MACROECONOMIC AND FINANCIAL MARKET DEVELOPMENTS

BACKGROUND MATERIAL

TO THE ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING

OF 25 MAY 2021

MAY

2021

Time of publication: 2 p.m. on 9 June 2021

The background material 'Macroeconomic and financial market developments' is based on information available until 19 May 2021.

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

Table of contents

1. Macroeconomic developments

1.1. Global macroeconomic environment

The third wave of coronavirus forced several countries in the world to re-tighten the previous restrictive measures. However, incoming GDP data for the first quarter were more favourable than expected. Recovery of the EU economies showed a mixed picture in the first quarter of 2021, economic performance of the USA outstripped expectations, while growth of the Chinese economy continued. In the United States consumer price index rose from 2.6 percent in March to 4.2 percent in April, which was the highest since September 2008. The reopening of economies commenced in an increasing number of countries, and its pace significantly depended on the changes in the pandemic situation and the population's vaccination coverage.

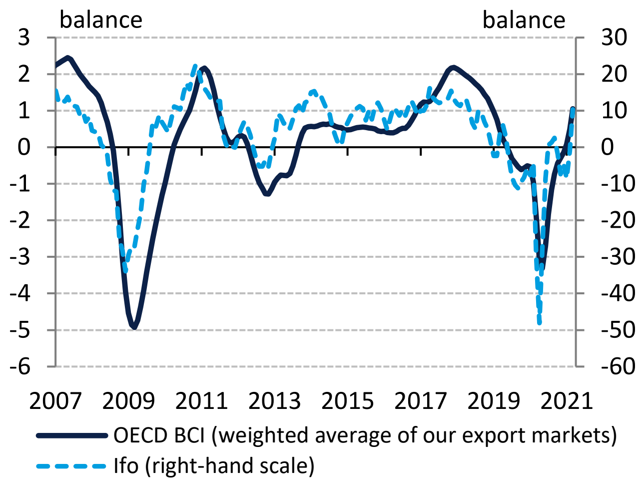
Trends in economic performance are continued to be determined by the COVID-19 pandemic and the measures implemented. New waves of the virus appear to have restrained industrial production to a lesser degree, while the service sector remains significantly exposed to the impacts of the measures related to the pandemic. World trade and global industrial production already exceed the level registered in January 2020. On the other hand, the future of global tourism is surrounded by major uncertainty. In the past period air traffic counted around 80,000 flights per day (while in the same period of 2019 it was around 110,000 and below 30,000 last year). Until the necessary vaccination rate is achieved, the sector's global outlook will remain markedly uncertain. On the other hand, reopening of the economies commenced in an increasing number of countries, the pace of which significantly depends on the changes in the pandemic situation and the vaccination rate of the population.

In the first quarter of 2021, GDP of the United States rose by 4.1 percent year-on-year. In the United States the consumer price index rose from 2.6 percent of March to 4.2 percent in April, being the highest value since September 2008. The rise is mostly attributable to last year's base effect. In March, US industrial output rose by 1.0 percent year-on-year, being the first positive value since the start of the coronavirus crisis. Manufacturing performance increased by 3.1 percent. In March 2021, retail sales were up by 27.7 percent year-on-year. In the week ending on 7 May, the number of new unemployment benefit claims was 473,000, which is a further decrease compared to previous week. In April, the unemployment rate rose by 0.1 percentage point compared to the previous month to 6.1 percent.

In the first quarter of 2021, the Chinese economy grew by 18.3 percent year-on-year, which was also attributable to the low base effect of the coronavirus pandemic. Business sentiment in China deteriorated in April, but the Purchasing

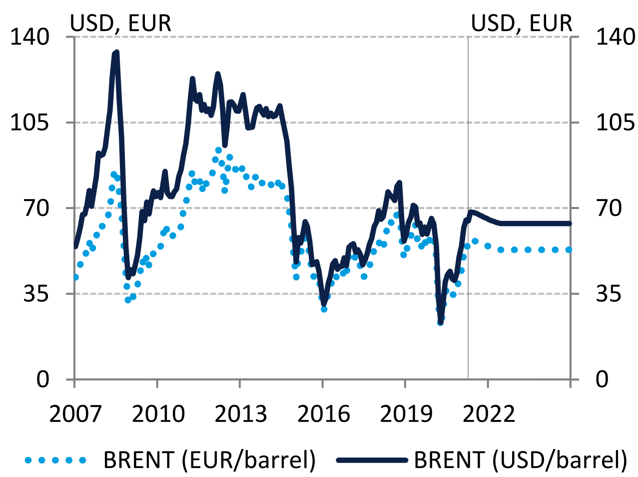
Manager Indices are still in the (growth) range of over 50 points. In March, industrial production and the volume of retail sales rose by 14.1 and 34.2 percent, respectively, year-on-year.

Chart 1 Business climate indices in Hungary's export markets



Source: OECD, Ifo

Chart 2 World market prices of Brent crude oil



Source: Bloomberg

Economic performance of the United Kingdom shrank by 6.1 percent in annual terms in the first quarter. In March, industrial production and the volume of retail sales exceeded the level registered in March 2020 by 3.6 and 7.2 percent, respectively.

In the first quarter of 2021 economic performance of the euro area fell by 1.8 percent year-on-year (while quarter-on-quarter it fell by 0.6 percent according to the seasonally and working-day adjusted data). In March, industrial output rose by 10.9 percent, while the volume of retail sales was up by 12 percent year-on-year, which was also attributable to the low base of last year resulting from the lockdowns. The unemployment rate declined further, and in March it stood at 8.3 percent.

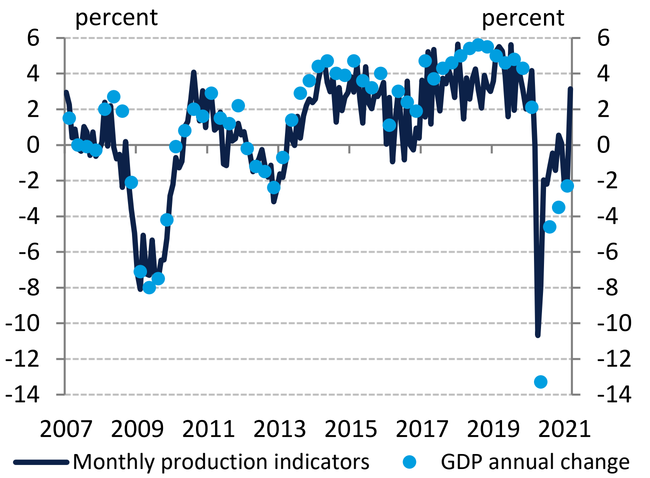
Recovery of the European Union's economies showed a mixed picture in the first quarter of 2021. In the first quarter, the economy of Germany – Hungary's main trading partner – shrank by 3 percent year-on-year and by 1.7 percent quarter-on-quarter. In March, German industrial production rose by 5.1 percent in annual terms, while the volume of retail sales grew significantly, by 11 percent. German business sentiment (Ifo Business Climate Index) continued to improve in April and it stood at the highest level since June 2019 (Chart 1). Based on the presently available data, in the first quarter the largest quarter-on-quarter GDP growth was measured in Romania (2.8 percent) and in Bulgaria (2.5 percent). On the other hand, the greatest decline occurred in Portugal (-3.3 percent) quarter-on-quarter. **In April, euro area inflation – in line with the consensus forecast – rose to 1.6 percent, after the March value of 1.3 percent, while core inflation, slightly falling short of analysts' expectations (0.8 percent), declined to 0.7 percent.** A rise in euro area inflation was expected due to the base effects of last year.

In April 2021, the average world market price of Brent crude oil was USD 64.7 per barrel, while the spot price – under significant volatility – came close to USD 70 per barrel in the past period. (Chart 2). In April oil price developments were determined primarily by the news related to the global pandemic situation: while infection data in the USA, Europe and certain parts of Asia improved, the situation in India significantly deteriorated, which also impacted global demand. In the first week of May, quotes came close to the level USD 70 per barrel, following the cyber attack on US Colonial Pipeline. The attack forced Colonial to shut down 5,500 miles of oil pipeline, disrupting US onshore fuel supplies. The US government has taken emergency measures to secure the supply chain and the full restoration of the system is under way. **The world market price of both industrial commodities and unprocessed food increased in April.**

1.2. Domestic real economy developments

Hungary's economy has a potential of rapid recovery, which is also supported by the outstanding vaccination coverage even in international comparison and by the reopening ahead of the European average. Based on adjusted data, in the first quarter of 2021, gross domestic product fell by 1.8 percent year-on-year, while it grew by 1.9 percent quarter-on-quarter. The first quarter's growth figure exceeded both the MNB's March projection and market expectations. Due to the quick recovery, and assuming that the pandemic situation remains favourable, Hungarian GDP may return to the level seen at the end of 2019 even in the third quarter of 2021 or until the fourth quarter, at the latest. The projection in the March Inflation Report suggests a growth rate of 4-6 percent for this year; however, based on the data received since then it is likely to be in the upper part of the band. In March, construction performance increased, the industrial output already outstripped its pre-crisis level and also came close to its pre-pandemic trend. However, the volume of retail sales declined in March. So far, labour market adjustment has been modest in Hungary. In March 2021, the unemployment rate stood at 4 percent, while the number of people in employment rose by 0.9 percent year-on-year.

Chart 3 Monthly production indicators and GDP growth



Note: Weighted average of monthly production indicators (industrial output, construction output and retail sales). The weights are derived from regression explaining GDP growth.
Source: MNB calculation based on HCSO data

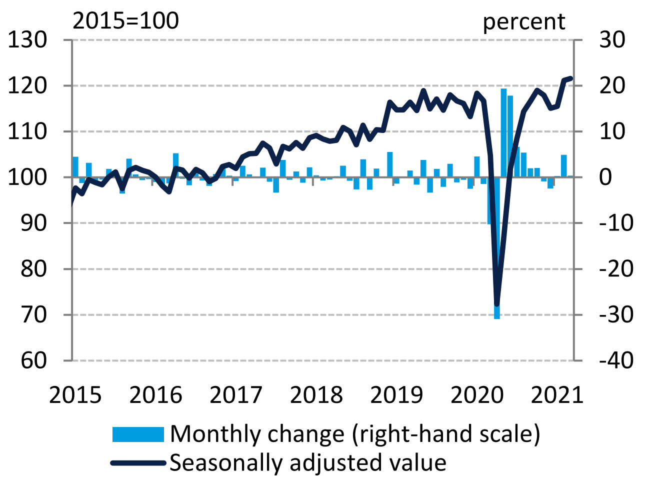
1.2.1. Economic growth

According to raw data, **in the first quarter of 2021 Hungary's gross domestic product declined by 2.3 percent year-on-year** (Chart 3). The seasonally and calendar adjusted index showed a year-on-year decline of 1.8 percent, while quarter-on-quarter the Hungarian economy grew by 1.9 percent. **According to the HCSO release, in the first quarter it was primarily the favourable performance of the industry, financial and insurance, and the infocommunication sectors that contributed to the quarter-on-quarter growth in GDP**. As regards the performance of sectors, at present we have monthly production indicators. In the first quarter, Hungary's industrial production grew by 3.9 percent year-on-year. The contribution of the service sector's branches to growth may have varied. Performance of the financial and infocommunication sector was favourable. On the other hand, retail sales declined by 2.1 percent, while the number of overnight stays at commercial accommodations fell by 86.2 percent year-on-year in the first quarter. Statistics shows that construction output fell by 2.1 percent on an annual basis.

The decline in domestic economic output on an annual basis was between the average of the euro area (-1.8 percent) and the European Union (-1.7 percent). In a quarterly comparison, Hungary is in vanguard of the European ranking, while in an annual comparison it is in the mid-range, based on the GDP data registered in the first quarter of 2021.

In the first quarter, Hungary's GDP fell by 1.8 percent compared to previous year, which is well below the decline of 6.8 percent projected in our March Inflation Report. As a result of the full re-opening in the second quarter of 2021 and the low base of last year, a double-digit growth is likely to be achieved. Owing to the fast recovery, Hungarian economy may return to the level registered at the end of 2019 already in the third quarter of this year or by the fourth quarter, at the latest. The March Inflation Report projected a growth of 4.0-6.0 percent for this year. Based on current

Chart 4 Development in industrial production



Source: MNB calculation based on HCSO data

information, this year's growth in GDP may be in the upper part of the forecast band, close to 6.0 percent. This will put the rate of the Hungarian economy's recovery in the top third of the countries in Europe, due to an outstanding domestic vaccination trend by European standards and Hungary's rapid and effective economic policy response.

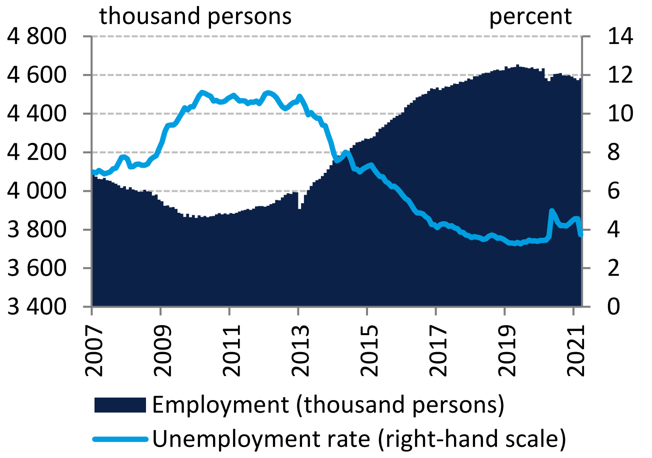
In March 2021, industrial production rose by 16.5 percent year-on-year. The significant growth is also attributable to the low base of last March. Based on seasonally and calendar adjusted data, a growth of 16.1 percent was registered, while on a monthly basis the volume of output rose by 0.4 percent (Chart 4). In March, industrial production was above its pre-crisis level and close to, but still below, its pre-pandemic trend. Almost all manufacturing sub-sectors contributed to the growth in industrial production. Based on raw data, the output of automotive industry – representing the largest weight in domestic output – registered an outstanding, i.e. 28.1 percent, growth on an annual basis, which is mostly connected to the low base value resulting from the temporary factory stoppages last March. The HCSO registered significant growth in the rubber and plastic (+14.3 percent), in the chemical industry (+14.3 percent), in the wood and paper industry (+14.0 percent) and in the computer, electronics and optical products sector (+ 9.6 percent). Production of electrical equipment rose by 37,3 percent mostly due to the soar in the production of batteries and electric motors. Decline in the volume of production was registered only in the textile industry (-1.9 percent).

In March 2021, the volume of construction output was up by 4.3 percent year-on-year, as a result of which it came close to the level registered prior to the outbreak of the coronavirus pandemic. Compared to February 2021, the volume of output was up by 11.5 percent based on seasonally and calendar adjusted data. Construction of buildings rose by 6.4 percent, while other construction stagnated in March in an annual comparison. The volume of new contracts concluded in March increased by 41.9 percent, while the construction companies' end-of-month contract portfolio rose by 13.2 percent compared to last March.

After the previous two months, in April, the manufacturing Purchasing Manager Index (PMI) once again rose above the growth threshold of 50 points in Hungary. Available high frequency data imply that recovery has continued, but most sectors still perform below their pre-pandemic level.

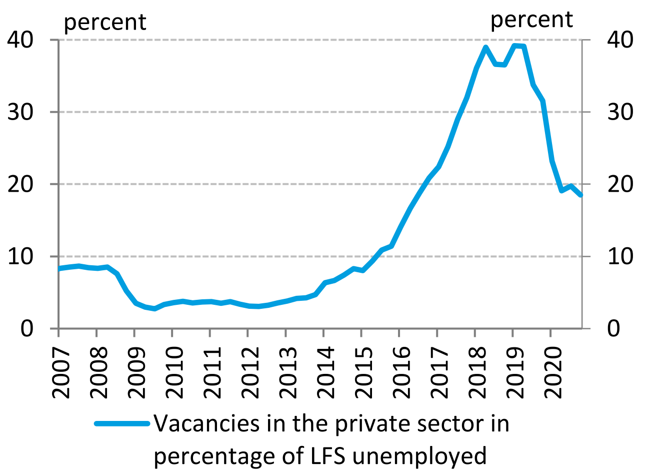
According to the HCSO's preliminary data release, **goods exports and imports rose by 22.3 percent and 15.3 percent, respectively, in euro terms, year-on-year in March 2021**. Merchandise trade surplus amounted to EUR 1 billion and 13

Chart 5 Number of persons employed and the unemployment rate



Source: HCSO

Chart 6 Development of labour market tightness indicator



Note: Quarterly data.
Source: National Employment Service, HCSO

million, representing a year-on-year increase of EUR 685 million.

In March, the volume of retail sales (including fuel sales) **was down by 2 percent year-on-year, after accounting for calendar effects.** In March, the volume of retail sales in food stores and groceries fell by 2 percent, while that of non-food stores was down by 5.9 percent. The volume of sales declined to the largest degree in the furniture and technical articles (-46 percent), textile, clothing and footwear shops (-48 percent) and second-hand goods (-59 percent). Sales volume was up in the automotive and vehicle parts (+2.9 percent), mixed industrial goods (+8.8 percent) and mail order shops (+62 percent), according to the data adjusted for calendar effects. The volume of fuel sales increased by 2.1 percent year-on-year.

In March, the number of tourist overnight stays at domestic commercial accommodations fell short of that registered a year ago by 70 percent. As a result of the entry restrictions and the measures taken to contain the pandemic, applicable to commercial accommodations, the number of overnight stays by foreign and domestic tourists fell by 74 and 66 percent, respectively, year-on-year.

1.2.1. Employment

Based on the data of the Labour Force Survey (LFS), **in March 2021 total employment counted 4,616,000 persons, which is an increase of 41,000 persons year-on-year** (Chart 5). Since March 2020, the number of employees in the primary labour market rose by 72,000 persons, while the number of public employees and the number of those working abroad declined by 24,000 and 7,000 persons, respectively.

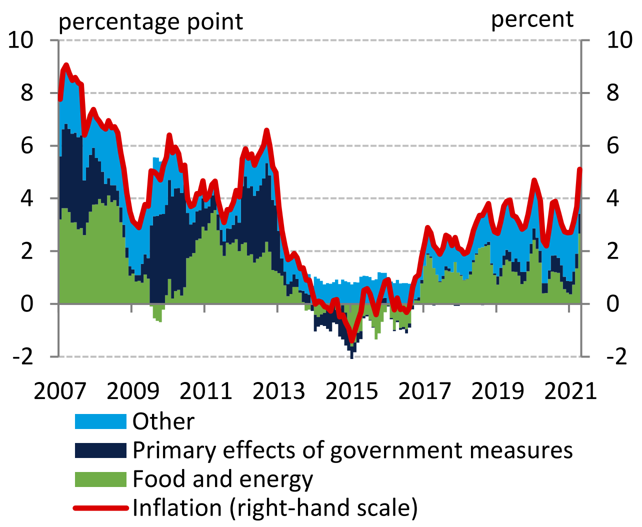
In March, the number of the unemployed was 194,000, exceeding the year-on-year figure by 25,000 persons, thus on the whole the unemployment rate stood at 4.0 percent. Compared to the previous month, the number of the unemployed decreased by 4,200 persons. Based on the data published by the National Employment Service (Nemzeti Foglalkoztatási Szolgálat - NFSZ) in March and April the number of registered jobseekers in Hungary was 304,000 (+22,000 on an annual basis) and 288,000 (-43,000 on an annual basis), respectively.

In the fourth quarter of 2020, private sector vacancies amounted for 40,800, falling short of the year-on-year value by 23.3 percent. **Compared to the previous quarter the annual decline in labour demand decreased moderately; a slight improvement was registered in manufacturing.** However, in the market services sector job vacancies declined by almost 9 percent compared to a year ago; 80 percent of the fall is connected to trade, transportation and tourism The number of vacancies increased in annual terms only in the education sector, but this was unable to offset the declining number of jobs in the rest of the sectors connected to the government (healthcare, public administration). **Overall, the labour market tightness indicator** calculated from the ratio of job vacancies and unemployed persons, **has not changed significantly compared to the previous quarter,** and it still falls short of the values registered in the previous three years (Chart 6).

1.3. Inflation and wages

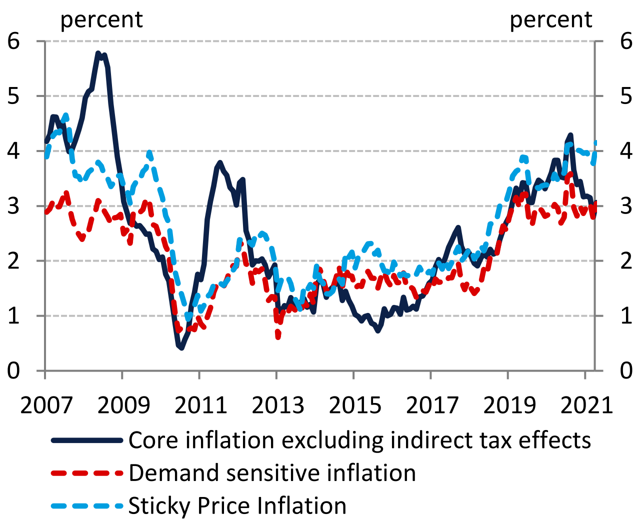
In April 2021, inflation calculated on a year-on-year basis was 5.1 percent, while both core inflation and core inflation excluding indirect tax effects stood at 3.1 percent. Underlying inflation indicators capturing persistent trends (price index of demand sensitive and inflation of sticky price products and services) increased compared to the previous month. In February 2021, gross average earnings in the private sector rose by 8.9 percent year-on-year.

Chart 7 Decomposition of inflation



Source: MNB calculation based on HCSO data

Chart 8 Measures of underlying inflation indicators



Source: MNB calculation based on HCSO data

1.3.1. Wage setting

In February 2021, gross average earnings in the private sector rose by 8.9 percent year-on-year. Based on the detailed analysis of the sectors, the degree of the distortion in the gross average wage of full-time employees increased compared to the last quarter of 2020. Regular average wages moderately decreased compared to January, while the degree of bonus payments has not changed significantly compared to previous years.

Within the private sector, the wage dynamics of market services continues to exceed that in manufacturing. In February, wages in manufacturing were higher by 7.9 percent year-on-year. Wages in the automotive industry – representing the largest share – increased by 7.8 percent in annual terms. In market services, HCSO registered a growth of 9.7 percent. Wages in construction and trade rose by 10.1 percent, 10 percent, respectively, while in catering fell by 0.1 percent, year-on-year.

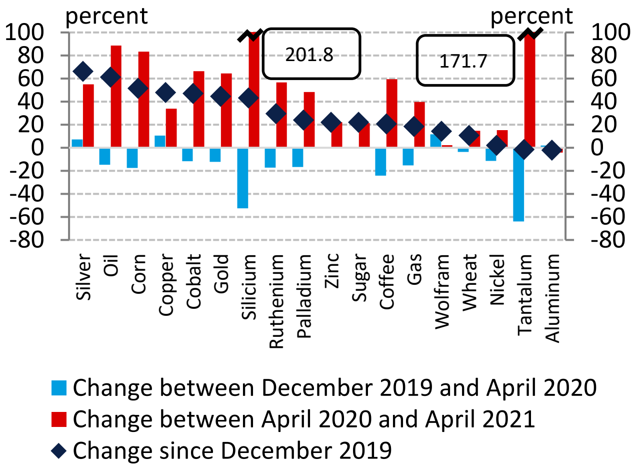
1.3.2. Inflation developments

In April 2021, inflation calculated in annual terms was 5.1 percent, while both core inflation and core inflation excluding indirect tax effects stood at 3.1 percent (Chart 7)**.** Compared to the previous month, inflation increased by 1.4 percentage point and core inflation by 0.3 percentage point. The rise in inflation was mainly due to increasing fuel prices, which on the whole contributed by 1.3 percentage points to the rise in inflation in April. Market services prices rose by 0.4 percent compared to the previous month.

According to the communication of the Hungarian Central Statistical Office, published on 4 May 2021, the calculation of core inflation has changed. As of the publication of the April 2021 consumer price index data (11 May 2021), the HCSO will remove alcoholic beverages and tobacco from the range of products that will be taken into account in the calculation of core inflation. The amendment will not cause a major change in the core inflation excluding indirect tax effects and in the inflation of demand sensitive products, calculated by the MNB, since those have eliminated the effect of tax rate changes before as well.

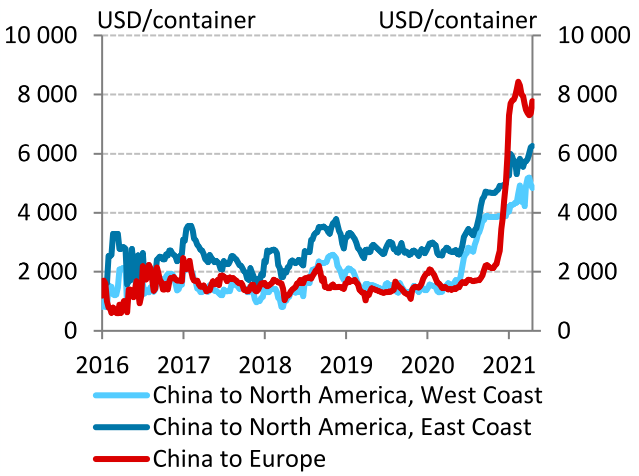
Underlying inflation indicators capturing persistent trends (inflation of demand sensitive and sticky price products and services) **increased compared to the previous month** (Chart 8). In March 2021, agricultural producer prices increased by

Chart 9 Changes in major commodity prices since December 2019



Source: Bloomberg

Chart 10 Developments in the Freightos Baltic Index for shipments from China



Source: Bloomberg

16.1 percent in annual terms, while domestic sales prices in sectors of consumer goods increased by 2.3 percent.

1.3.3. Inflation risks

In line with the forecast in the March Inflation Report, inflation outliers have emerged in the incoming inflation data. Although incoming data were in line with the MNB's expectations and we still expect that in the summer months inflation will return to the central bank tolerance band, **the data received in the past period suggest that inflation risks have increased.**

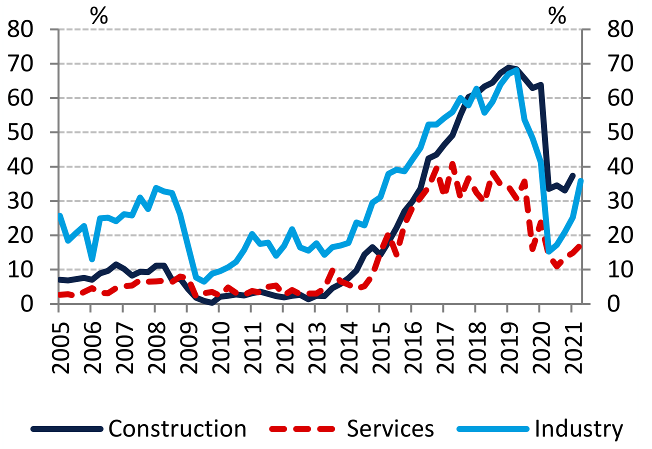
The growth in risks is equally attributable to international and domestic trends. Due to the different nature and management of the crisis, global economic activity and the labour market may recover faster than in the 2008/2009 crisis. **In addition to the rapid economic recovery, a loose fiscal and monetary policy stance, high public debt ratios and expanding lending, together with deglobalisation and shortening value chains, all point to rising inflation globally. Prices of key commodities** significantly rose in the first months of the year, and by now they exceed even the levels observed at the end of 2019 (Chart 9). The rise in global commodity prices may trigger another commodities super cycle.

Global value chains may recover more slowly than demand, leading to increased cost pressures in global transportation and industrial production. For example, the cost of shipments from China to Europe increased more than five-fold by February 2021 from the level of June 2020 (Chart 10). In addition to a fast recovery in demand, the global chip shortage has caused disruptions in industrial production, particularly in the automotive sector, which may have a knock-on effects on prices.

In addition to international developments, several factors in the Hungarian economy also point to a higher inflation path. In the first quarter, Hungary's GDP fell by 1.8 percent compared to previous year, which is well below the decline of 6.8 percent projected in our March Inflation Report. In the second quarter of 2021, as a result of the full re-opening and the low base of last year, a double-digit growth is likely to be achieved. Full employment may be achieved as early as next year, but based on pre-crisis patterns, bottlenecks may already be in place, especially in the services and construction sectors, in parallel with the recovery (Chart 11).

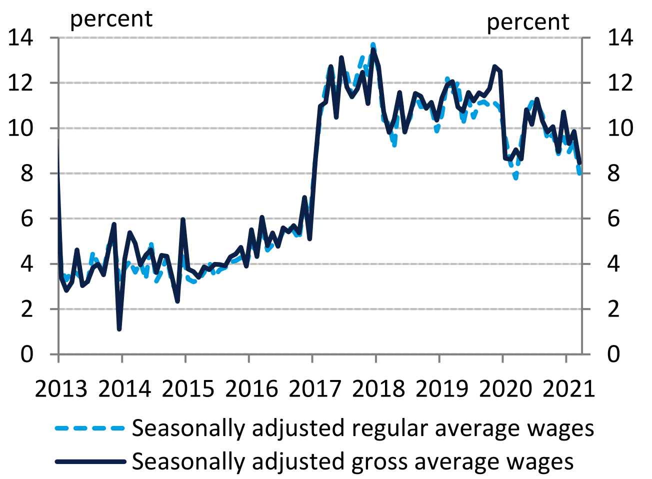
High wage dynamics may persist as the labour market tightens (Chart 12)**, with the rise in savings over the past year, postponed consumption and the availability of an increasing range of services projecting a growth in consumption expenditures.** The opening of the economy

Chart 11 Labour shortage as a factor limiting production in Hungary



Note: Percentage of companies reporting that "Shortage of labour force" is a main factor currently limiting their production.
Source: European Commission

Chart 12 Dynamics of average earnings in the private sector



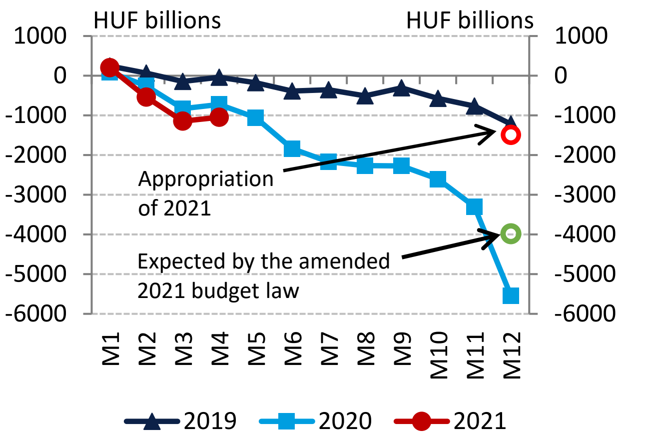
Source: MNB calculation based on HCSO data

could generate demand and supply conflicts, also observed last year, which could lead to a rise in inflation in the short run. Moreover, a higher-than-expected budget deficit next year also points to a higher inflation path.

1.4. Fiscal developments

Similarly to the April balance observed in the past two years, in April 2021, the central sub-sector of the general government had a surplus of HUF 101 billion, and thus the cumulated cash deficit of 2021 declined to HUF 1,044 billion.

Chart 13 Intra-year cumulative cash balance of the central government budget



Source: Budget Act of 2021, Hungarian State Treasury

Similarly to the April balance observed in the past two years, in April 2021 the central sub-sector of the general government had a surplus of HUF 101 billion, and thus the cumulated cash deficit of 2021 declined to HUF 1,044 billion (Chart 13).

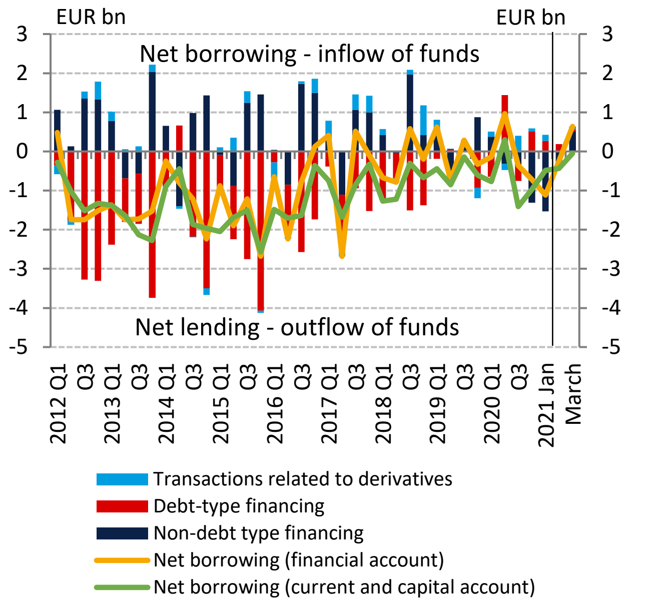
In April, revenues of the central sub-sector were substantially lower than a year ago. However, this is mainly due to two one-off factors: revenues related to EU schemes and to public asset management in the reporting month were lower than in April 2020. Tax and contribution payments increased significantly in April compared to the previous year, with almost all tax and contribution types making a positive contribution.

In April 2021, expenditures of the central sub-sector fell short of those registered last April, which was mainly attributable to the expenditures brought forward to March due to the bank holidays at the beginning of the month. As a result, most of the expenditures on curative and preventive care and family support as well as certain expenditures of the budgetary organisations were already disbursed at the end of March. This effect was partly offset by a significant surplus expenditure in April related to public asset management.

1.5. External balance developments

In March, the current account surplus and the economy's net lending rose to EUR 330 million and EUR 442 million, respectively. The growth is attributable to the rise in net current transfers in addition to the increase in the surplus of the goods and services balance. Regarding trends in financing, the economy's net external debt has not changed significantly, under a net outflow of foreign direct investments due to a rise in investments abroad.

Chart 14 Structure of net lending (unadjusted transactions)



Note: Positive values indicate net borrowing (inflow of funds), while negative values indicate net lending (outflow of funds).
Source: MNB

In March, current account surplus rose further, and thus it amounted to EUR 330 million. Both the goods and services balances rose at a similar rate compared to previous month, as a result of which trade surplus substantially exceeded the year-on-year level. The rise in the current account balance was also supported by the growth in the balance of unrequited current transfers, while the deficit of the income balance was broadly stable (Chart 14).

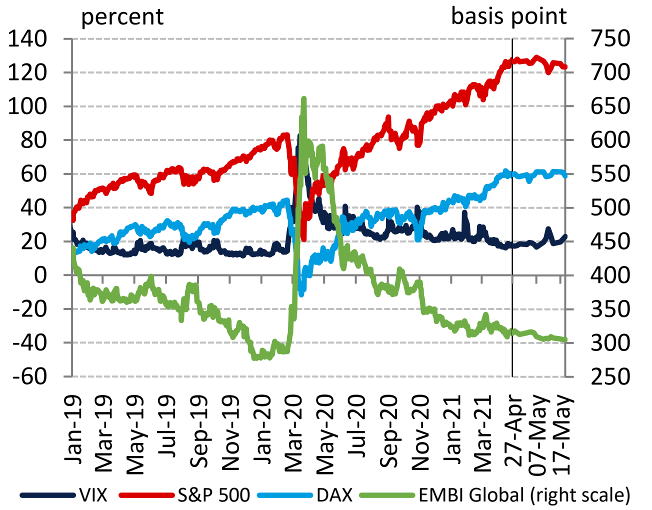
Based on the financial account data, net foreign direct investment outflow amounted to roughly EUR 170 billion, while net external debt of the economy has not changed on the whole. The fall in FDI was attributable to the fact that the rate of the rise in investments abroad exceeded the inflow of foreign direct investments. Net external debt due to transactions has not changed materially. On the other hand, at the end of the quarter, the foreign currency liquidity provided by the central bank to banks once again resulted in a realignment of sectors, and due to this banks' net external debt declined, while that of the consolidated general government rose.

2. Financial markets

2.1. International financial markets

Since the last interest rate decision, financial market sentiment developed unfavourably, largely caused by the rise in commodity prices and inflation expectations. The VIX index, measuring equity market volatility, rose above 20 percent, although both the EMBI global spread in the emerging bond market and the MOVE index, measuring developed bond market volatility, slightly decreased. Last month developed and emerging stock market indices fell, while developed market long-term yields rose. The dollar depreciated against both the advanced and emerging currencies. It depreciated against the euro by 1.1 percent. Last month, oil prices continued to rise, reaching a high of more than one year.

Chart 15 Developed market equity indices, the VIX index (left-hand scale) and the EMBI Global Index (right-hand scale)



Source: Bloomberg

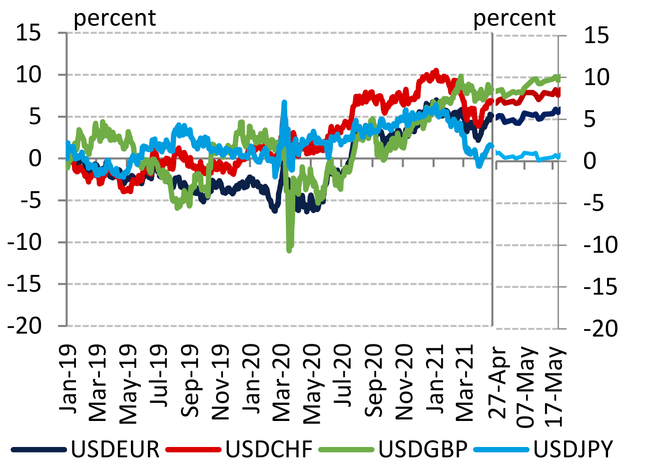
In the period since the last interest rate decision, global financial market sentiment has deteriorated (Chart 15)**.** The rise in inflation expectations had a primarily role in the focus of market participants, evaluated by investors as a consequence of the major monetary and fiscal stimulus, and the rising commodity prices. Last month, the rise in commodity prices, particularly in **oil prices**, was mostly caused by one-off factors, e.g. the cyber attack on the US oil distribution pipeline. On the other hand, global supply side problems – such as the global shortage of chips and containers – may also pose difficulties to satisfying the soaring demand of reopening economies, which may entail a rise in consumer prices.

Of the **risk indicators**, slightly adjusting after a rise in mid-May over 25 percent, the VIX index, the key measure of equity market volatility, rose compared to the level registered at the previous interest rate decision by almost 4 percentage points to 21.3 percent. On the other hand, the emerging bond market EMBI Global spread rose by almost 10 percentage points to 305 basis points, while the MOVE index, measuring volatility in the developed bond market, fell by 3 basis points to 57 basis points.

Last month developed and emerging composite stock exchange indices declined: the MSCI developed market equity index and the emerging market composite index fell by 0.8 and 2.1 percent, respectively. **While the S&P 500, the leading US stock exchange index, fell by almost 1.5 percent, the key stock exchange indices in Europe rose: the British stock market index rose by 1.1 percent, the German by 0.9 percent and the French and Italian by 0.5 percent.** The Japanese stock exchange index fell by 3.3 percent, while the Chinese stock exchange rose by 1.6 percent during the period. **Stock market indices rose in the countries of the region as well**: the Czech one rose by 4.1, the Hungarian one by 4.9 and the Polish one by 5.7 percent.

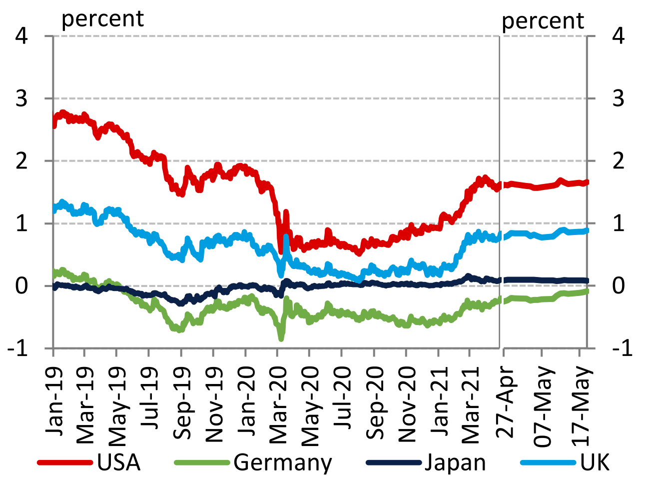
The dollar depreciated against the developed market currencies, with the exception of the Japanese yen (Chart

Chart 16 Developed market FX exchange rates



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

Chart 17 Yields on developed market long-term bonds



Source: Bloomberg

16). It depreciated against the euro by 1.1 percent, the Swiss franc by 1.6 percent, the British pound by 2 percent, while it appreciated against the Japanese yen by 0.3 percent. At the end of the period, the euro-dollar exchange rate stood at above 1.2. **All currencies of the region appreciated against the dollar.** Since the last interest rate decision the price of gold rose by 5.3 percent, to USD 1,870/oz.

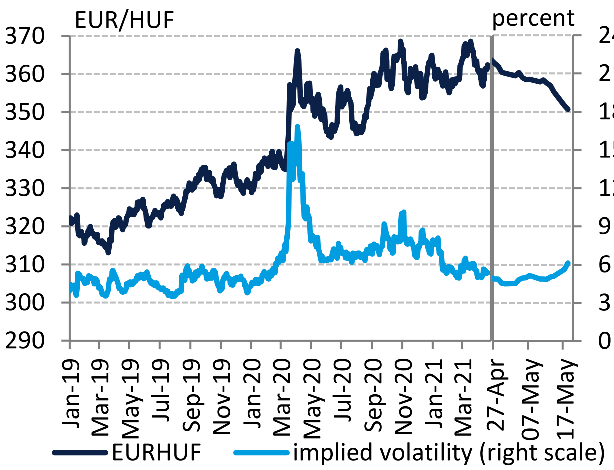
Developed bond yields have increased further since the last interest rate decision in parallel with the rise in inflation expectations (Chart 17)**.** The German, British and US 10-year yield was up by 17, 12 and 5 basis points, respectively, and thus the German, British and US yields closed the period at around -0.09, 0.90 and 1.67 percent, respectively. **Yields in the Mediterranean countries also rose** by 20-30 basis points. The countries of the CEE region were also characterised by increasing yields: the Hungarian, Polish and Romanian 10-year yield rose by 54, 44 and 30 basis points, respectively. On the other hand, the Czech yield fell by 5 basis points.

On the whole oil prices continued to rise in the previous period. The improving growth prospects and the IT attack on the US oil distribution pipeline pushed oil prices higher, despite the severe pandemic situation in India, which reduced demand in the world's third largest oil importer. At the beginning of the period, oil prices rose due to the larger-than-expected fall in US inventories and the attack on the oil pipeline. Then, in the second half of the period, US oil stocks rose slightly and news related to the return to the Iran nuclear deal also had some downward impact on prices. **Accordingly, during the period under review, the price of Brent crude oil rose by 2.6 percent to USD 68.1, while the US benchmark WTI oil price grew by 3 percent to USD 64.8.**

2.2. Developments in domestic money market indicators

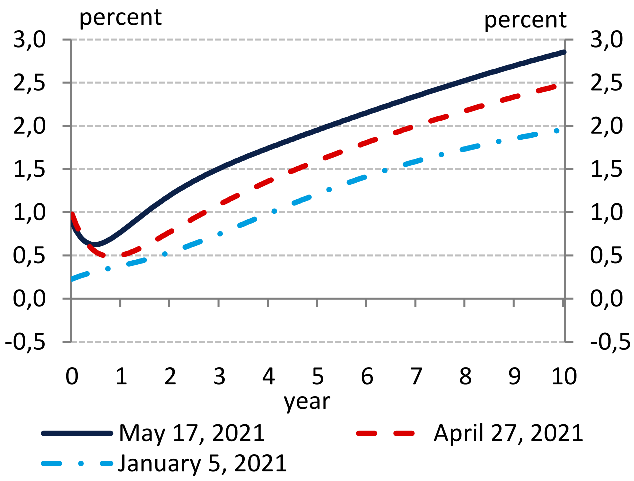
In the period under review, the forint appreciated against the euro to a larger degree than the Polish zloty and the Czech koruna. The government securities yield curve rose. In the past month, mostly there was a strong demand at government bond auctions. On the other hand, the average auction yields significantly rose compared to mid-April.

Chart 18 EUR/HUF exchange rate and the implied volatility of exchange rate expectations



Source: Bloomberg

Chart 19 Shifts in the spot government yield curve



Source: MNB, Reuters

Since the interest rate decision in April, the forint appreciated against the euro to a larger degree than the zloty and the koruna, i.e. by 3.3 percent. Of the currencies of the CEE region, the Czech koruna and the Polish zloty appreciated against the euro by 2 percent and 1.1 percent, respectively, while the exchange rate of the Romanian leu remained broadly unchanged (Chart 18).

The 3-month BUBOR, relevant for monetary policy transmission, rose by 10 basis points to 0.89 percent since the last interest rate decision.

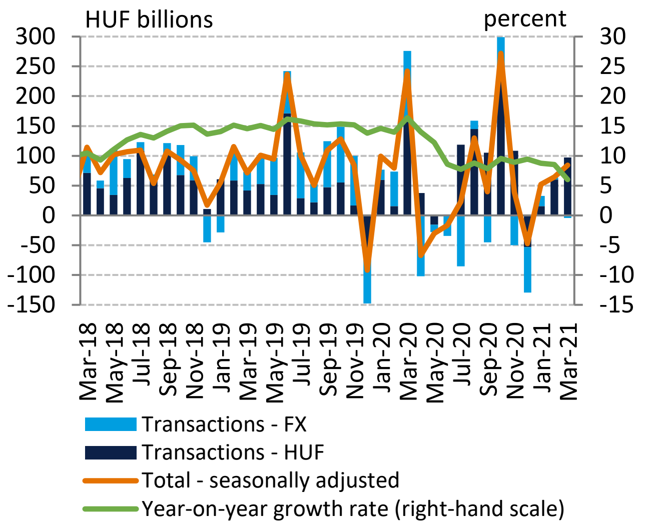
The government securities market yield curve rose. (Chart 19).**.** Around the 1-year section, in the middle section and in the longest section of the yield curve a rise of 25-30, 35-40 and almost 50 basis points could be observed, respectively.

In the past month, the demand was strong at government bond auctions. Under the mostly strong demand, the Government Debt Management Agency sold the announced volume at the 3- and 12-month Treasury bill auctions, and on one occasion it accepted bids below the announced volume. Since the last interest rate decision, the average yield at the 3-month auctions rose from 0.54 percent to 0.6 percent, while the average auction yield at the 12-month Treasury bill auctions increased from 0.68 percent to 0.69 percent. Government bond auctions were usually also characterised by strong demand. Accordingly the Government Debt Management Agency accepted bids in excess of the announced volume on several occasions, while on one occasion (15-year) it accepted bids below the announced volume. At the latest auction, the average yield of the 10-year securities was 2.77 percent, representing an increase of 4 basis points compared to average auction yield before the interest rate decision in April. The average yield on 5-year government securities decreased by 5 basis points to 1.68 percent, while at the 15-year securities it rose by 19 basis points to 3.19 percent. The average auction yield on 30-year government securities was 3.69 percent. The Hungarian 5-year CDS spread fell by 1 basis point to 58 basis points during the period under review.

3. Trends in lending

In March 2021, outstanding lending to non-financial corporations rose by HUF 92 billion, reflecting a rise of HUF 97 billion in foreign currency loans and a decline of HUF 5 billion in forint loans. Households' outstanding borrowing rose by HUF 114 billion in the month, and as a result, the annual growth rate remained at 13.7 percent, i.e. the level seen last month.

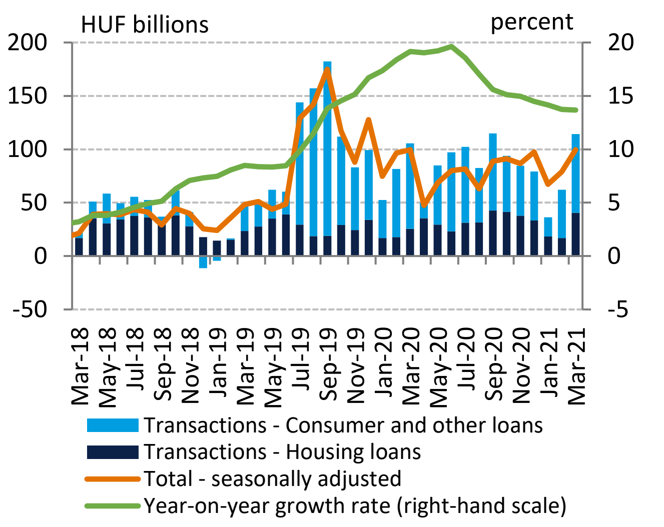
Chart 20 Net borrowing by non-financial corporations



Source: MNB

In March 2021, outstanding loans to non-financial corporations rose by HUF 92 billion, reflecting a rise of HUF 97 billion in foreign currency loans and a decline of HUF 5 billion in forint loans. (Chart 20). The annual growth rate in outstanding borrowing of corporations was down to 6 percent in March, representing a significant slowdown compared to 8.5 percent of last month. The substantial decline in the growth rate was attributable to the removal of last March's growth due to transactions including high-volume deals from the 12-month rolling balance. In March, credit institutions disbursed new loans in the amount of HUF 406 billion, which exceeds the value registered last March by 86 percent. During the month under review, banks concluded non-overdraft forint contracts with enterprises under FGS Go! in the amount of HUF 100 billion, which accounts for 27 percent of the total forint corporate loan disbursements in March.

Chart 21 Net borrowing by households

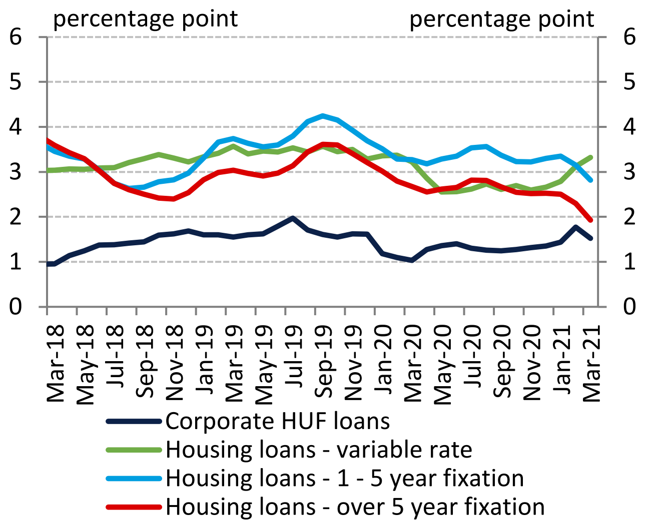


Source: MNB

In March, outstanding borrowing of households rose by HUF 114 billion, and thus the annual growth rate remained at 13.7 percent, i.e. the level registered last month (Chart 21)**.** The instalment reducing effect of the moratorium on payments still largely supports the outstanding growth, also by international standards, in domestic retail lending. The volume of new loan contracts concluded in March registered a 4 percent year-on-year growth. Disbursements of housing loans achieved an unprecedented volume, i.e. HUF 104 billion, with major contribution by the family support measures effective from this year, which are now on the rise after a short preparation period. Until March, inclusive, interest subsidised home improvement loans – offered by banks since February – were disbursed in the amount of HUF 2.3 billion to pre-finance the home improvement subsidy. State subsidised loans still have significant role in retail lending, primarily due to the prenatal baby support loans: in March the outstanding volume of this product amounted to HUF 1,192 billion, thereby accounting already for 14 percent of outstanding household loans.

The smoothed interest rate spread of forint corporate loans was 1.52 percent in March 2021, representing a decrease of 0.25 percentage point compared to the previous month (Chart 22). **The average smoothed interest rate spread on variable rate housing loans calculated on**

Chart 22 Development of corporate and household credit spreads



Note: In the case of corporate forint loans, the spread over the 3-month BUBOR. In the case of 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 APR-based margin above the relevant IRS.
Source: MNB

the basis of the annual percentage rate (APR) increased during the month and amounted to 3.32 percentage points. The spread on products with interest rate fixation periods longer than one year, up to 5 years and more than 5 years also decreased compared to February. The average spread on housing loans with interest rate fixation periods longer than one year and up to 5 years reached 2.82 percentage points in March, while the spread on products with interest rate fixation periods of more than 5 years was 1.92 percentage points.