MACROECONOMIC AND FINANCIAL MARKET DEVELOPMENTS

BACKGROUND MATERIAL

TO THE ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING

OF 19 DECEMBER 2023

DECEMBER

2023

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

The background material 'Macroeconomic and financial market developments' is based on information available until 13 December 2023.

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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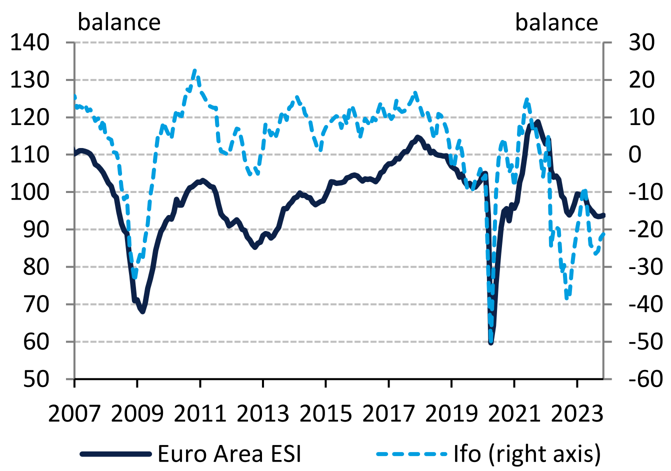
1. Macroeconomic developments

1.1. Global macroeconomic environment

In 2023 Q3, economic growth slowed in the European Union and China, while it accelerated in the United States. Monthly production indicators worsened in the euro area, were mixed in the USA and rose in China on an annual basis. In November, the Purchasing Managers' Index for manufacturing improved in China and the euro area, while it deteriorated in the United States. Annual inflation in the United States slowed to 3.1 percent in November from 3.2 percent in October, while in China consumer prices fell by 0.5 percent year-on-year in November, following a 0.2 percent decline in October. According to preliminary data, year-on-year inflation in the euro area was 2.4 percent in November, while core inflation was 3.6 percent. The preliminary inflation figure was lower than analysts' expectations of 2.7 percent, while core inflation was also below analysts' expectations (3.9 percent). Preliminary data show that inflation rose in two EU Member States in November.

In 2023 Q3, economic growth decelerated in the European Union and China, while it accelerated in the United States. In the third quarter, economic growth was 4.9 percent in China and 3.0 percent in the United States in annual terms. The economic performance of both the euro area and the EU-27 stagnated (0.0 percent) year-on-year. Based on currently available data, the largest year-on-year growth was registered in Malta (+7.1 percent) and Croatia (+3.0 percent) in annual terms. 10 Member States reported a year-on-year downturn, with output decreasing most sharply in Ireland (–5.6 percent) and Estonia (–4.0 percent). Among the other countries in the region, the economy of the Czech Republic contracted (–0.7 percent), while the Polish (+0.6 percent), Slovakian (+1.1 percent) and Slovenian (+1.6 percent) economies expanded compared to the same period of the previous year. The output of Germany, Hungary's main trading partner, declined (-0.4 percent) year-on-year.

Chart 1 Business climate indices in Hungary's export markets



Source: European Commission, Ifo

Monthly production and sales indicators deteriorated in the euro area, were mixed in the USA and rose in China on an annual basis. In October, the industrial production of China was up 4.6 percent year-on-year, while it declined by 6.6 percent in the euro area and by 0.7 percent in the United States. Retail sales rose by 7.6 percent in China and 2.5 percent in the USA, whereas the euro area registered a 1.2 percent decline.

In November, the Purchasing Managers' Index for manufacturing improved in China and the euro area, while it deteriorated in the United States. In the euro area and the USA the index was below and in China it was above the expansion threshold. The Economic Sentiment Indicator (ESI) of the euro area improved by 0.3 point in November 2023 (Chart 1).

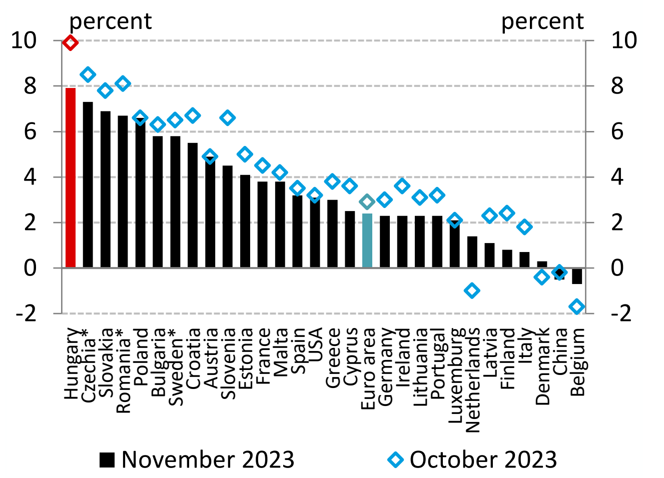
There is still no sign of a significant deceleration in international labour market developments. In November, the unemployment rate dropped to 3.7 percent in the

United States from 3.9 percent recorded in the previous month; this figure still remains low in historical terms. In the previous month, the number of non-agricultural employees grew at a greater rate than expected, i.e. by 199,000 persons; an acceleration from the 150,000-person growth registered in October. In the euro area the unemployment rate stood at 6.5 percent in October.

Annualised inflation in the United States decelerated to 3.1 percent in November from 3.2 percent in October, while in China consumer prices fell by 0.5 percent year-on-year in November, following a 0.2 percent decline in October. Based on preliminary data, year-on-year inflation in the euro area was 2.4 percent in November, with core inflation standing at 3.6 percent. The preliminary inflation figure was lower than analysts' expectations of 2.7 percent, while core inflation was also below analysts' expectations (3.9 percent).

Preliminary data show that inflation rose in two EU Member States in November. Among the EU countries, the highest inflation was recorded in Hungary. The annual price index was also high in the CEE region. In the region, prices rose by 6.9 percent in Slovakia, 6.6 percent in Poland, 5.5 percent in Croatia and 4.9 percent in Austria, year-on-year (Chart 2).

Chart 2 Developments in the international inflation environment



Note: HICP (where available) and CPI (*) rates.
Source: Eurostat

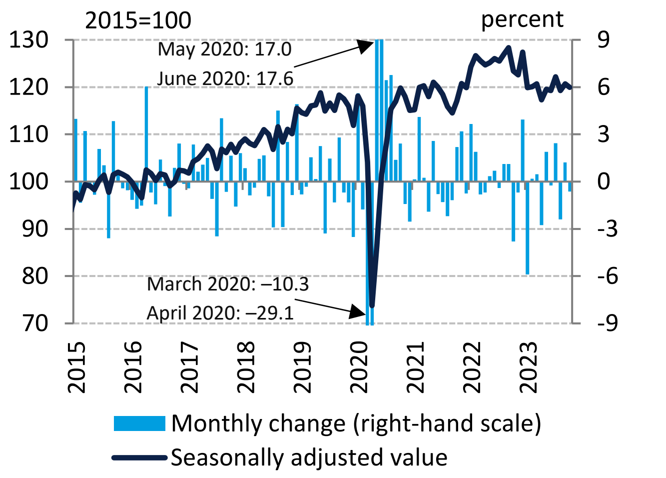
1.2. Real economic developments in Hungary

In 2023 Q3, GDP was down 0.4 percent year-on-year, while the economy expanded by 0.9 percent quarter on quarter. In October 2023, the volume of industrial production and retail sales fell by 3.2 percent and 6.5 percent, respectively, while construction output declined by 6.0 percent year-on-year. In October 2023, the average number of employees aged 15–74 was 4,757,000. In the period of August through October 2023, 30,000 more people were in employment in Hungary on average than in the same period of the previous year. The unemployment rate stood at 4.1 percent in October.

1.2.1. Economic growth

In 2023 Q3, GDP was down 0.4 percent year-on-year, while the economy expanded by 0.9 percent quarter on quarter. Compared to the low base following last year's drought, agricultural value added rose by 88.2 percent year-on-year, dampening the economic downturn by 3.4 percentage points. The value added of industry fell by 5.4 percent, while the output of manufacturing dropped by 4.1 percent compared to the same period of the previous year. Value added in the construction sector was 1.6 percent lower than in the same period of the previous year. On the whole, the value added in the services sector decreased by 3.1 percent, while services linked to the state (public administration, defence; compulsory social security, education, human health and social work activities) increased by 1.6 percent overall. On the consumption side, the fall in domestic demand was mitigated by net exports. Household consumption expenditure dropped by 2.7 percent and gross fixed capital formation fell by 15.1 percent compared to the same period of the previous year. Net exports mitigated the economic downturn by 5.0 percentage points.

Chart 3 Developments in industrial production



Source: MNB calculation based on HCSO data

In October 2023, the volume of industrial production fell by 3.2 percent, marking ten months of year-on-year contraction. Compared to the previous month, the level of production contracted by 0.6 percent and accordingly, it is still close to the figure seen at the beginning of the year (Chart 3). The HCSO measured a decline in most of the manufacturing subsectors, except for the automotive industry, representing the largest share, and electrical equipment production, both of them registering a growth. The output of the automotive industry, representing the largest share, grew by 4.9 percent compared to the level recorded last October, while the production of electrical equipment rose by 9.0 percent. Production of the food, beverage and tobacco sector fell short of the level seen a year ago by 2.8 percent.

In September 2023, the volume of construction output declined by 6.0 percent. Construction of buildings declined by 9.5 percent, while other construction increased by 0.4 percent compared to the September base last year. Based on seasonally and calendar-adjusted data, total construction output fell by 1.8 percent compared to August. The volume of new contracts decreased by 32.0 percent. Within this, the number of new contracts concluded for construction of buildings declined by 43.9 percent and for other construction works by 2.7 percent year-on-year. At the end of September, the contract portfolio of construction companies fell by 30.6 percent on an annual basis. Within this, the volume of contracts for the construction of buildings was 13.4 percent lower, while that for the construction of other structures 42.6 percent lower than a year earlier.

In October 2023, the volume of retail turnover contracted by 6.5 percent, whereby the decline observed on an annual basis lasts for the eleventh month. In the first ten months, turnover declined by 9.0 percent on average, to which the fall in fuel sales was a major contributor. Excluding fuel trade, turnover shrank by 3.3 percent in October based on calendar-adjusted data. The volume of retail sales, excluding fuel trade, has been declining since last July on an annual basis. Retail sales decreased in all product groups except pharmaceuticals, cosmetics and motor vehicles and vehicle parts. Sales of industrial goods (–12.6 percent), furniture and appliance products (–15.2 percent) and fuel (–21.1 percent) dropped by more than 10 percent.

Based on preliminary data, the trade balance showed a surplus of EUR 1.0 billion in October 2023. The balance deteriorated by EUR 303 million compared to the previous month, while it improved by EUR 2.0 billion in annual terms. After the decline observed in the previous two months, the export of goods rose by 1.2 percent in euro terms year-on-year in October. As energy prices fell and domestic demand contracted, the nominal value of imports shrank by 13.3 percent in euro terms in the span of a year.

The inflation-adjusted turnover of online cash registers has been declining since January 2023, but the pace of the decline continued to slow in October. Based on online cash register data, nominal turnover increased by 6.8 percent, while inflation-adjusted real turnover fell by 3.1 percent year-on-year in October. In November, freight traffic was stagnant, while passenger flights (–10.0 percent) and road passenger traffic (–11.0 percent) decreased. Electricity load decreased by 2.0 percent. Cinema attendance fell by 23.0 percent, while catering turnover increased by 8.0 percent. The number of Google searches for the term ‘unemployment benefit’ increased in November.

1.2.2. Employment

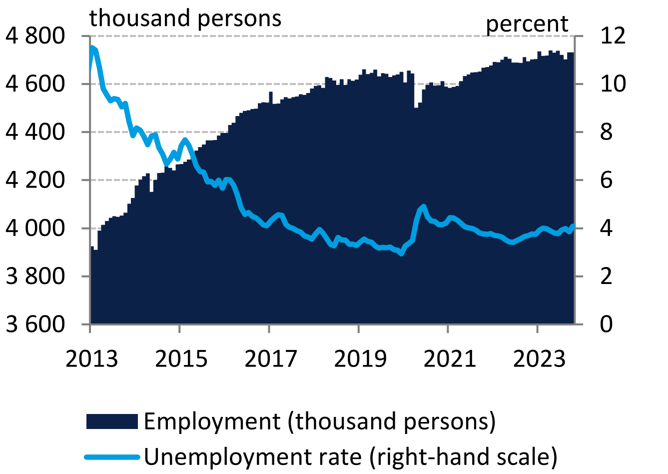
According to the Labour Force Survey, the average number of employees aged 15–74 was 4,757,000 in October 2023. In the period of August–October 2023, the average number of employees was 4,745,000, which is 30,000 more than in the

same period of the previous year (Chart 4). On average in August–October, the number of people employed in the primary labour market and the number of people working abroad increased by 26 thousand and 12 thousand, respectively, while the number of fostered workers decreased by 8 thousand compared to the same period of the previous year.

In October, the number of the unemployed was 202,000, increasing the year-on-year figure by 22,000 persons, and accordingly, the unemployment rate stood at 4.1 percent. Based on seasonally adjusted data, the number of the unemployed was 11 thousand higher in October than in September. Based on data published by the National Employment Service (NES), there were 226,000 registered jobseekers in Hungary in October and November 2023, which translates to an annual decline of 9,000 and 7,000, respectively. Based on seasonally adjusted data, in November 2023 the number of registered jobseekers was essentially the same as in October, and it is still lower than in the months before the outbreak of the coronavirus pandemic.

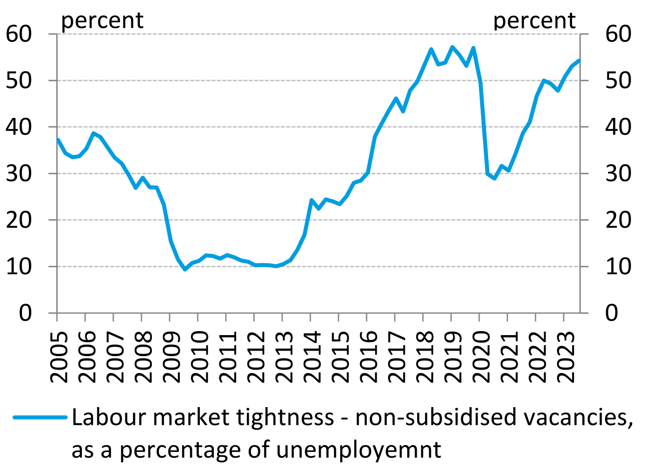
The number of non-subsidised job vacancies grew further in the previous quarter, standing at historically high levels (Chart 5). Based on data published by the National Employment Service (NES) in 2023 Q3 the number of job vacancies was 114,000, representing a year-on-year growth of 22.5 percent. Based on seasonally adjusted data, the number of vacancies has been rising steadily in the past five quarters.

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: Quarterly data.
Source: NES, HCSO

1.3. Inflation and wages

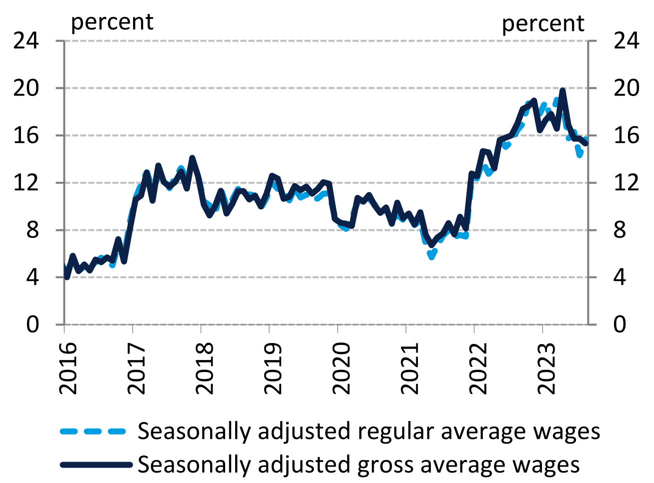
In November 2023, domestic inflation continued to decline rapidly. Consumer prices rose by 7.9 percent year-on-year. Both core inflation and core inflation excluding indirect tax effects fell into single-digit territory to 9.1 percent. Incoming data were somewhat below analysts' expectations. In September 2023, average regular wages (excluding bonuses) rose by 14.9 percent in the national economy and by 15.4 percent in the private sector in annual terms.

1.3.1. Wages

In September 2023, gross average wages in the private sector rose by 14.6 percent year-on-year. Bonus payments were below the historical average for September. Average regular earnings (excluding bonuses) rose by 14.9 percent in annual terms in the national economy and by 15.4 percent in the private sector.

According to seasonally adjusted data, gross average wage dynamics decelerated, while regular average wages accelerated in the private sector compared to the previous month (Chart 6). Within the private sector, wage dynamics in manufacturing exceeded the dynamics observed in market services. Based on raw data, manufacturing wages were 15.0 percent higher in September than in the same period in the previous year. In market services, the growth registered by the HCSO was 14.3 percent. Annual wage dynamics were over 14 percent in most sectors of the national economy. Wages in construction increased by 15.3 percent, in tourism by 14.2 percent and in trade by 13.5 percent compared to the same period of the previous year.

Chart 6 Dynamics of average earnings in the private sector

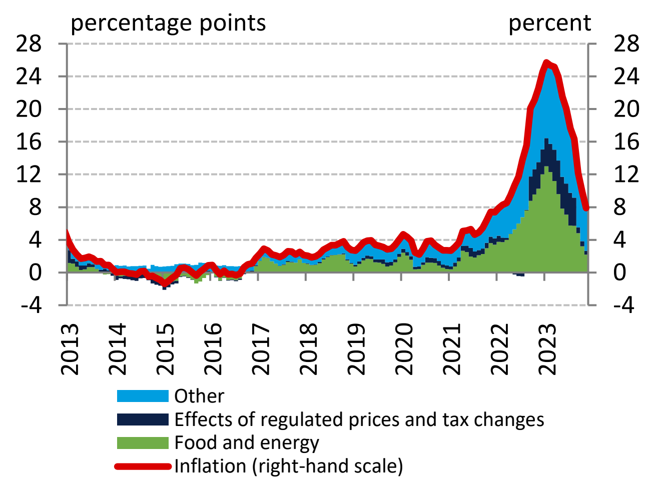


Source: MNB calculation based on HCSO data

1.3.2. Inflation developments

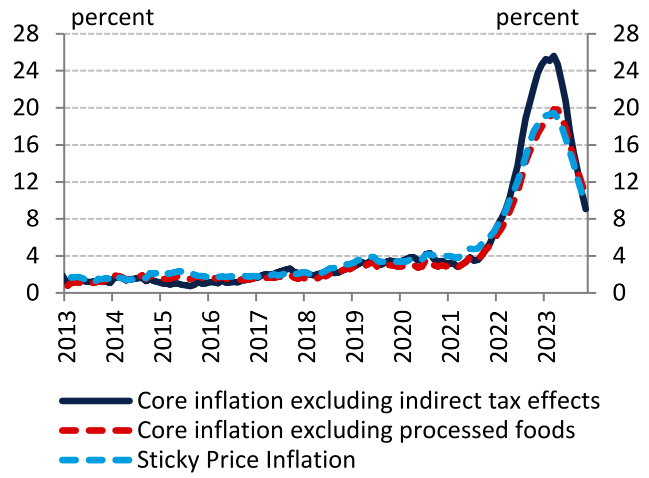
In November 2023, inflation in Hungary continued to fall rapidly, and consumer prices rose by 7.9 percent year-on-year (Chart 7). Both core inflation and core inflation net of indirect taxes fell into single-digit territory to 9.1 percent. The price of the representative consumer basket remained unchanged on a monthly basis, whereas core inflation rose by 0.3 percent, similar to the previous month. Inflation slowed by 2.0 percentage points compared to the previous month. The general perception of disinflation was mainly driven by food (–0.6 percentage points), fuels (–0.4 percentage points) and industrial goods (–0.4 percentage points). Year-on-year core inflation eased by 1.8 percentage points. The annual inflation rate for industrial goods dropped to 7.2 percent, while the annual average price index for market services fell to 13.5 percent. Annual food inflation continued to decelerate, with unprocessed and processed food price dynamics reported at 2.4 percent and 3.6 percent, respectively. Fuel inflation eased to 25.4 percent, while the price index for regulated goods and services was –2.3 percent. Incoming data were somewhat

Chart 7 Decomposition of inflation



Source: MNB calculation based on HCSO data

Chart 8 Measures of underlying inflation indicators



Note: Core inflation excluding processed food corresponds, with unchanged content, to the former demand sensitive inflation measure.

Source: MNB calculation based on HCSO data

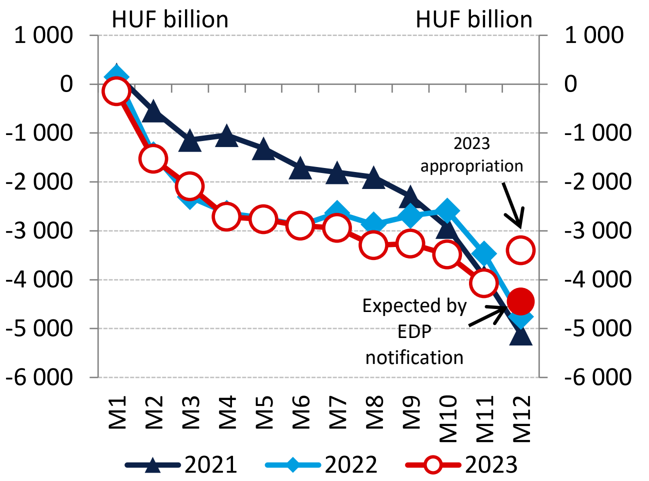
below analysts' expectations. The median was 8.0 percent, with expectations ranging from 7.8 to 9.0 percent.

The MNB's annualised indicators, which capture more persistent inflation trends, also declined (Chart 8). Inflation for sticky-price goods fell by 1.3 percentage points, and annual core inflation excluding processed food decreased by 1.4 percentage points compared to the previous month.

1.4. Fiscal developments

The central sub-sector of the general government had a deficit of HUF 587 billion in November, which represents a HUF 290 billion improvement compared to November 2022. By the end of the month, the year-to-date cumulative deficit rose to HUF 4,074 billion, accounting for 120 percent of the cash deficit target, prescribed by legislation, and almost 92 percent of the deficit target of HUF 4,450 billion, raised in October.

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



Source: Budget Act of 2023, HCSO, Hungarian State Treasury, EDP notification

The **central sub-sector of the general government** registered a deficit of HUF 587 billion in November, which represents a HUF 290 billion improvement compared to November 2022. By the end of the month, the year-to-date cumulative deficit rose to HUF 4,074 billion, representing 120 percent of the statutory cash-based deficit target and almost 92 percent of the early-October, raised deficit target of HUF 4,450 billion (Chart 9).

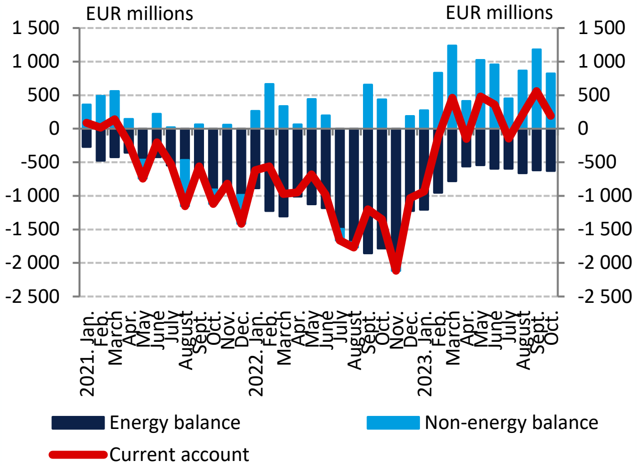
In November, **revenues of the central sub-sector** were HUF 299 billion higher than a year earlier, of which tax and contribution revenues exceeded the year-on-year figure by HUF 116 billion (7 percent). Tax and contribution revenues from labour increased by HUF 125 billion (16 percent), while payments by enterprises rose by HUF 36 billion (17 percent). After the decrease in October, net VAT revenues increased by HUF 26 billion (7 percent) year-on-year in November, while gross VAT revenues essentially stagnated. Other sizeable government revenues of the month amounted to HUF 398 billion, mainly related to state assets, including, in particular, the HUF 309 billion dividend advance paid by MVM in November.

Expenditures were only marginally higher (by HUF 9 billion) than in November 2022. Expenditures on curative and preventive care increased by HUF 115 billion, while pension expenses were HUF 29 billion higher than the value recorded in November 2022, which included the additional increase and pension premium. Normative and specific subsidies decreased by HUF 141 billion year-on-year, due to a significant decline in energy expenditures, while housing subsidies contracted by HUF 49 billion. Net interest expenses rose by HUF 24 billion on an annual basis.

1.5. External balance developments

In October 2023, the current account surplus amounted to around EUR 191 million and net lending around EUR 300 million. Monthly developments in the current account balance were largely due to a moderation in goods surplus. However, this still exceeded the value seen in October 2022 by about EUR 1.5 billion. This was mainly driven by a continued decline in imports amidst a falling energy imports bill and waning domestic demand. Based on financial accounts data, net direct investment inflows amounted to EUR 0.9 billion in October, mainly reflecting an increase in reinvested earnings in Hungary.

Chart 10 Developments in current account and energy balance



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

In October 2023, the current account surplus amounted to EUR 191 million and net lending around EUR 300 million (Chart 10). The current account balance exceeded the value recorded in October 2022 by about EUR 1.5 billion. This was mainly driven by a continued decline in imports amid a contraction in the energy imports bill and waning domestic demand. In October, the services balance surplus declined in line with seasonality as compared to previous months; however, it increased year-on-year. The income balance deficit deteriorated somewhat, while the transfer balance stood at a fairly low level amid the decline in EU funds.

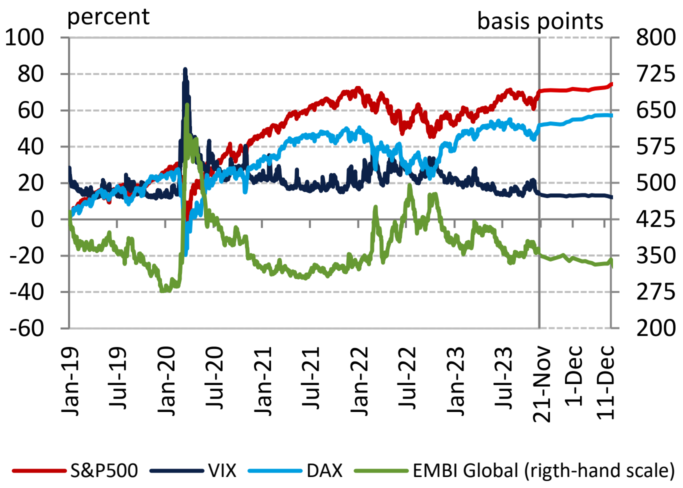
Based on financial accounts data, net direct investment inflows amounted to EUR 0.9 billion in October, mainly reflecting an increase in reinvested earnings in Hungary. The EUR 0.8 billion reduction in net external debt resulting from transactions was the net result of a decline in the public sector and corporate indicator and an increase in banking sector debt.

2. Financial markets

2.1. International financial markets

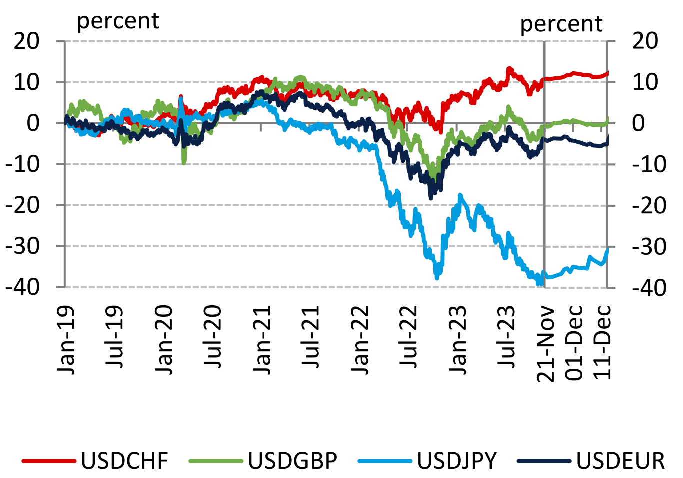
Risk appetite has improved. Market participants' attention was still focused on expectations for the monetary policy by the world's leading central banks and macroeconomic data releases, while geopolitical risks moderated.

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



Source: Bloomberg

Chart 12 Evolution of developed market FX exchange rates from January 1, 2019



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

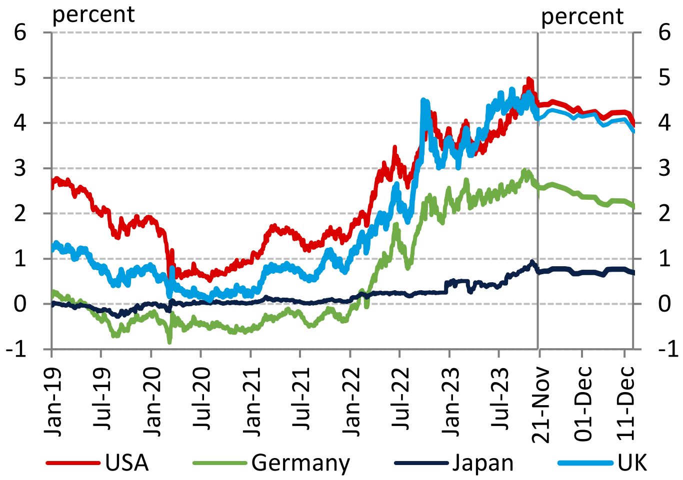
In recent months, market participants have continued to focus on expectations regarding the monetary policy of the world's leading central banks and recent macroeconomic data releases, while geopolitical risks have eased on the back of encouraging results in the Middle East conflict, leading to an overall improvement in risk appetite. Of the risk indicators, the VIX index, the key measure of equity market volatility, declined by 1 percentage point to 12 percent from its level registered on 21 November, while the emerging market EMBI Global bond market premium fell by 7 basis points to 342 basis points (Chart 11).

Developed market stock indices typically rose during the period. The US S&P 500 and the Dow Jones advanced by 3.7 and 5.7 percent, respectively. Among leading European stock market indices, the German DAX and the French CAC40 rose by 6.1 and 5.4 percent, respectively. Of the Asian indices, the Shanghai stock market index decreased by 3.6 percent, while the Japanese Nikkei dropped by 2.0 percent since the last interest rate decision. The developed market MSCI composite index rose by 3.4 percent, while the emerging market index fell by 1.5 percent.

The dollar's performance against major currencies was mixed (Chart 12). The dollar's exchange rate was broadly unchanged against the euro at around 1.091 and strengthened by 1.2 percent against the pound sterling, while it depreciated by 1.5 percent against the Swiss franc and by 4.2 percent against the Japanese yen.

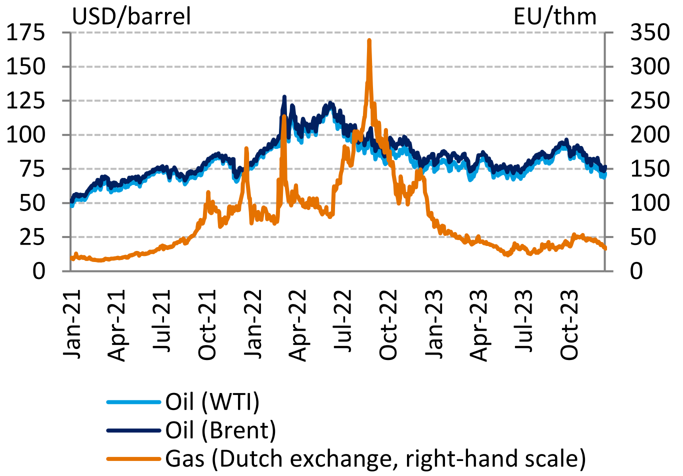
Long-term yields in developed markets have declined further since the previous interest rate decision (Chart 13). The US 10-year yield has fallen by 43 basis points to 3.98 percent (its lowest level since the summer), the German long-term yield has declined by 49 basis points to 2.13 percent, and the Japanese yield has fallen by 5 basis points to 0.67 percent. Yields in the Mediterranean countries fell by 45–50 basis points. In the region, 10-year government bond yields decreased by 48, 66 and 34 basis points in Poland, Romania and the Czech Republic, respectively. The Hungarian yield has fallen by 89 basis points since the November rate-setting decision.

Chart 13 Yields on developed market long-term bonds



Source: Bloomberg

Chart 14 Developments in oil and gas prices since January 2021



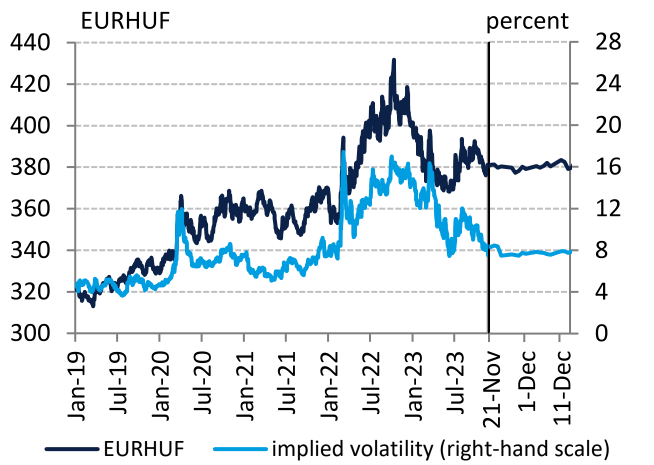
Source: Bloomberg

Oil prices have moderated since the previous interest rate decision: the price of North Sea Brent crude oil per barrel fell by 12.1 percent from USD 82.5 at the end of November to USD 72.5 in mid-December (Chart 14). The price of the US benchmark, WTI, fell by 16.5 percent from USD 78.5 at the end of November to USD 65.5 in mid-December. The main contributors to the price moderation were expectations of a supply surplus, falling demand due to a challenging economic outlook and high US inventory levels. European gas prices have fallen since the previous interest rate decision from 47 EUR/MWh to 34 EUR/MWh, as gas storage facilities of the European Union are close to full capacity and demand is subdued.

2.2. Developments in domestic money market indicators

Overall, the forint exchange rate has appreciated slightly against the euro since the November interest rate decision. The government securities yield curve shifted downward. The 3-month BUBOR fell by 63 basis points to 10.32 percent.

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



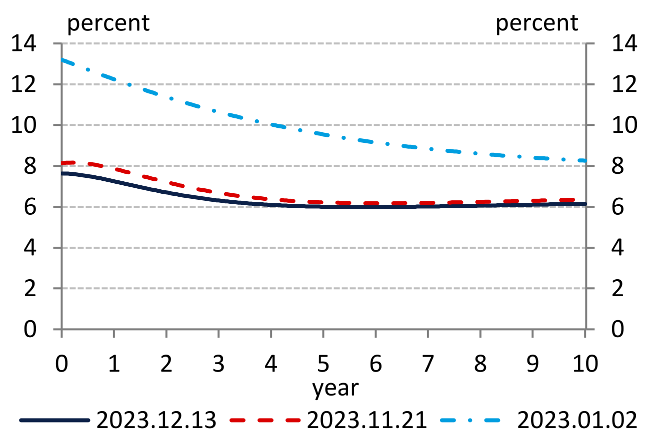
Source: Bloomberg

Overall, the forint has strengthened somewhat against the euro since the last interest rate decision (Chart 15). In the days following the November interest rate decision, the forint appreciated by 1 percent, before weakening amid the strengthening of the dollar. At the end of the period, there was a significant rebound following positive news concerning the Fed's interest rate decision and the EU funding. Overall, it appreciated by 0.4 percent against the euro over the period. Regional currencies typically strengthened with the zloty appreciating by 1.3 percent and the Czech koruna by 0.4 percent, while the Romanian leu remained practically unchanged.

The 3-month BUBOR, relevant for the monetary policy transmission, has decreased by 63 basis points to 10.32 percent since the last interest rate decision.

The government securities market's yield curve has shifted downwards since the previous interest rate decision (Chart 16). Yields on the medium- and long-term maturities fell by 25 basis points on average, while the section within a year of the yield curve declined by 60 basis points on average.

Chart 16 Shifts in the spot government yield curve



Source: Bloomberg

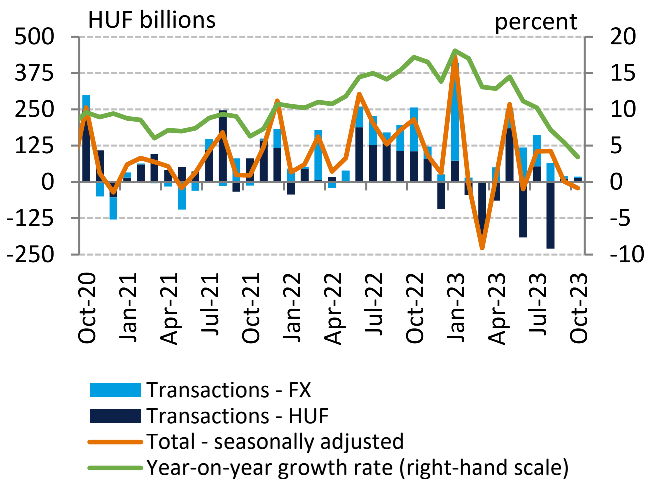
Government securities auctions held by the Government Debt Management Agency (ÁKK) since the last interest rate decision were characterised by adequate demand. During the period under review, the volume of bids submitted was consistently above the announced volume both at the discount Treasury bill and bond auctions, and in most cases the Government Debt Management Agency accepted higher volumes than announced.

Non-residents' holdings of forint government bonds declined. The stock held by non-residents decreased by HUF 171 billion to HUF 6,932 billion. The market share of forint government securities held by non-residents declined to 20.1 percent.

3. Trends in lending

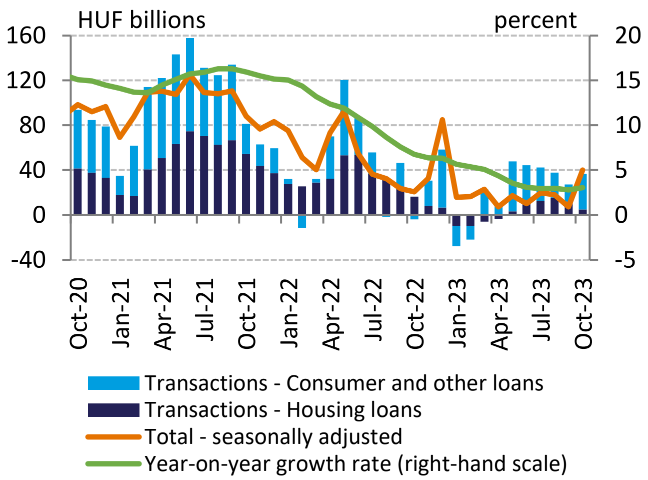
In October 2023, outstanding loans to non-financial corporations increased by HUF 19 billion, due to the rise of HUF 13 billion in forint loans and of HUF 6 billion in foreign currency loans. In October, households' outstanding borrowing increased by HUF 37 billion due to transactions improving the annual growth rate slightly to 3.0 percent from 2.8 percent last month. Compared to the previous month, the smoothed interest rate spread on forint corporate loans decreased slightly by 0.15 percentage points to 2.67 percentage points in October 2023.

Chart 17 Net borrowing by non-financial corporations



Source: MNB

Chart 18 Net borrowing by households



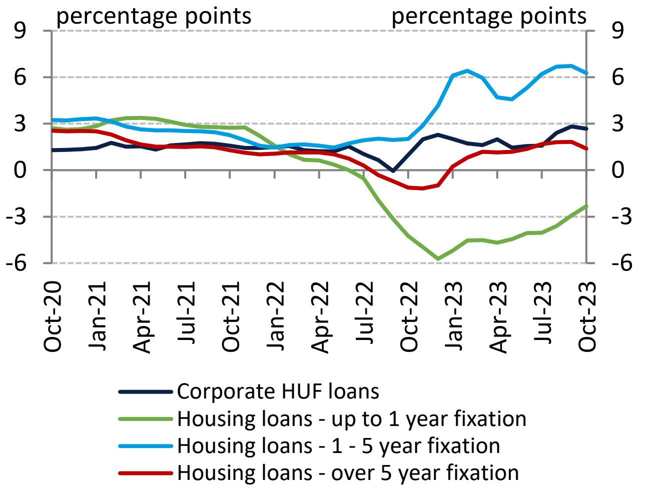
Source: MNB

In October 2023, outstanding loans to non-financial corporations increased by HUF 19 billion, due to the rise of HUF 13 billion in forint loans and of HUF 6 billion in foreign currency loans (Chart 17). As a result, the annual growth rate slowed to 3.4 percent from 5.4 percent registered in the previous month. Credit institutions issued new non-overdraft corporate loans in the amount of HUF 206 billion during the month, down by 19 percent from the same period last year.

In October, outstanding borrowing to households increased by HUF 37 billion due to transactions, whereby the annual rate of growth rose moderately to 3.0 percent from 2.8 percent in the previous month (Chart 18). The HUF 150 billion volume of new household loan contracts was 10 percent higher than in the same period of the previous year. The expansion can be attributed to an increase in personal loan issuance on the one hand, and to demand brought forward induced by the changes in prenatal baby loan conditions effective from January 2024 on the other. New housing loan volumes declined year-on-year.

Compared to the previous month, the smoothed interest rate spread on forint corporate loans decreased slightly by 0.15 percentage points to 2.67 percentage points in October 2023 (Chart 19). In the case of housing loans, compared to the previous month the spread on products with interest rate fixation for more than 5 years decreased significantly by 0.44 percentage points to 1.40 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