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Analyst background discussion
19 December 2023

BACKGROUND DISCUSSION AFTER THE MONETARY COUNCIL'S 19 DECEMBER 2023 DECISION

MAIN MESSAGES: MACROECONOMIC ASSESSMENT AND OUTLOOK

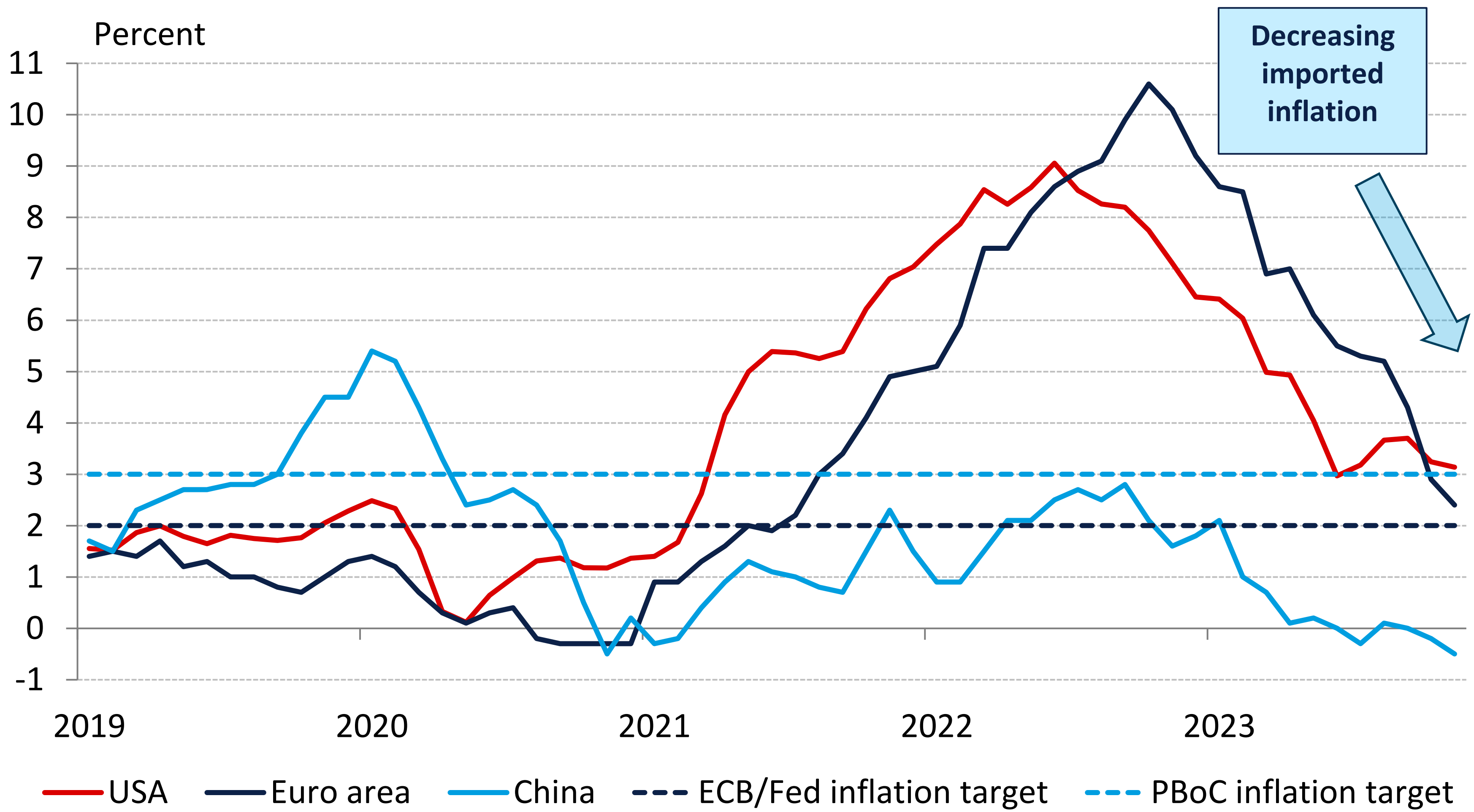
- **Hungary's economic fundamentals have clearly continued to improve in several areas.**
- **The widespread and general decline in domestic inflation continued at a rapid pace in November.** Inflation will drop to around 6 percent by the end of 2023. Strong disinflation is expected to continue in 2024 Q1, before slowing down, and thus the consumer price index is likely to return to the central bank inflation target persistently in 2025.
- **The recession ended in 2023 Q3.** Hungary's GDP rose by 0.9 percent compared to the previous quarter, and it fell by 0.4 percent in annual terms.
- **The gradual revival of the economy has continued in 2023Q4**.
- **The rapid and substantial improvement in the external balance continued.** The monthly current account balance was in surplus in October 2023 as well.
- **International risk appetite has increased since the November policy decision.**
- **The EU agreement will improve Hungary's risk perception and net lending.**

MAIN MESSAGES: MONETARY POLICY DECISIONS

- The dynamic disinflationary path and **a further improvement in the country's risk perception** allow **the MNB to continue its cycle of base rate cuts**. In line with this, at its meeting today the Monetary Council **cut the base rate by 75 basis points to 10.75 percent**.
- At the meeting, the Council **discussed two options (-75, -100 basis points)**. Regarding the pace of interest rate cut, **a unanimous decision was reached**.
- **The positive real interest rates support the continuation of disinflation.** As inflation approaches the central bank tolerance band, **real interest rates decline**.
- **To address the recent FX swap market tensions**, the MNB will hold an additional tender with longer **maturity extending beyond the year-end** on 21 December.
- Risks surrounding global disinflation and volatility in international investor sentiment warrant a **careful approach to monetary policy**.
- The Council is **constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment**.
- In the coming months, **decisions on any further reductions in the base rate and their optimal pace will be made** on the basis of this information, **in a data-driven manner**.
- **Disinflation needs to be continued in 2024! It is necessary to maintain a disciplined monetary policy** in order to achieve price stability.

MACROECONOMIC ASSESSMENT AND OUTLOOK

INFLATION RATES IN DEVELOPED COUNTRIES ARE APPROACHING CENTRAL BANK TARGETS. IN CHINA, DEFLATION WAS REGISTERED.

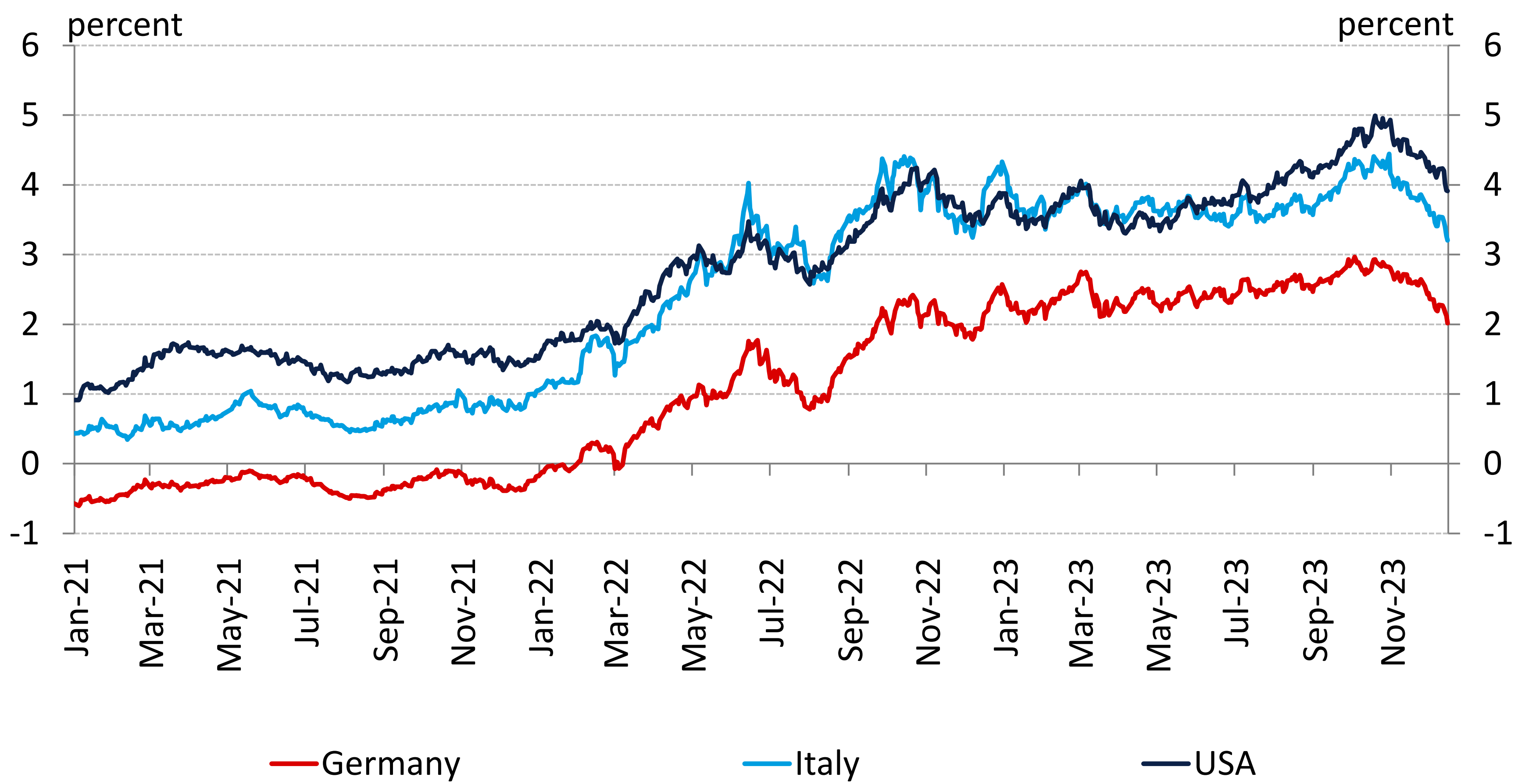


INFLATION IN THE US, CHINA AND THE EURO AREA

Source | Eurostat, OECD

LONG-TERM YIELDS IN DEVELOPED MARKETS FELL SIGNIFICANTLY

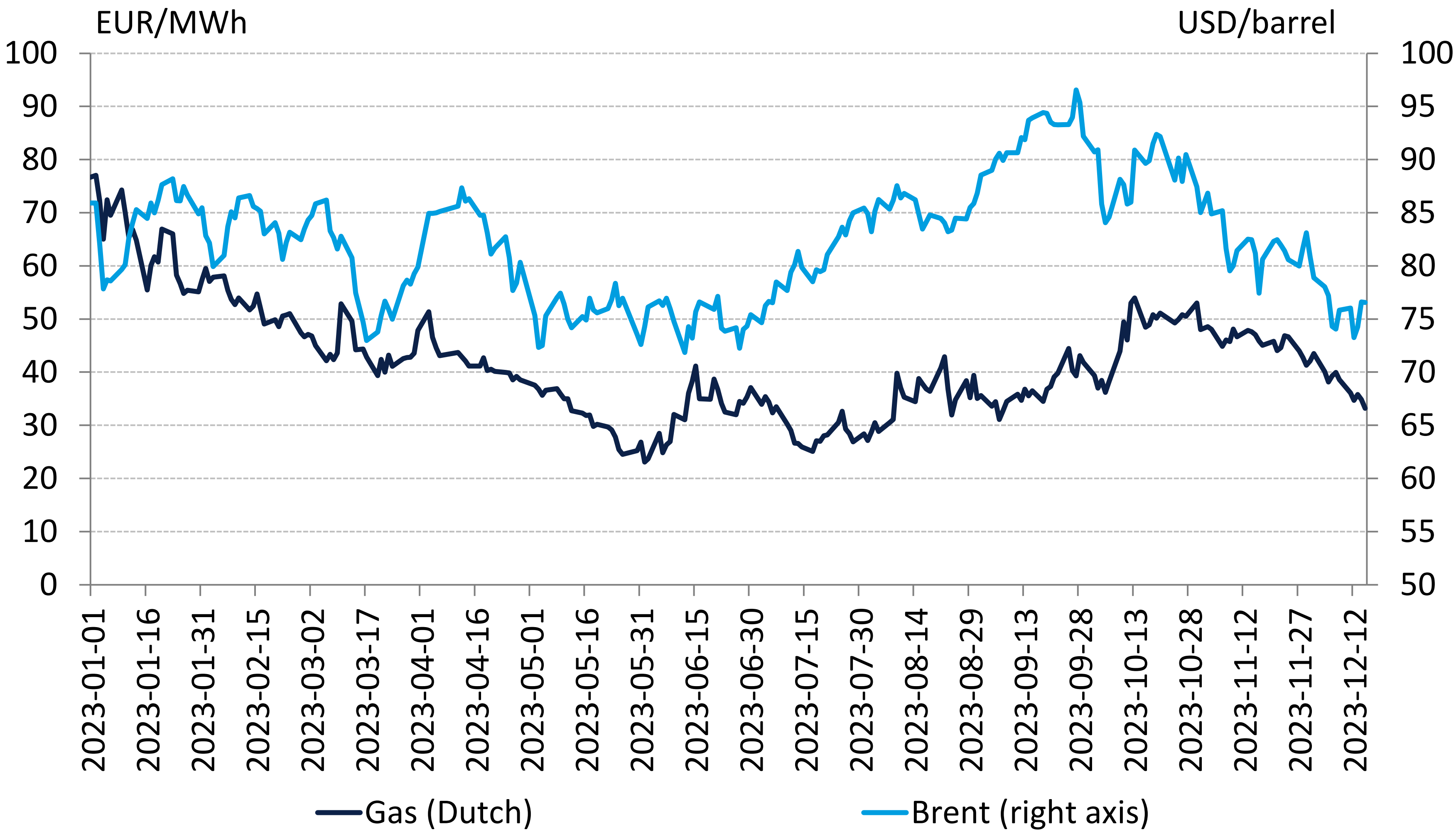
The international outlook is surrounded by significant risks.



THE EVOLUTION OF TEN-YEAR ZERO-COUPON GOVERNMENT BOND YIELDS

Source | Bloomberg

THE WORLD MARKET PRICE OF OIL CONTINUED TO DECREASE DESPITE THE GEOPOLITICAL CONFLICTS



EVOLUTION OF OIL AND GAS PRICES

Source | Bloomberg

INTERNATIONAL RISKS STILL CALL FOR CAUTION

Geopolitical tensions, sanctions

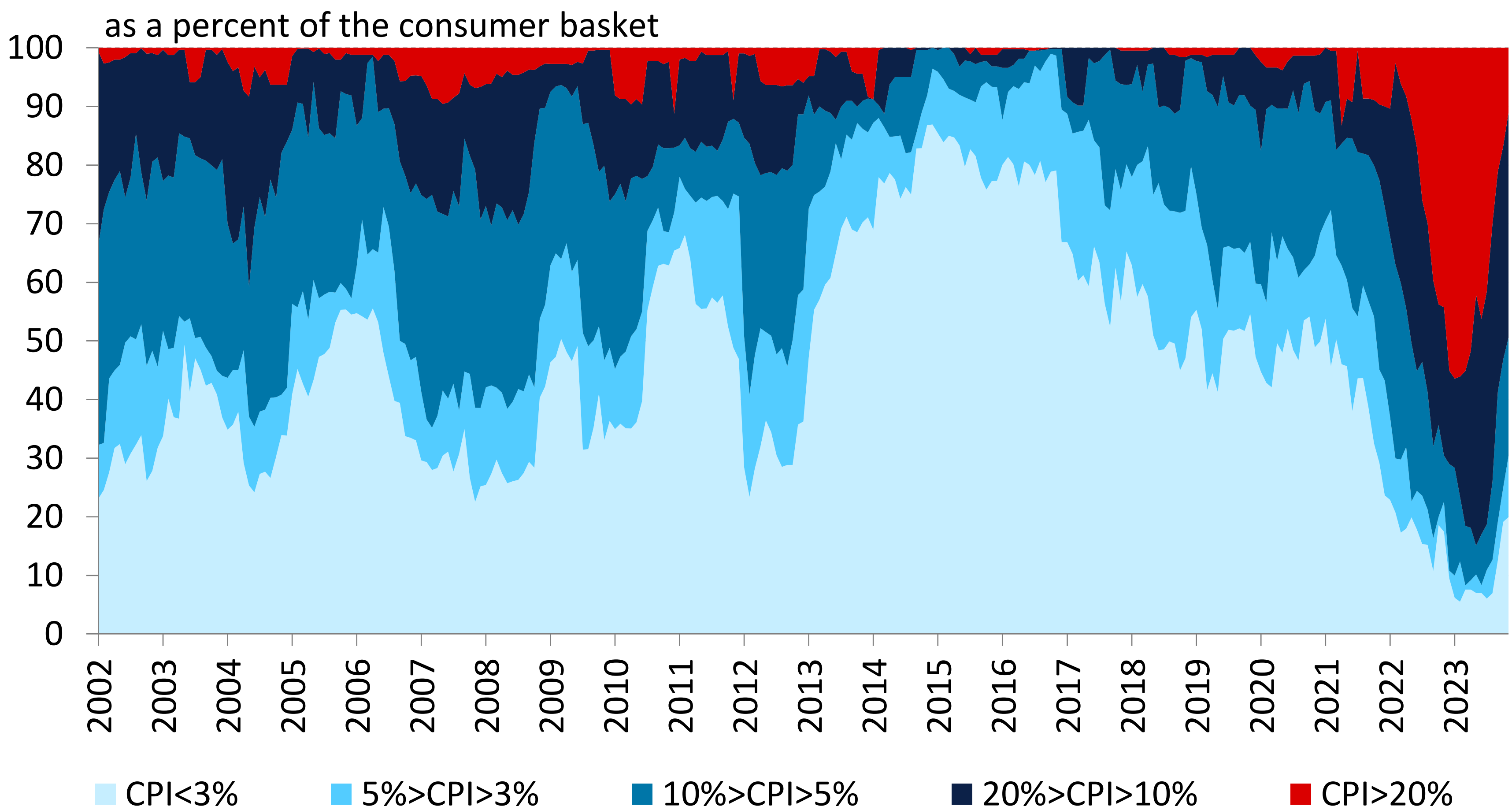
Energy and commodity market shocks

Recession fears, labour market tensions

Armed conflicts, nuclear armament

The economic landscape has become volatile and difficult to predict due to increased risks, which warrants a cautious approach.

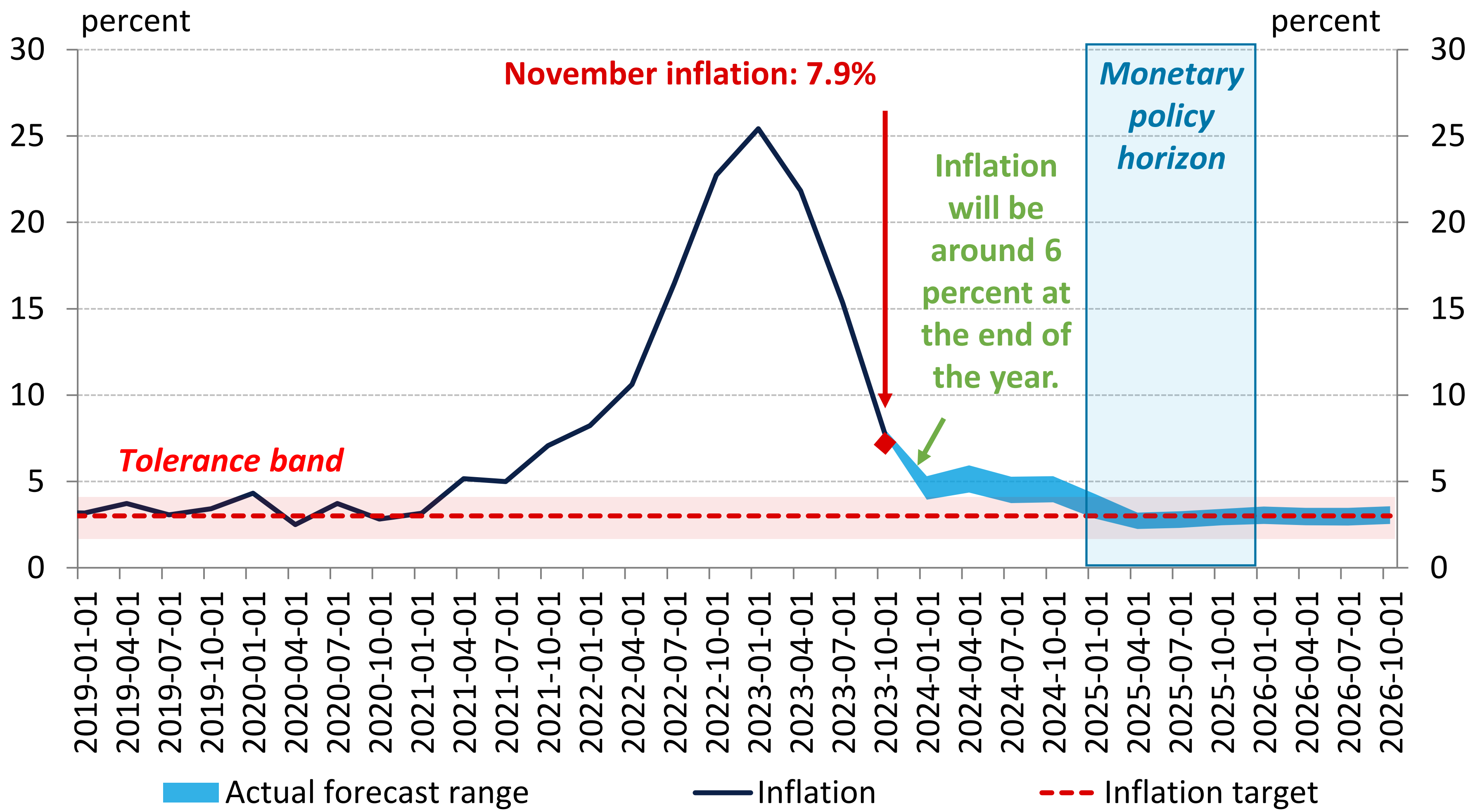
DISINFLATION IS BROAD-BASED AND WIDESPREAD



DISTRIBUTION OF THE CONSUMER BASKET BY YEAR-ON-YEAR PRICE CHANGE

Source | HCSO, MNB

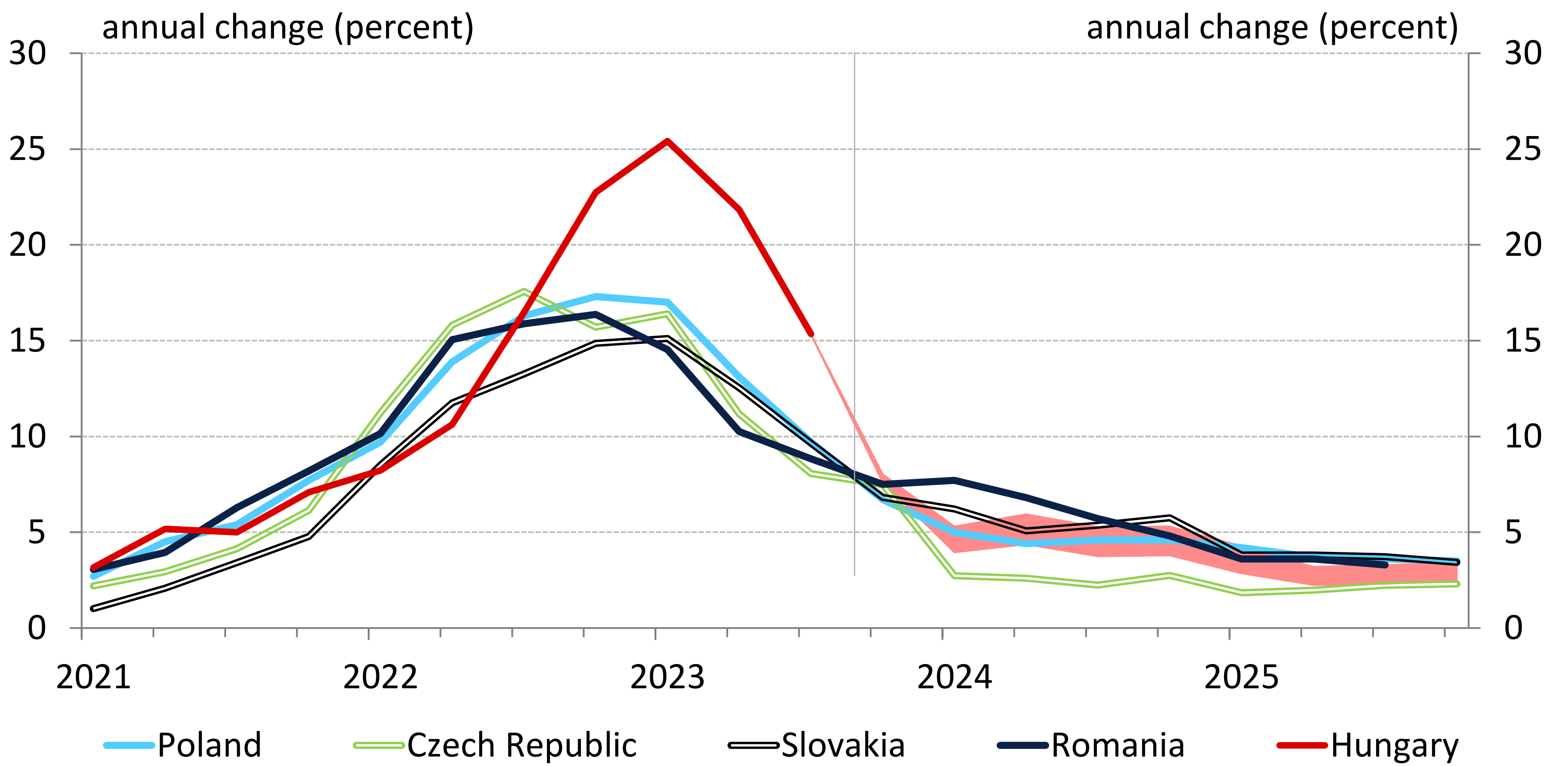
INFLATION WILL BE AROUND 6 PERCENT AT THE END OF THE YEAR, BUT DISINFLATION MUST CONTINUE IN 2024!



INFLATON FORECAST

Source | HCSO, MNB

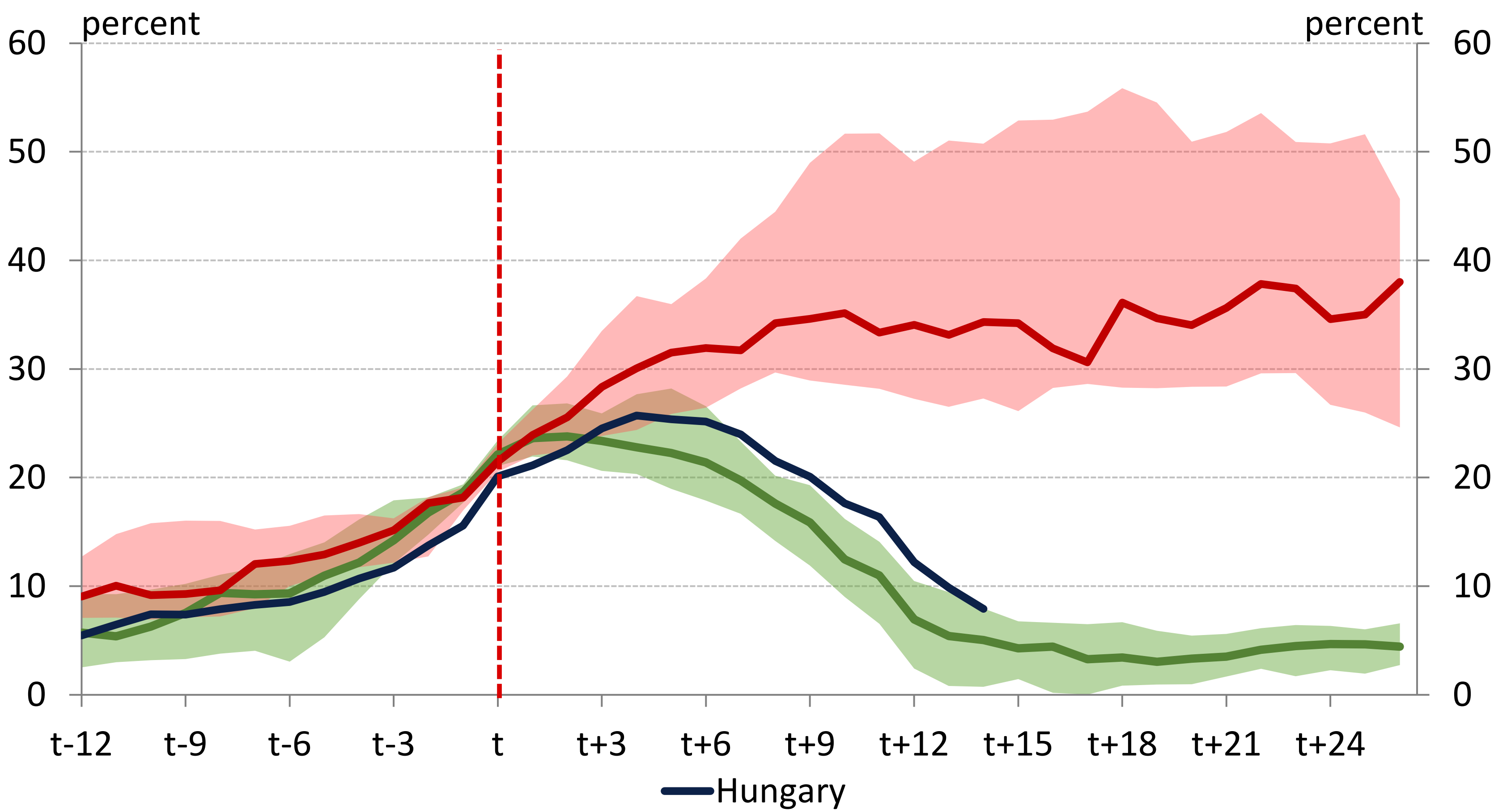
FROM THE END OF THE YEAR, DOMESTIC INFLATION WILL DEVELOP IN LINE WITH REGIONAL TRENDS



THE EXPECTED DEVELOPMENT OF DOMESTIC AND REGIONAL INFLATION BASED ON THE FORECASTS OF THE CENTRAL BANKS

Note | The regional forecasts are based on the inflation forecast of the central banks.
Publication date of inflation reports: Czech Republic: 2023-11-02, Poland: 2023-11-10, Slovakia: 2023-10-05, Romania: 2023-11-08, Euro area: 2023-09-14.
In the case of Hungary, the middle of the December preliminary forecast range is indicated.
Source | CNB, MNB, NBP, NBR, NBS

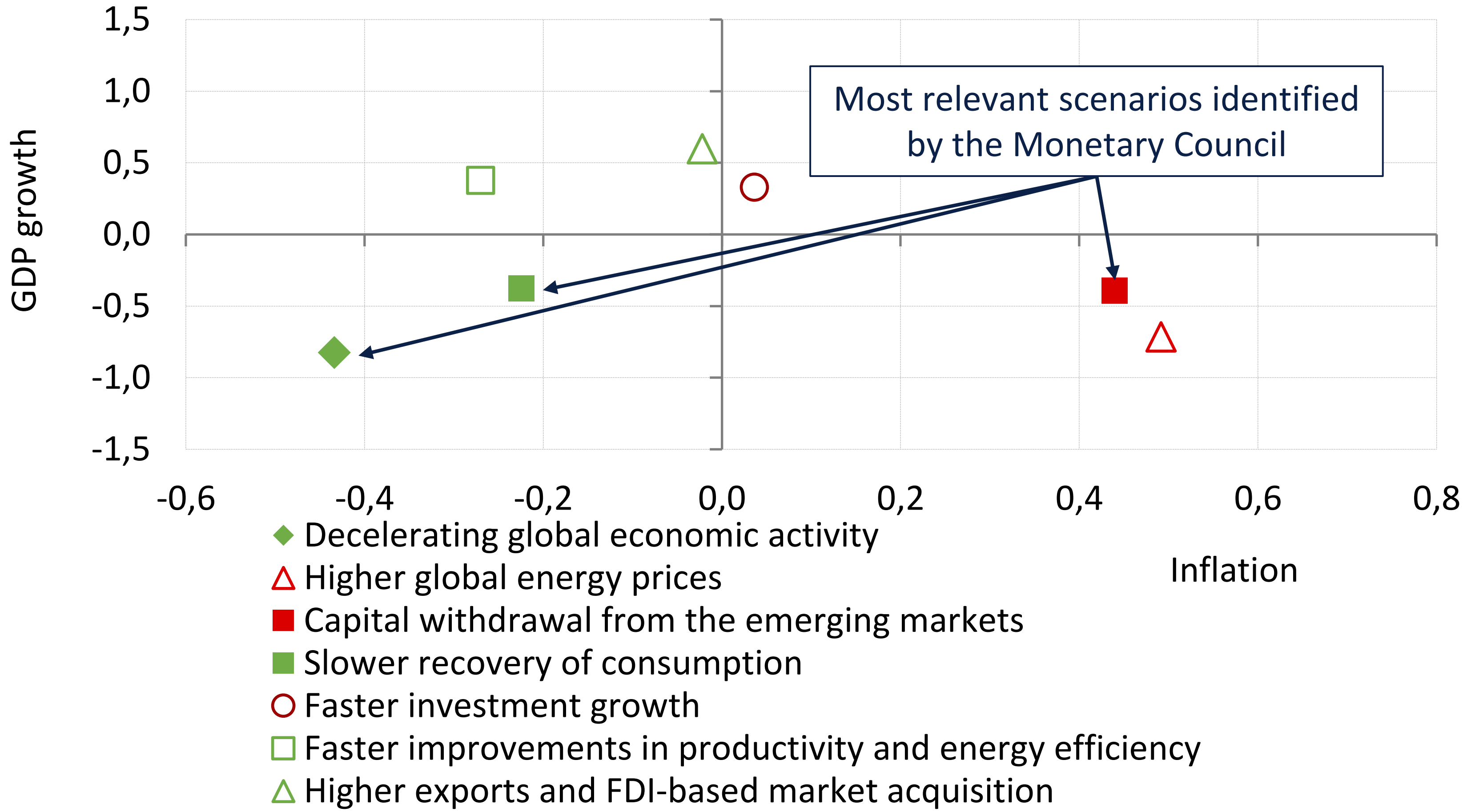
HUNGARIAN PRICE DYNAMICS RESEMBLE THOSE OF COUNTRIES WITH PREVIOUSLY SUCCESSFUL DISINFLATION



SUCCESSFUL AND UNSUCCESSFUL HISTORICAL DISINFLATIONS AFTER INFLATION EPISODES EXCEEDING 20 PERCENT AND THE DEVELOPMENT OF RECENT HUNGARIAN INFLATION

Note | Medians (continuous lines) and 25th and 75th percentiles range. Green: successful, red: unsuccessful disinflation cases. For Hungary, t period denotes 2022 September.
Source | World Bank, HCSO, MNB calculations

RISKS SURROUNDING THE INFLATION BASELINE HAVE SHIFTED DOWNWARDS

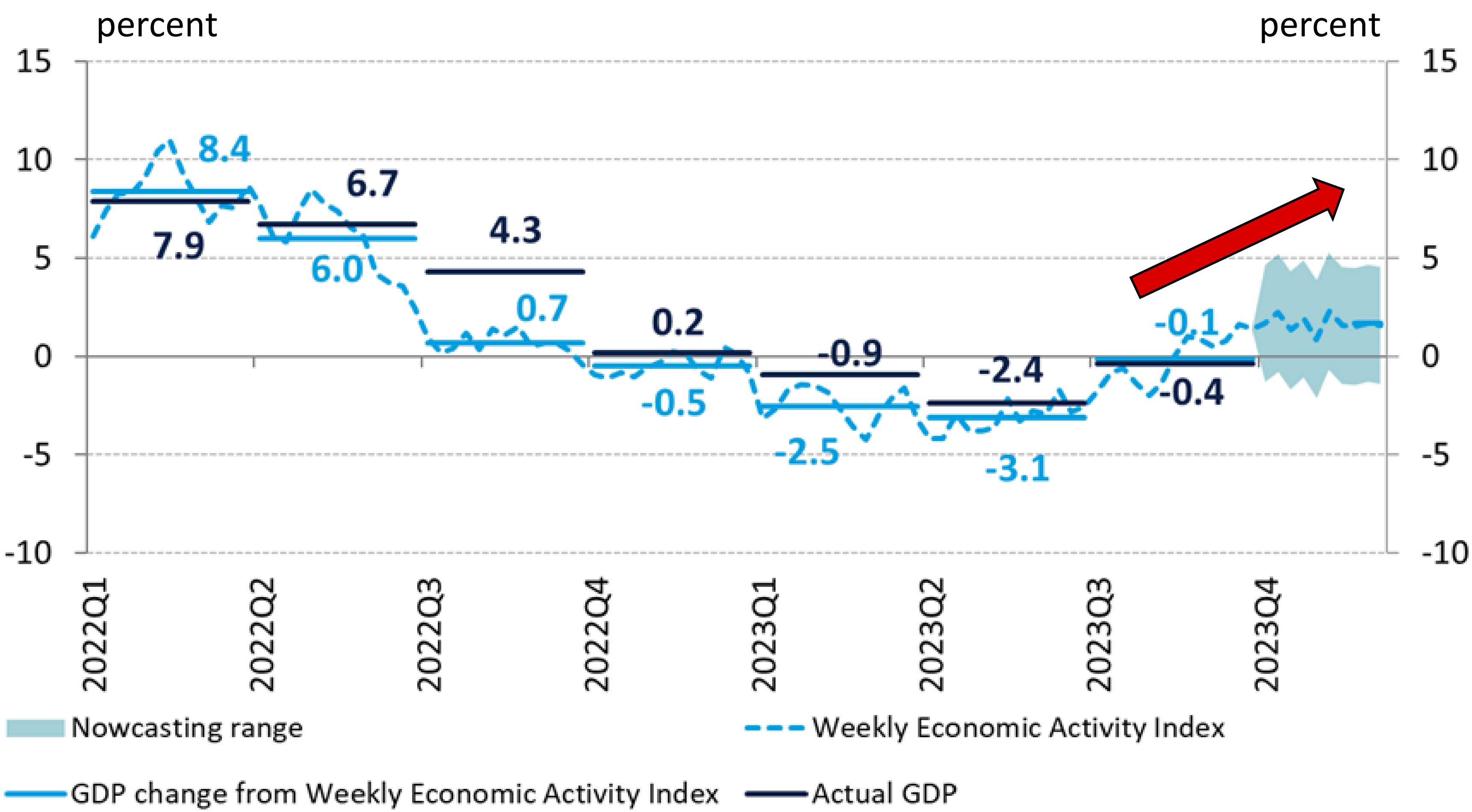


RISK SCENARIOS (DECEMBER 2023)

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

Source | MNB

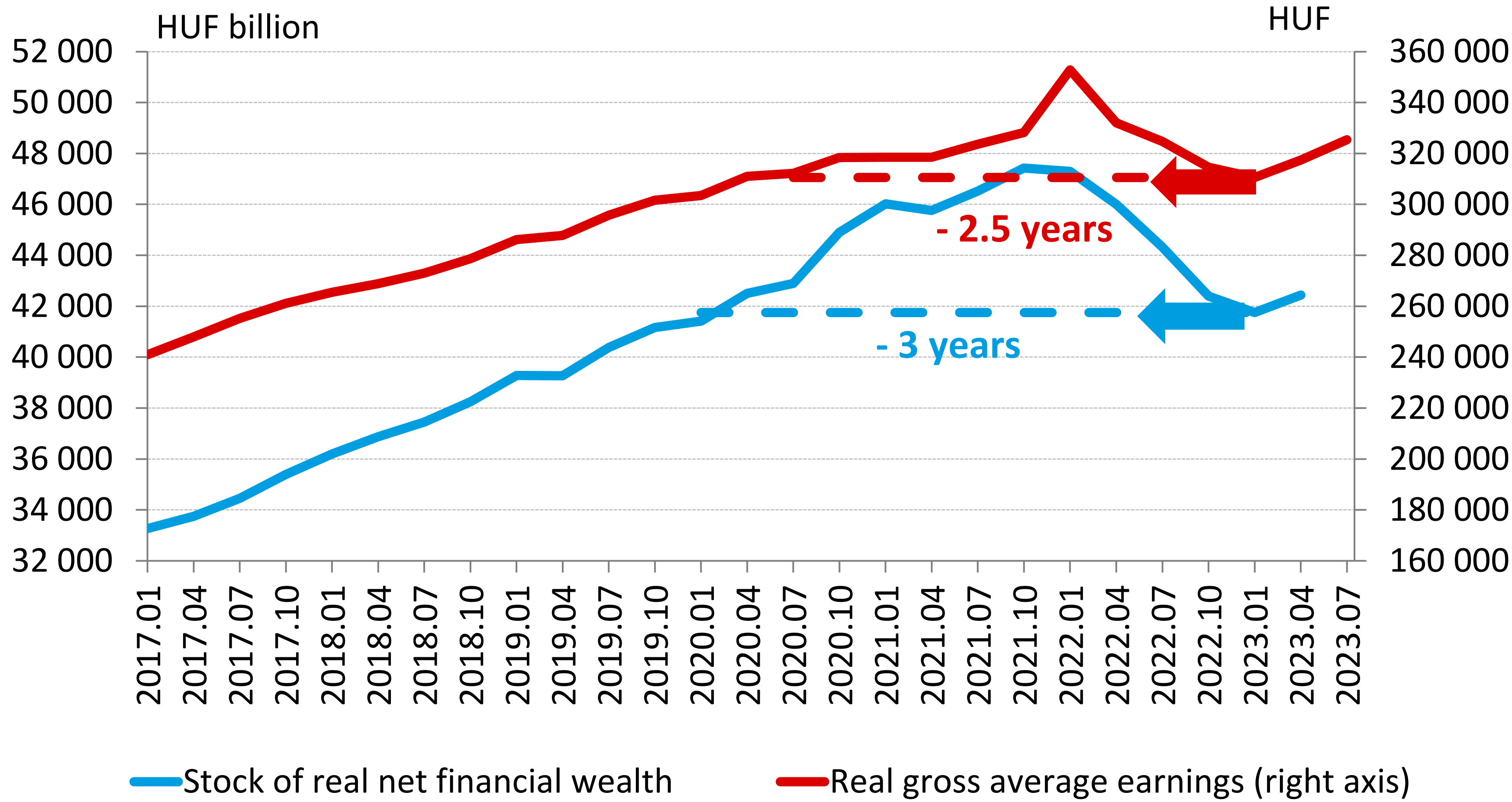
THE GRADUAL REVIVAL OF THE ECONOMY IS EXPECTED TO CONTINUE IN 2023 Q4



WEEKLY GDP TRACKER

Source | HCSO, MNB

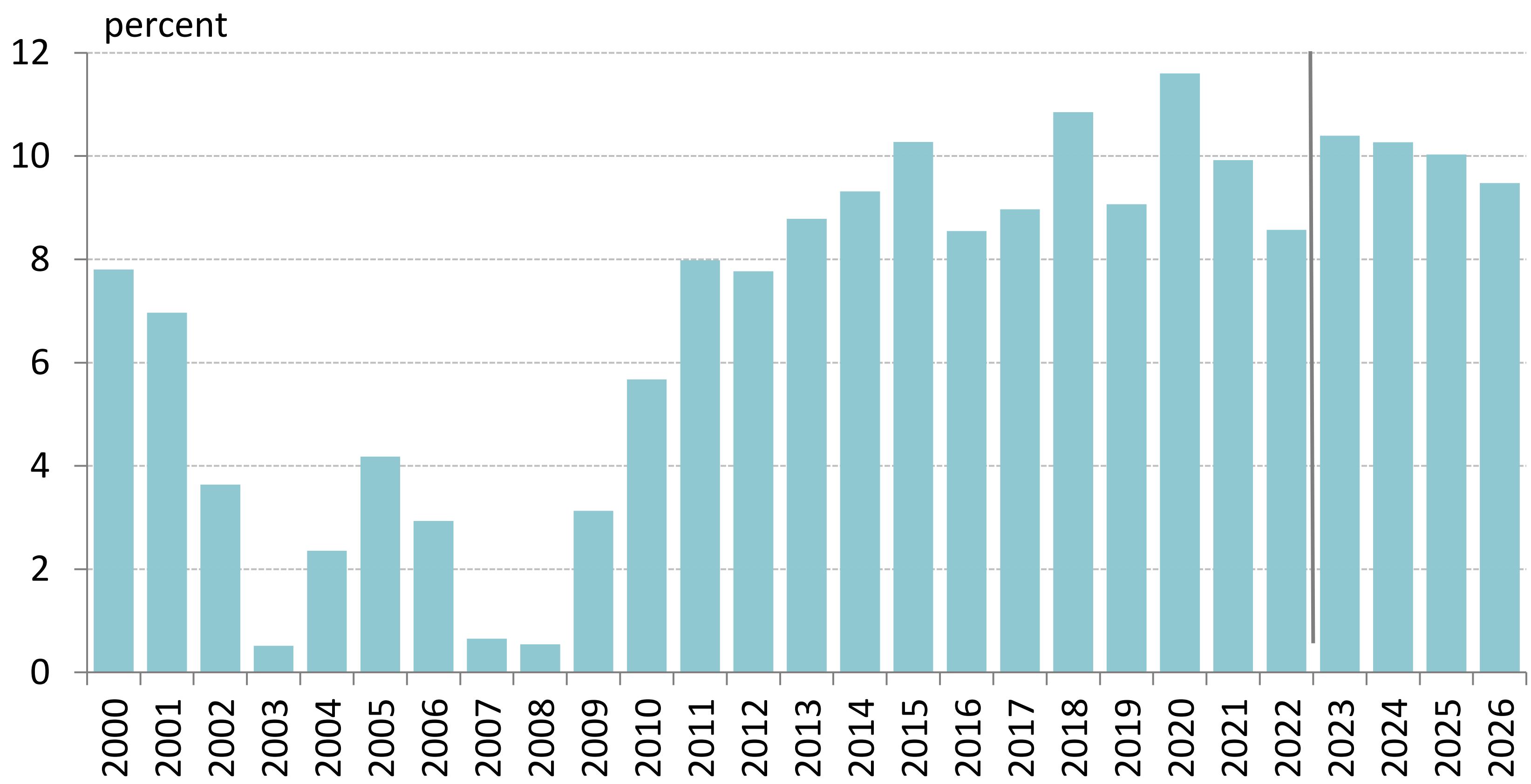
HIGH INFLATION DECREASED THE REAL VALUE OF WAGES AND NET FINANCIAL WEALTH



HOUSEHOLD SECTOR FINANCIAL WEALTH AND AVERAGE EARNINGS IN REAL TERMS

Note | At the average price level of 2010, quarterly values.
Forrás | HCSO, MNB

IN ORDER TO RESTORE FINANCIAL BUFFERS, HOUSEHOLDS HAVE INCREASED THEIR SAVINGS

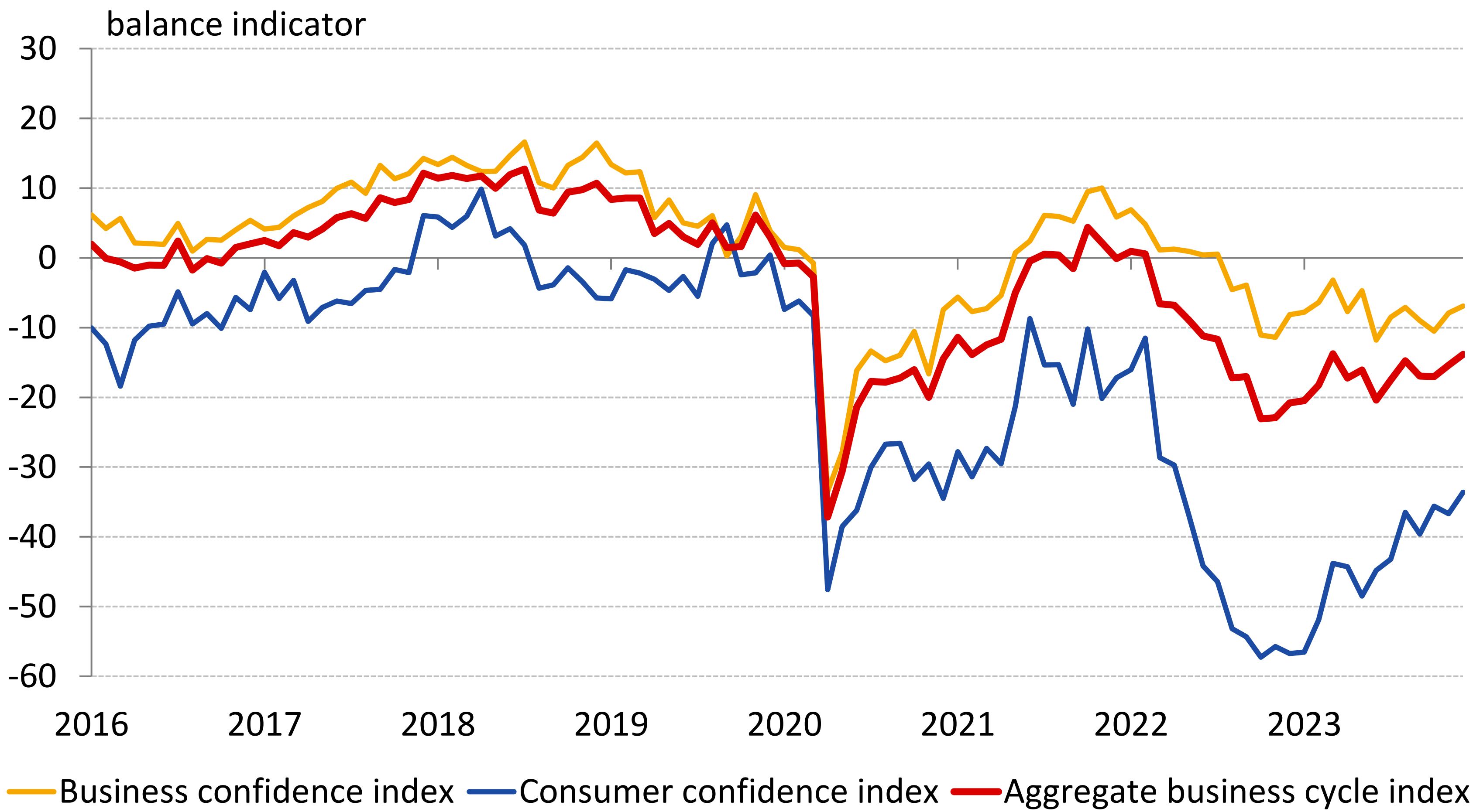


EVOLUTION OF HOUSEHOLDS' CONSUMPTION AND FINANCIAL SAVINGS RATES AS A PERCENTAGE OF DISPOSABLE INCOME

Source | HCSO, MNB

CONSUMPTION WILL RECOVER AS A RESULT OF A PERSISTENT IMPROVEMENT IN CONFIDENCE

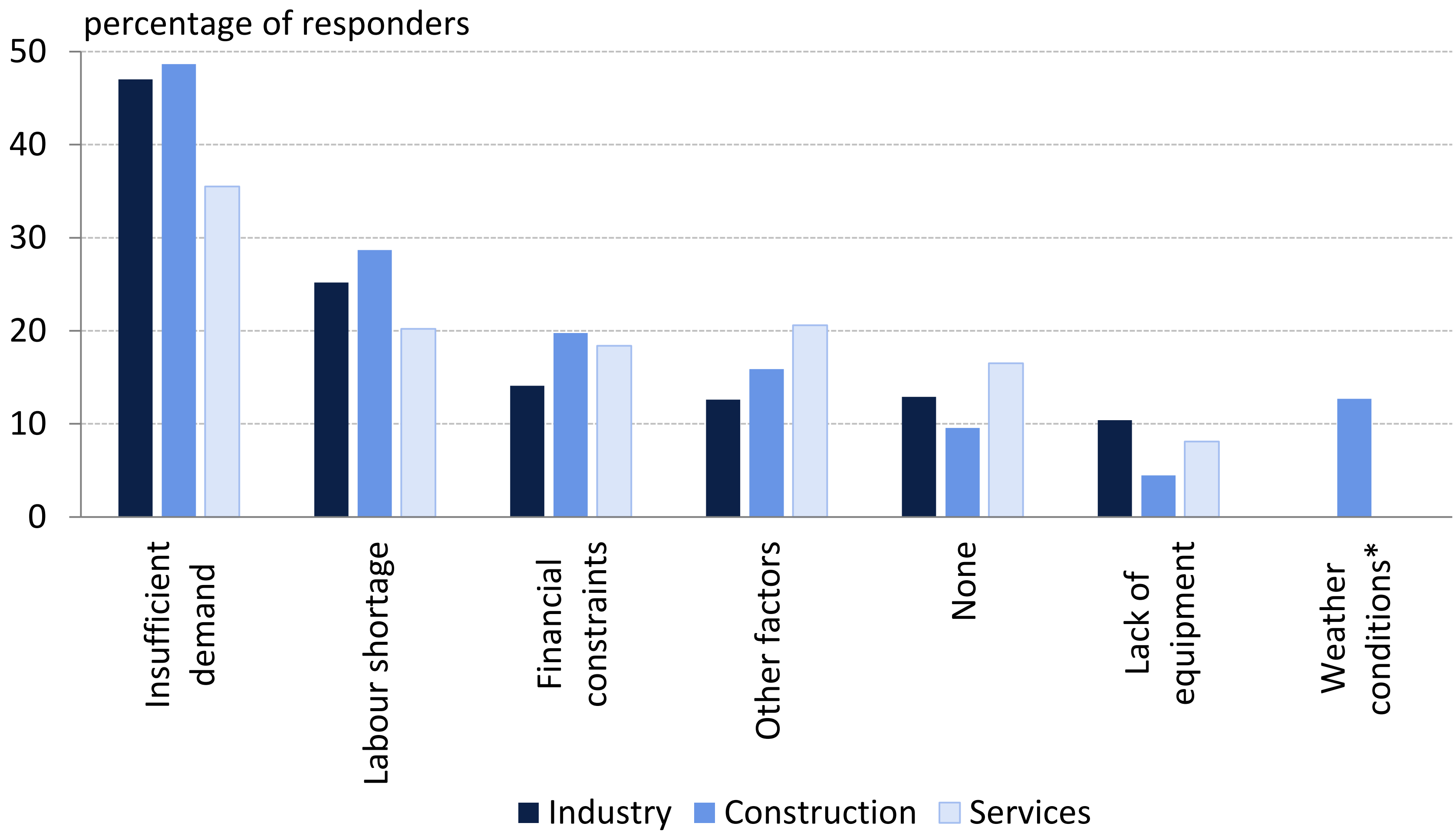
In that, achieving price stability is key.



THE HUNGARIAN BUSINESS CYCLE INDEX OF GKI AND THE DEVELOPMENT OF ITS COMPONENTS

Source | GKI Gazdaságkutató Zrt., MNB

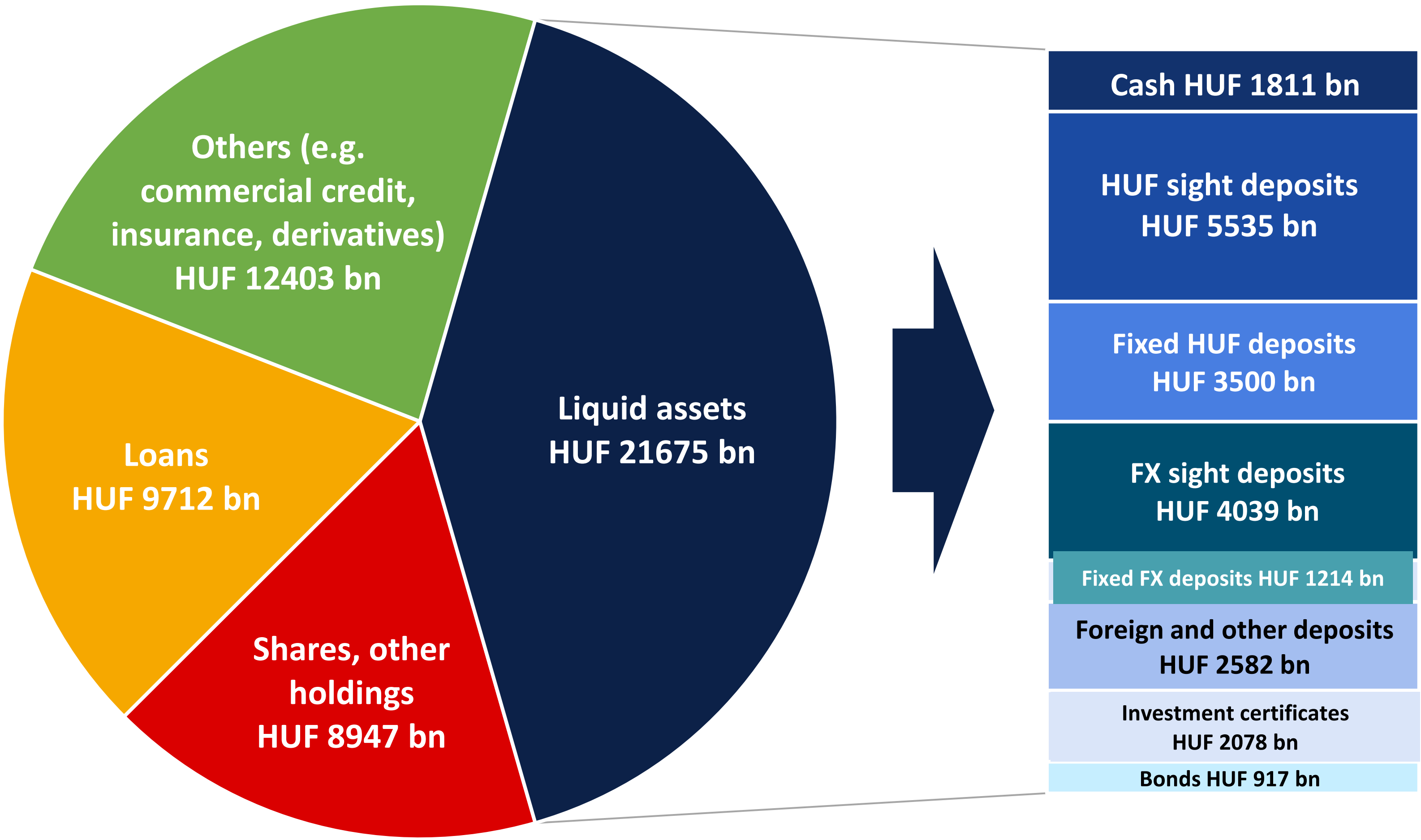
CURRENTLY, THE BARRIER TO INVESTMENTS IS NOT THE LACK OF FAVOURABLE FUNDS, BUT THE LACK OF DEMAND



FACTORS HAMPERING PRODUCTION IN THE VARIOUS SECTORS

Note | Data for the fourth quarter of 2023 in the case of industry and services, and the average of September-November 2023 in the case of the construction industry. *Weather conditions for the construction industry only.
Source | European Commission, MNB

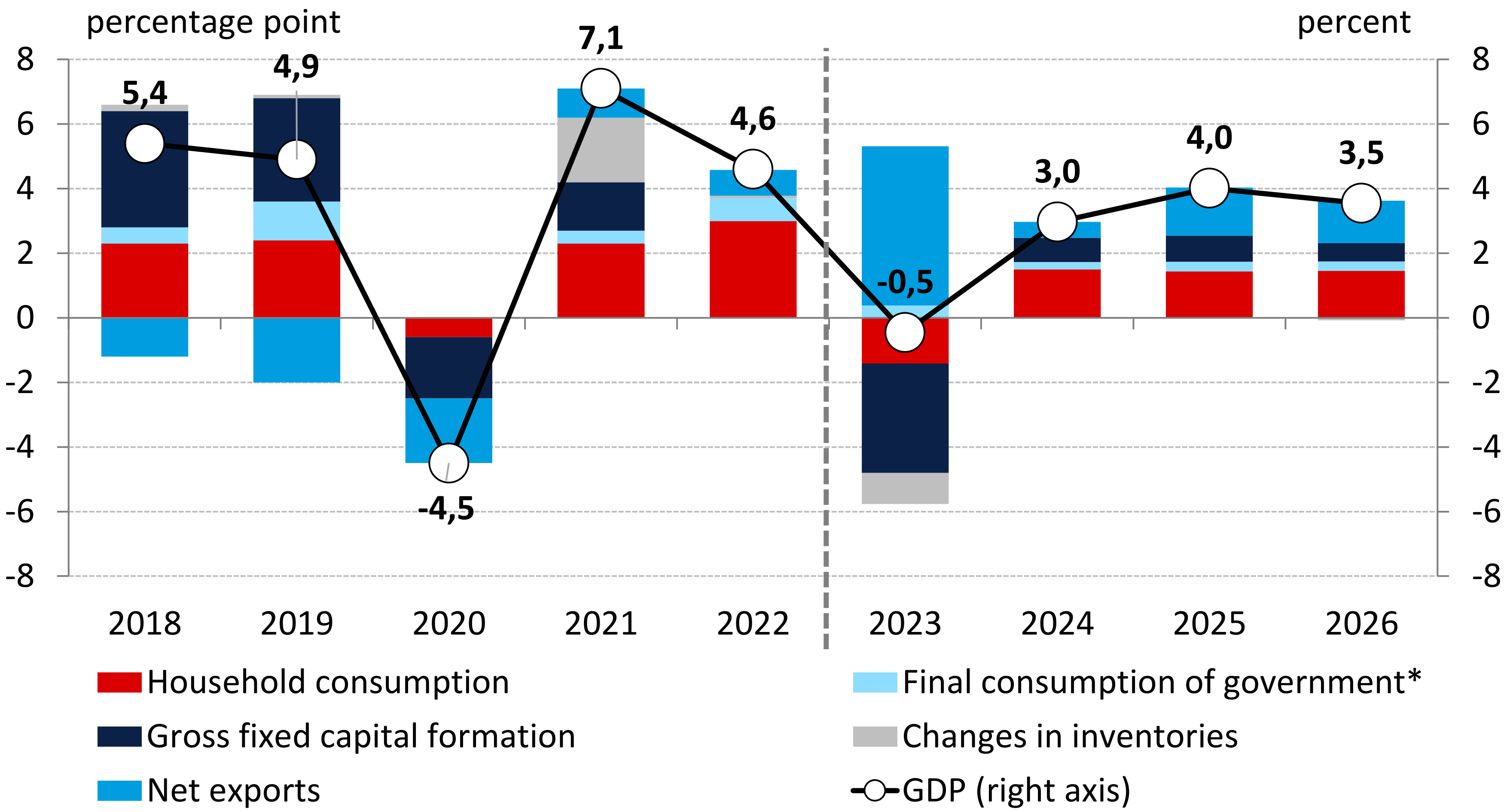
Around 80 percent of liquid assets are unaffected by the base rate.



DISTRIBUTION OF FINANCIAL ASSETS OF NON-FINANCIAL COMPANIES

Source | MNB

IN 2024, WE EXPECT A BALANCED ECONOMIC GROWTH

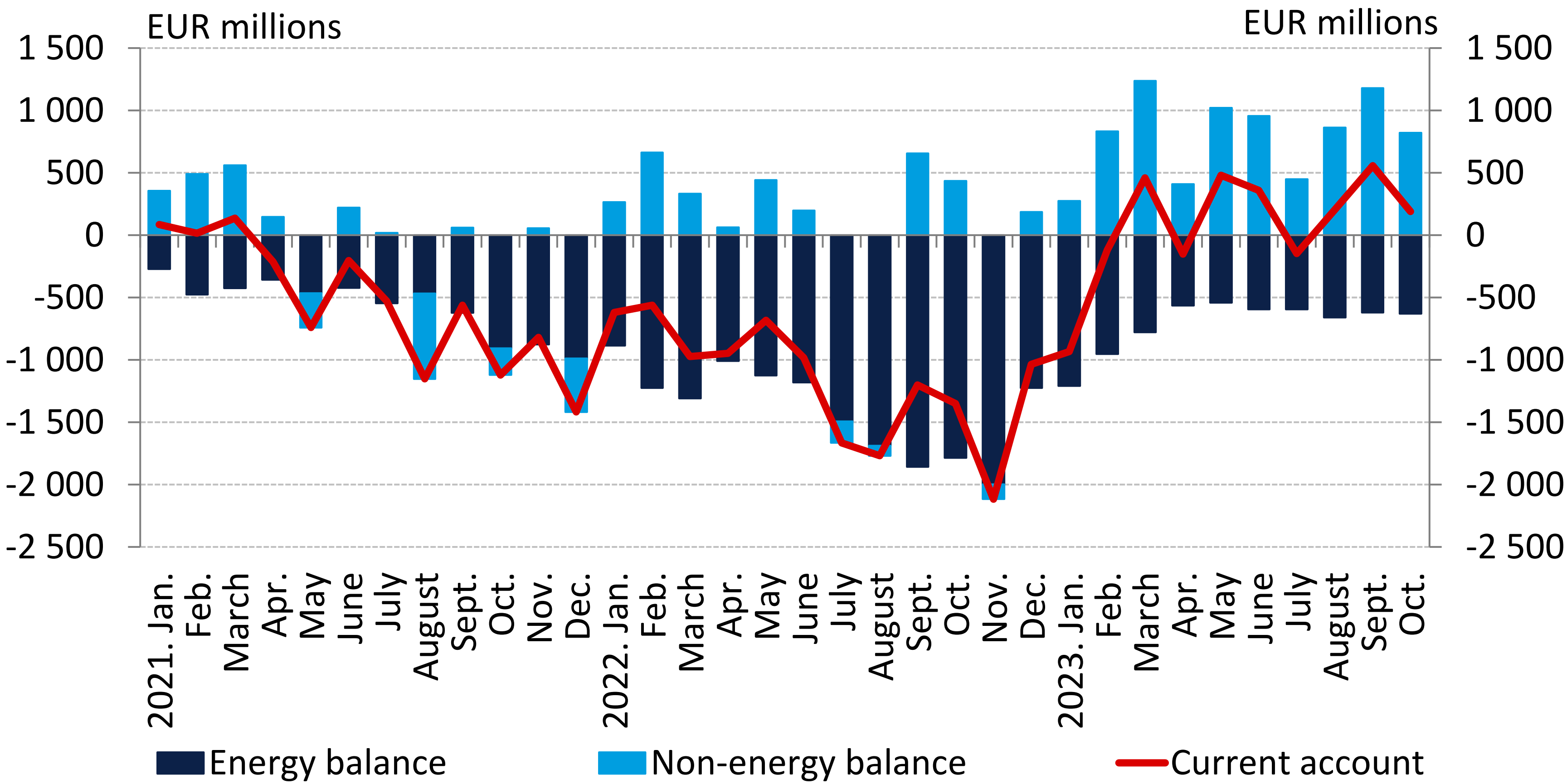


EXPENDITURE SIDE DECOMPOSITION AND FORECAST OF GDP

Note | *Final consumption of government includes collective consumption of government and the transfers from government and non-profit institutions.
Source | HCSO, MNB

OUR EXTERNAL BALANCE POSITION SHOWS RAPID AND SIGNIFICANT IMPROVEMENT

The current account balance in proportion to GDP is expected to improve by even more than 8 percentage points this year.



DEVELOPMENT OF THE CURRENT ACCOUNT BALANCE AND THE ENERGY BALANCE

Note | The October value of the energy balance is an estimate.

Source | HCSO, MNB

MONETARY POLICY

Central bank instrument	Interest rate	Previous interest rate (percent)	New interest rate (percent)
Central bank base rate		11.50	**10.75**
O/N deposit rate	Central bank base rate minus 1.00 percentage point	10.50	**9.75**
O/N collateralised lending rate	Central bank base rate plus 1.00 percentage point	12.50	**11.75**

RISK ENVIRONMENT HAS IMPROVED, ITS PERSISTENCE INCREASES THE ROOM FOR MANOEUVRE FOR MONETARY POLICY

A cautious approach remains warranted.

INTERNATIONAL FACTORS

- The external inflation environment is better than expected.
- The Fed and the ECB may start cutting interest rates in 2024, the ECB has communicated more tightly.
- In developed markets, long-term yields have fallen substantially.
- Geopolitical tensions are still with us.
- The risk of shocks in energy and commodity markets remains high.

DOMESTIC DEVELOPMENTS

- The rapid and widespread decline in inflation has continued.
- The current account balance is improving faster than expected.
- As a result of the negotiations, the drawdown of Cohesion Funds may start.
- The country's credit rating has not changed as a result of the reviews.
- The domestic swap market is showing greater tension than in previous years.

IT IS NECESSARY TO MAINTAIN CAREFUL MONETARY POLICY IN ORDER TO ACHIEVE PRICE STABILITY

Inflation target

Inflation is expected to fall to around 6 percent by the end of the year, from that point it will be in line with regional trends. The consumer price index is likely to return to the central bank inflation target persistently in 2025.

Financial market stability

Ensuring financial market stability is a condition for achieving price stability.

Data-driven mode

In the coming months, the Council will take decision on any further reductions in the base rate and their optimal pace based on incoming data, the outlook for inflation and developments in the risk environment, in a data-driven manner.

Communication in advance

The base rate may reach the single-digit territory in the near future.

IN LIGHT OF FX SWAP MARKET DEVELOPMENTS, THE MNB HOLDS AN ADDITIONAL TENDER WITH MATURITY EXTENDING BEYOND THE YEAR-END

A key priority for the central bank is that **short-term rates in every sub-market and at all times should develop consistently with the level of short-term rates deemed optimal by the Monetary Council.**

In line with this, **the MNB is closely monitoring developments in FX swap market conditions.**

Against this backdrop, **the central bank will hold an additional tender on 21 December (Thursday) with maturity extending beyond the end of the year,** as a targeted response.

In addition, the MNB will continue with the one-day (T/N) swap facility on a daily basis, **including the tender on 28 December with maturity extending beyond the year-end.**

The effectiveness of monetary transmission is supported by **the central bank's discount bill**, with the auctions **held by the MNB on Wednesdays, as in the past**.

THE MONETARY COUNCIL'S FORWARD GUIDANCE

„Risks surrounding global disinflation and volatility in international investor sentiment warrant a careful approach to monetary policy. The Council is constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment. ***In the coming months, decisions on any further reductions in the base rate and their optimal pace will be made on the basis of this information, in a data-driven manner.****"*

THANK YOU FOR YOUR KIND ATTENTION!