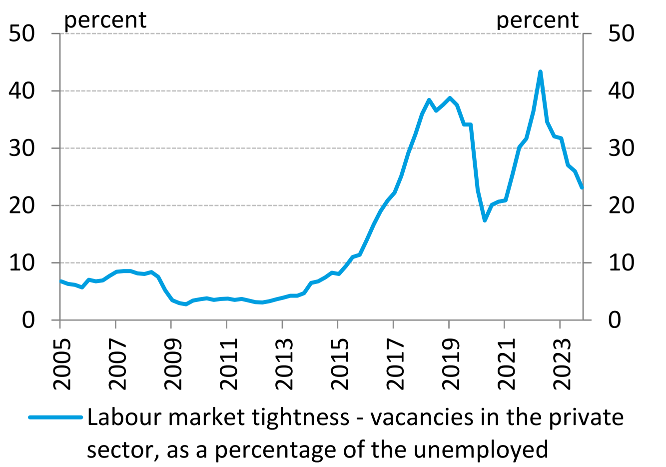
After a decline since January 2023, the inflation-adjusted turnover of online cash registers increased in February 2024. Based on online cash register data, nominal turnover increased by 7.5 percent, while inflation-adjusted real turnover grew by 3.7 percent year-on-year in February. Freight transport (+11.1%) and air passenger transport (+8.1%) increased, while road passenger transport (–14.9%) shrank. The demand for electricity stagnated. Cinema admissions increased by 3.7 percent, while catering turnover grew by 11.2 percent. The number of Google searches for the term ‘unemployment benefit’ stagnated 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

1.2.2. Employment

According to the Labour Force Survey, the average number of employed persons aged 15-74 in January 2024 was 4 million 699 thousand, the same as in January last year. In the period November 2023 to January 2024, the average number of employed persons was 4 million 718 thousand, which is 13 thousand higher than in the same period of the previous year. In November to January, the average number of people employed in the primary labour market increased by 17 thousand, the number of people working abroad increased by 4 thousand, while the number of people in public employment decreased by 8 thousand compared to the equivalent period of the previous year.

The number of unemployed persons was 222 thousand in January, according to the data of the Hungarian Central Statistical Office, which is 30 thousand more than in the same period of the previous year. Thus, the overall unemployment rate was 4.5 percent (Chart 4). Based on seasonally adjusted data, the number of unemployed people in January increased by 5 thousand compared to December. According to raw data from the National Employment Service (NFSZ), there were 233,000 registered jobseekers in Hungary in January and 235,000 in February 2024. This represents a decrease of 11 thousand and 10 thousand respectively compared to the equivalent period of the previous year. Based on seasonally adjusted data, the number of registered jobseekers in February 2024 was slightly lower than in January and has remained lower than in the months before the outbreak of the coronavirus epidemic.

The tightness of the labour market has eased in recent months (Chart 5). There were 49,000 vacancies in the competitive sector in 2023 Q4, 16.3 percent fewer than in the equivalent quarter of the previous year and 8.7 percent fewer compared to the previous quarter. Labour demand in both manufacturing and market services fell compared to the previous quarter. In manufacturing, there were 2.6 thousand fewer job vacancies than in the third quarter. In the market services sector, there were 30.3 thousand job vacancies in 2023 Q4, 1.5 thousand fewer than in the previous quarter. In the public sector, demand for labour increased slightly compared to the previous quarter.

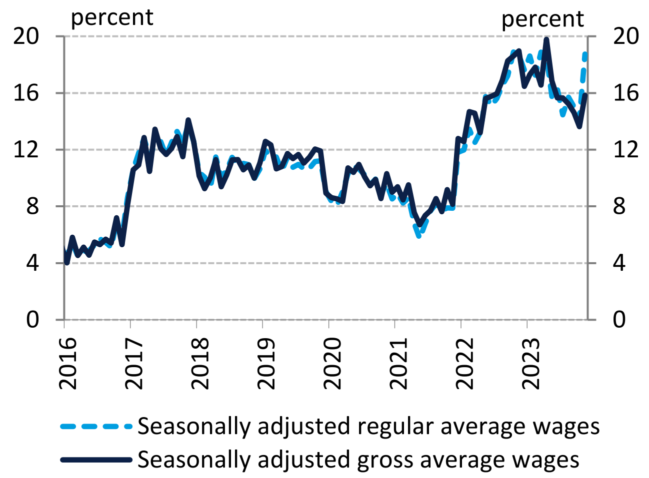
1.3. Inflation and wages

Domestic inflation continued to fall in February 2024. Year-on-year, consumer prices rose by 3.7 percent. Core inflation and core inflation net of indirect taxes both fell to 5.1 percent. Incoming inflation data were below analysts' expectations. In December 2023, average wages (excluding bonuses) rose by 17.3 percent in the national economy and by 18.1 percent in the competitive sector in annual terms.

1.3.1. Wages

In December 2023, gross average wages in the competitive sector were up 15.6 percent year-on-year. Regular earnings rose by 4.2 percent on a monthly basis, significantly exceeding the increase in previous years. This development may have been driven by the increase in the minimum wage in December. Bonus payments, however, remained somewhat lower than in the previous few years. Average regular earnings (excluding bonuses) rose by 17.3 percent in annual terms in the national economy and by 18.1 percent in the competitive sector.

Chart 6 Dynamics of average earnings in the private sector

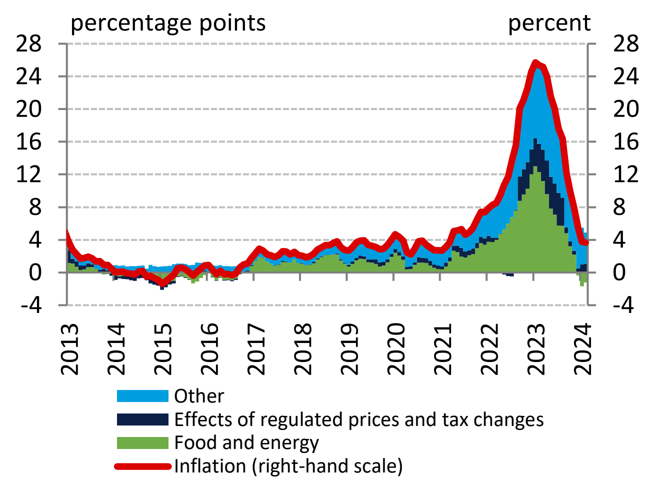


Source: MNB calculation based on HCSO data

Based on seasonally adjusted data, the dynamics of both gross average wages and regular average wages accelerated in the competitive sector compared to the previous month (Chart 6). Within the competitive sector, wage dynamics in market services exceeded the dynamics observed in manufacturing. Based on raw data, manufacturing wages were 13.0 percent higher in December than in the same period of the previous year. In market services, 16.1 percent growth was registered by the Statistical Office. As regards the sectors of the national economy, wages in construction increased by 21.8 percent, by 22.7 percent in tourism and by 14.8 percent in trade compared to the same period of the previous year.

1.3.2. Inflation developments

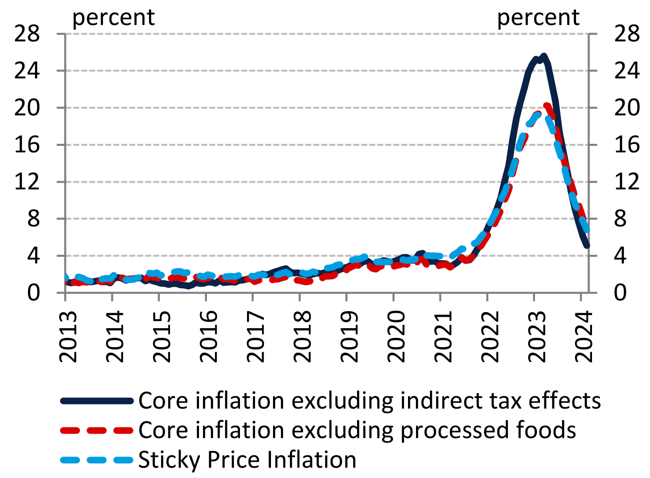
Chart 7 Decomposition of inflation



Source: MNB calculation based on HCSO data

In February 2024, domestic inflation continued to fall, with consumer prices rising by 3.7 percent year-on-year (Chart 7). Both core inflation and core inflation net of indirect taxes eased to 5.1 percent. The price of the representative consumer basket was up 0.7 percent on a monthly basis, whereas, core inflation was up 0.2 percent. Inflation eased by 0.1 percentage points compared to the previous month. The contribution of industrial goods (-0.4 percentage points) and food (-0.3 percentage points) to disinflation was offset by the upward impact of fuels (+0.6 percentage points). Annual core inflation eased by 1.0 percentage points, within which disinflation was generalised. The annual inflation rate for industrial goods fell to 3.9 percent, while the annual basis price index for market services dropped to 10.7 percent. Within food, the annual price index for processed food decreased to –2.8 percent and that for unprocessed food to +0.1 percent. Fuel inflation eased by 2.4 percent on an annual basis. The annual price index

Chart 8 Measures of underlying inflation indicators



Source: MNB calculation based on HCSO data

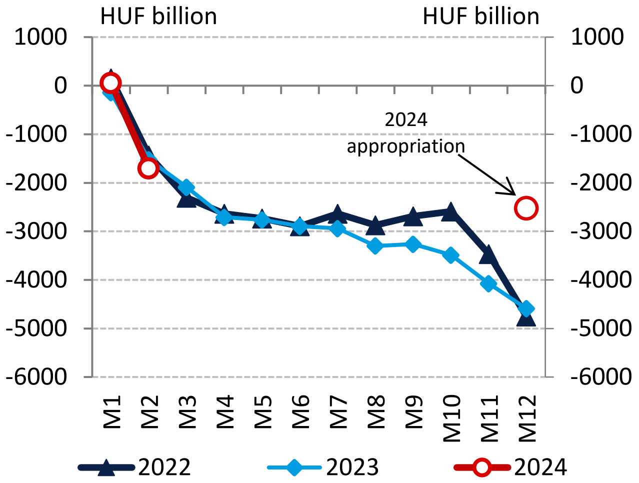
for goods and services with regulated prices was 1.9 percent. Incoming data were somewhat below the median of analysts' expectations. Expectations ranged from 3.5 to 4.3 percent, while the median was 3.9 percent.

The MNB's annualised indicators, which capture more persistent inflation trends, also diminished in February. The inflation rate of goods less exposed to price changes fell by 0.9 percentage points, while the annual core inflation excluding processed food dropped by 1.0 percentage points from the previous month (Chart 8).

1.4. Fiscal and external balance trends

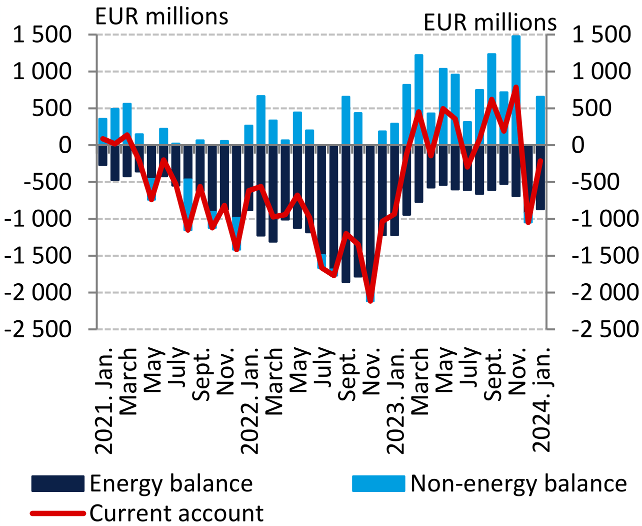
The central sub-sector of the general government closed February with a significant deficit, higher than a year ago. The current account balance increased significantly compared to the previous month, due mainly to an improvement in the trade balance.

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



Source: 2024 Budget Act, Hungarian State Treasury

Chart 10 Developments in current account and energy balance



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

1.4.1. Fiscal trends

The central sub-sector of the general government closed February with a significant deficit of HUF 1,758 billion, about HUF 377 billion higher than a year earlier. Since the beginning of the year, the accumulated deficit has risen to HUF 1,704 billion, 68 percent of the 2024 appropriation (Chart 9).

The revenues of the central sub-sector increased by HUF 105 billion on an annual basis, due primarily to a HUF 121 billion increase in labour taxes and contributions, HUF 28 billion higher VAT revenues and HUF 27 billion higher excise tax revenues. Net VAT revenues increased by 16 percent, while gross receipts decreased by almost 3 percent compared to the equivalent period of the previous year. EU revenues decreased significantly, by HUF 120 billion, compared to last February.

Budget expenditure in February was HUF 482 billion higher than in the same period of the previous year. The main reason for such increase was interest expenditure, which was HUF 343 billion, i.e. around three times higher than in February last year, due largely to inflation-linked government bonds that paid interest in February. Moreover, net expenditure of budgetary bodies and chapters increased by HUF 206 billion, while pension expenditure grew by HUF 94 billion compared to February 2023. Expenditure on public transport and utilities fell by HUF 277 billion on an annual basis, linked to a significant reduction in energy expenditure.

1.4.2. External balance developments

In January 2024, the current account deficit amounted to EUR 213 million, while net borrowing amounted to EUR 158 million (Chart 10). The significant increase in the current account balance compared with the previous month is due mainly to an improvement in the trade balance. In a subdued European economic environment, exports continued to decline, but the decrease of imports was even more substantial. In January, the services surplus remained close to the level of a year earlier. The income balance deficit shrank compared to December, while the transfer balance narrowed, with EU funds decreasing.

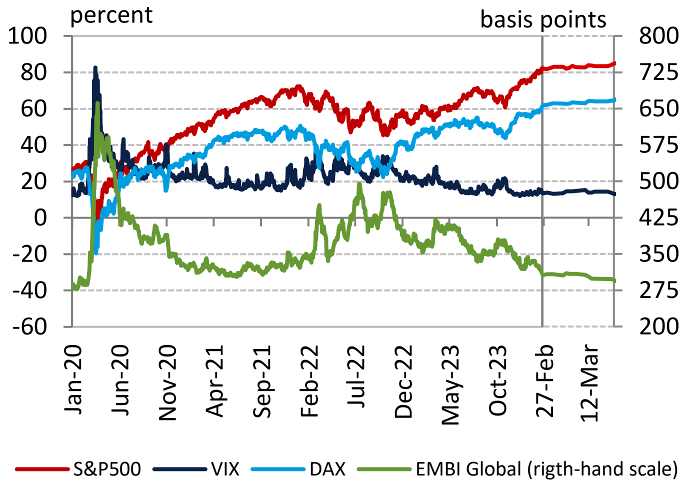
According to financial account data, net FDI inflows were EUR 0.6 billion in January, driven by high levels of reinvested earnings in Hungary. The EUR 0.2 billion increase in net external debt resulting from transactions was linked to the banking system, while the government's indicator fell and the corporate sector's hardly changed.

2. Financial markets

2.1. International financial markets

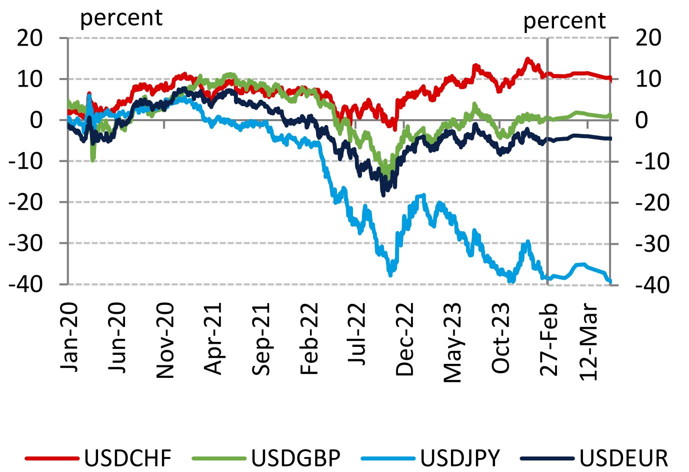
Global risk appetite has been volatile in recent times. Market participants have focused on expectations regarding the interest rate policies of the major central banks and incoming macroeconomic data. Developed market equity indices have typically risen, while long-term government bond yields have fallen slightly in developed markets since the February 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 the risk indicators, the VIX index measuring US equity market volatility fell by 0.5 percentage points to 13 percent, while the EMBI Global bond market spread in emerging markets narrowed by 11 basis points to 296 basis points (Chart 11).

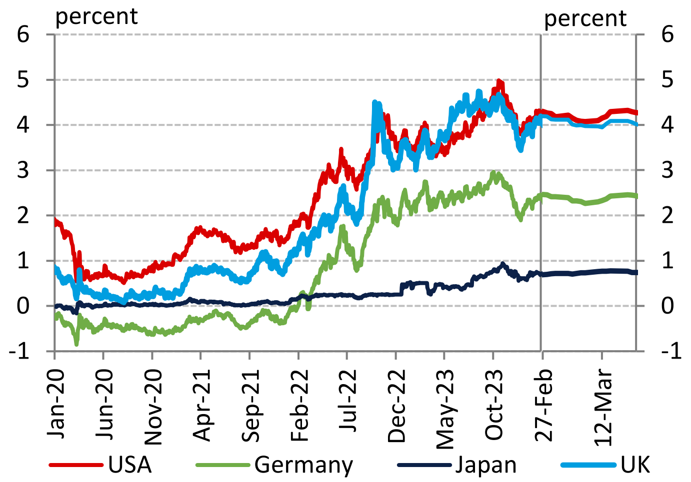
Developed market stock indices rose during the period. The US Dow Jones index rose 0.3 percent, the S&P 500 index rose 2 percent, while Nasdaq 100 rose 0.4 percent. Among Europe's leading stock indices, the German DAX index was up 2.33 percent and the French CAC 40 index rose by 2.31 percent. Among the Asian indices, the Shanghai stock index rose by 1.18 percent, the Japanese Nikkei rose by 1.9 percent, while Hang Seng rose by 0.4 percent since the previous interest rate decision. Overall, the MSCI composite index of developed stock market indices rose by 2.4 percent and the emerging market index increased by 0.4 percent over the period.

The US dollar exchange rate barely changed against the major developed market currencies (Chart 12)**,** weakening by 0.5 percent against the euro to around 1.09, weakening by 0.8 percent against the pound sterling, and appreciating by 1.8 percent against the Swiss franc and by 0.5 percent against the Japanese yen.

Long yields in developed markets have declined slightly since the previous interest rate decision (Chart 13). The US ten-year yield has fallen by 5 basis points since the previous rate decision to 4.24 percent. The German long yield fell by 6 basis points to 2.4 percent, while yields in the Mediterranean countries fell by 3 to 9 basis points. The Japanese 10-year yield rose by 4 basis points to 0.74 percent. Of the ten-year government bond yields in the region, yields in Romania are up by 10 basis points, in Poland by 7 basis points and in Hungary by 28 basis points, while Czech yields are up by 12 basis points.

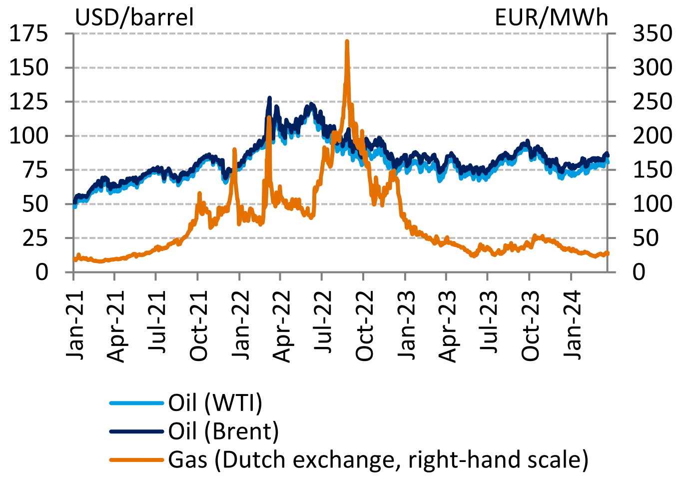
Oil prices have risen slightly since the previous interest rate decision. The price of Brent North Sea oil rose slightly over the period, by USD 3 per barrel to USD 86.25. The price of the US benchmark, WTI, rose by a similar amount to USD 81.53 per barrel. The combination of continued geopolitical risks and slightly more positive

Chart 13 Yields on developed market long-term bonds



Source: Bloomberg

Chart 14 Developments in oil and gas prices since January 2021



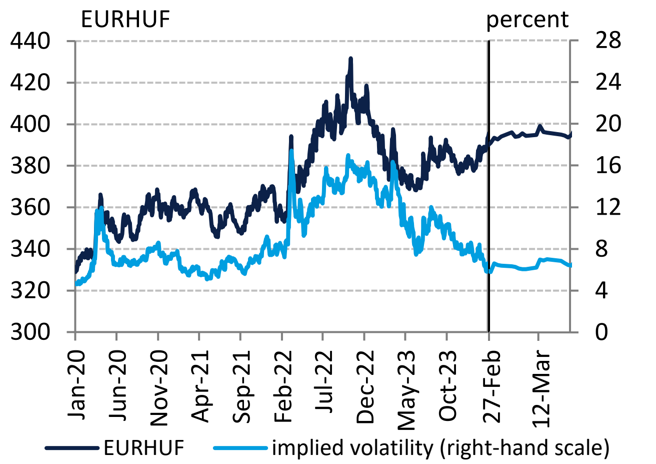
Source: Bloomberg

expectations for global growth have led to a rise in oil prices. European gas prices have risen since the previous rate decision, from EUR 24.3/MWh to EUR 28.8/MWh (Chart 14). The Dow Jones Commodity Index, which covers a large part of the commodity market, also rose slightly.

2.2. Developments in domestic money market indicators

Since the February interest rate decision, the forint has weakened against the euro, breaking away from other regional currencies. The yield curve for government bonds has shifted upwards beyond one year. The 3-month BUBOR fell by 54 basis points to 8.03 percent.

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



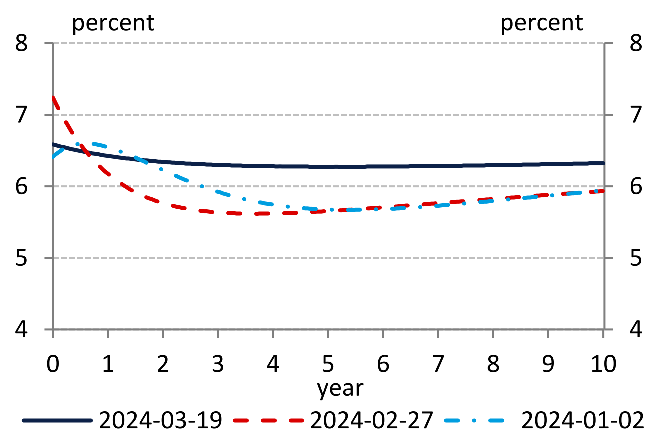
Source: Bloomberg

The forint has weakened against the euro since the previous interest rate decision (Chart 15). On the day of the February interest rate decision, the forint weakened slightly, by 0.3 percent, against the euro. The forint continued to weaken from the end of February, reflecting the upward shift in interest rate paths expected from major global central banks and country-specific factors. Overall, the forint depreciated by 1.2 percent against the euro over the period. Currencies in the region strengthened slightly, with the zloty gaining 0.1 percent and the Czech koruna 0.5 percent, while the exchange rate of the Romanian leu remained essentially the same.

The 3-month BUBOR, which is relevant for monetary transmission, has fallen by 54 basis points since the previous decision to 8.03 percent.

The yield curve for the government bond market has shifted upwards since the last interest rate decision (Chart 16). The yield curve has moved up by 25-65 basis points over the 1-3 year period. Yield levels rose by an average of 60 basis points in the mid-term and by 25 to 50 basis points in the long term.

Chart 16 Shifts in the spot government yield curve



Source: Bloomberg

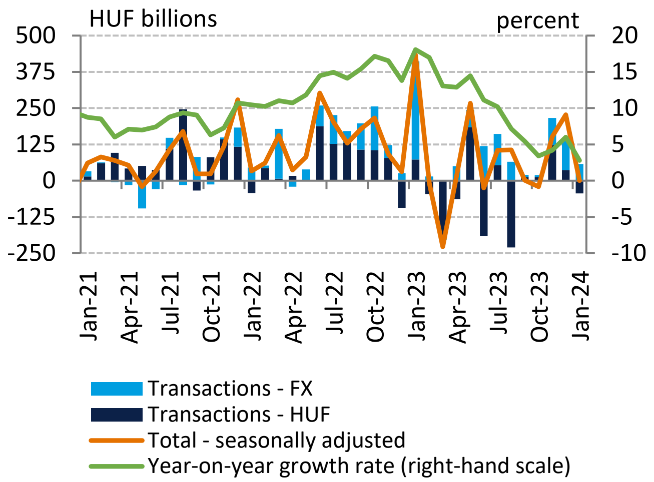
Since the previous interest rate decision, demand has been mixed at discount treasury bill auctions, and robust at government bond auctions. During the period under review, the SAIC accepted bids below the pre-advertised quantity in two discount rate auctions. At the bond auctions, however, demand was strong for all maturities, and therefore the ÁKK (Government Debt Management Agency) accepted more bids than announced in most auctions.

Foreign holdings of forint government bonds fell slightly. The stock owned by non-residents decreased by HUF 13 billion to HUF 7220 billion. The market share of HUF government securities held by foreigners was 20.2 percent.

3. Trends in lending

In January 2024, outstanding lending to both corporations and households increased. Smoothed interest rate spreads on forint corporate loans increased significantly in the first month of 2024 compared to the previous month.

Chart 17 Net borrowing by non-financial corporations

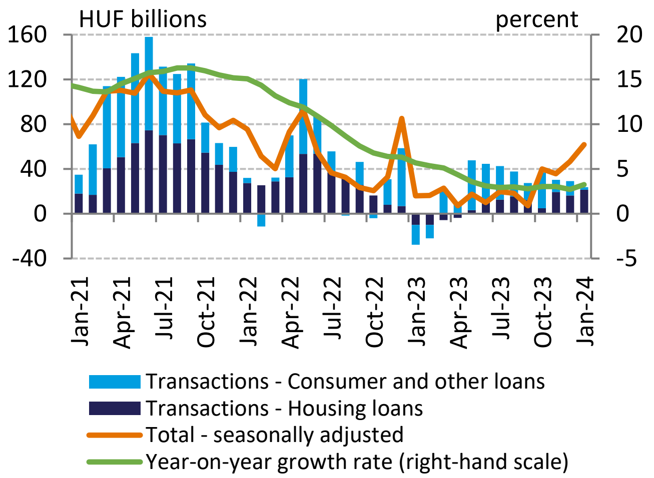


Source: MNB

In January 2024, loans outstanding to non-financial corporations increased by HUF 14 billion due to a HUF 44 billion decrease in forint loans and a HUF 58 billion increase in foreign currency loans (Chart 17). As a result, the annual growth rate fell to 2.8 percent from 6 percent in December, partly explained by the base effect of a large corporate transaction in the previous year. Credit institutions issued HUF 222 billion in new non-overdraft corporate loans during the month, down 57 percent from the same period last year, due mainly to large transactions.

In January, outstanding borrowing by households increased by HUF 24 billion due to transactions, accelerating the annual growth rate to 3.3 percent, up 0.6 percentage points compared to December 2023 (Chart 18)**.** The HUF 170 billion volume of new household loan contracts is 74 percent higher than in the same period last year, due to the low base, while the volume of newly extended housing loans doubled year-on-year. Under the HPS Plus programme, available from January, no contracts have yet been concluded due to the length of time required to close a contract.

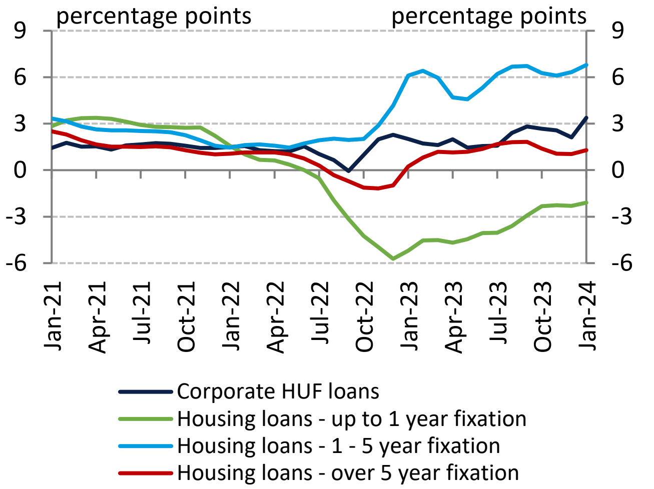
Chart 18 Net borrowing by households



Source: MNB

The smoothed interest rate spread on forint corporate loans increased significantly by 1.26 percentage points compared to the previous month and stood at 3.38 percentage points in January 2024 (Chart 19)**.** In the case of housing loans, the spread on products with interest rate fixation for more than 5years increased by 25 basis points to 1.29 percentage points at the end of the period under review.

Chart 19 Developments in corporate and household credit spreads



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