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BACKGROUND DISCUSSION AFTER THE MONETARY COUNCIL'S 26 MARCH DECISION

Analyst background discussion

26 March 2024



MAIN MESSAGES: MONETARY POLICY

- **Domestic and external demand pressures** in the Hungarian economy **are low** and have a disinflationary effect. **Underlying inflation is driven by two opposing factors:** the depreciation of the forint and the weaker cyclical position of the real economy.
- **We have entered a new phase regarding our financial markets, the increasing risk aversion justifies a slower pace of base rate cuts than in February.**
- With today's decision, **the phase of monetary policy operating with large steps is concluded.**
- **Monetary policy is entering a new phase. In the second quarter, the pace of interest rate cuts will be slower.**
- **A tight monetary policy stance is still required. Financial market stability is key to the sustainable achievement of the inflation target.**
- **Current interest rate expectations of 6.5-7 percent by the end of the first half of the year are realistic. This continues to represent a stable, positive real interest rate environment.**
- **Considering the changes in the global risk environment, an increasingly careful approach to monetary policy is warranted in the second half of the year.**



MAIN MESSAGES: MONETARY POLICY DECISIONS

- **At its meeting today, the Council cut the base rate by 75 basis points to 8.25 percent.**
- **Accordingly, the lower bound of the interest rate corridor, i.e. the O/N deposit rate, will be reduced to 7.25 percent, while the upper bound, i.e. the O/N lending rate, will be lowered to 9.25 percent.**
- **In line with its practice in past quarters, the MNB ensures the maintenance of financial market stability using two instruments with maturity extending beyond the end of the quarter: T/N FX swap tenders announced on a daily basis, and weekly discount bill auctions.**
- **To achieve price stability in a sustainable manner, a careful approach to monetary policy is warranted. In the coming months, The Monetary Council will make decisions on any further reductions in the base rate and their optimal pace in a data-driven manner.**



MAIN MESSAGES: MACROECONOMIC ASSESSMENT AND OUTLOOK

- **Disinflation is strong and general in the Hungarian economy. The strong tightness of the labour market has eased.**
- **Inflation will temporarily rise in the middle of this year. In 2024, average inflation may be lower than our previous forecast, annual inflation is expected to be between 3.5 and 5.0 percent.**
- **The anchoring of inflation expectations, the maintenance of financial market stability and the disciplined monetary policy are crucial for the consumer price index to return into the central bank tolerance band on a sustained manner from next year.**
- **In 2024 the gradual increase in Hungary's GDP will be supported by domestic demand components. Domestic GDP is expected to rise by 2.0–3.0 percent in 2024, by 3.5–4.5 percent in 2025 and by 3.0–4.0 percent in 2026.**
- **Risk aversion towards emerging market currencies has increased.** In the case of the world's leading central banks, expected interest rate paths shifted upwards relative to the beginning of the year, which was accompanied by rises in long-term yields in developed markets.

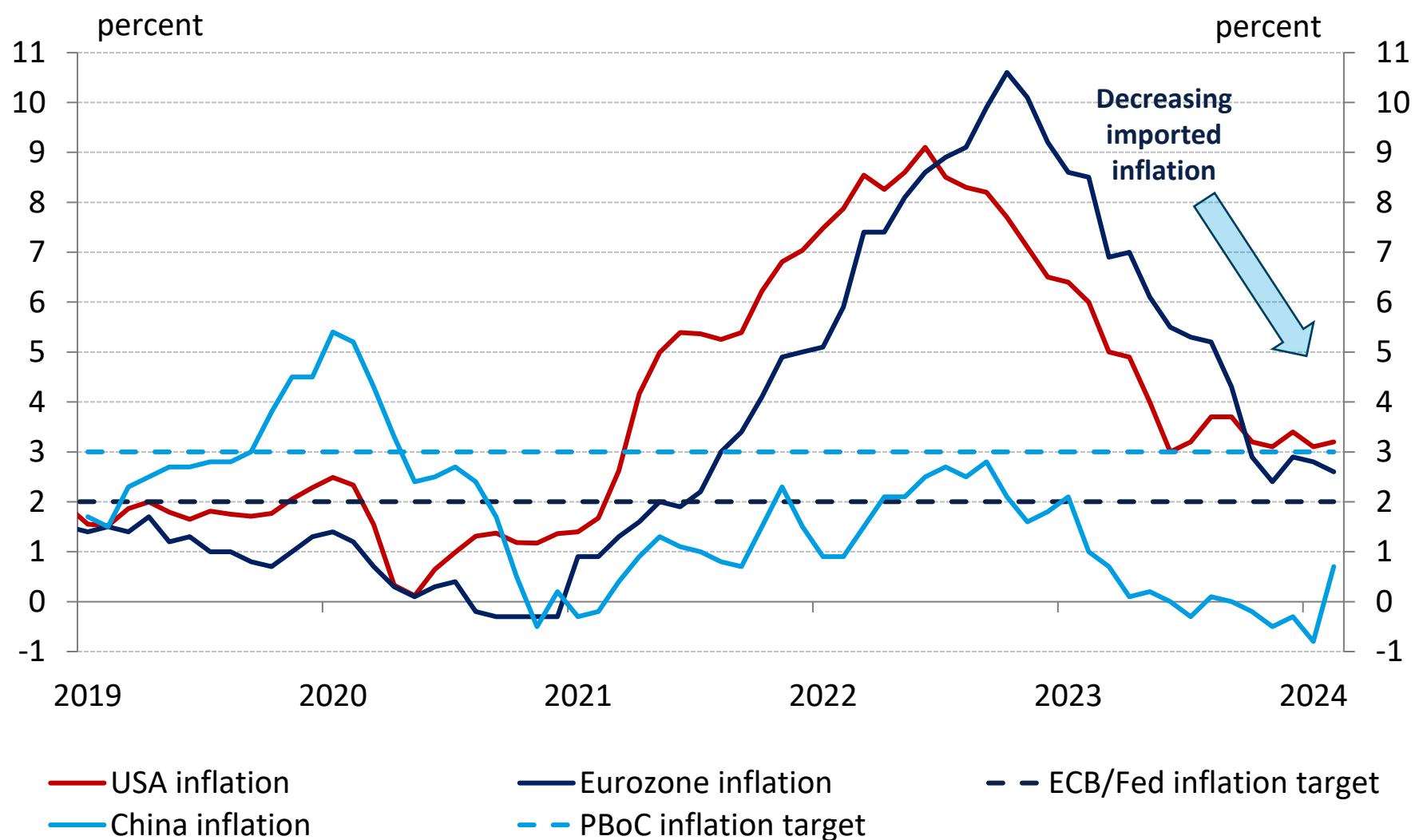


MACROECONOMIC ASSESSMENT AND OUTLOOK





THE INFLATION HAS REACHED A LOW LEVEL GLOBALLY...

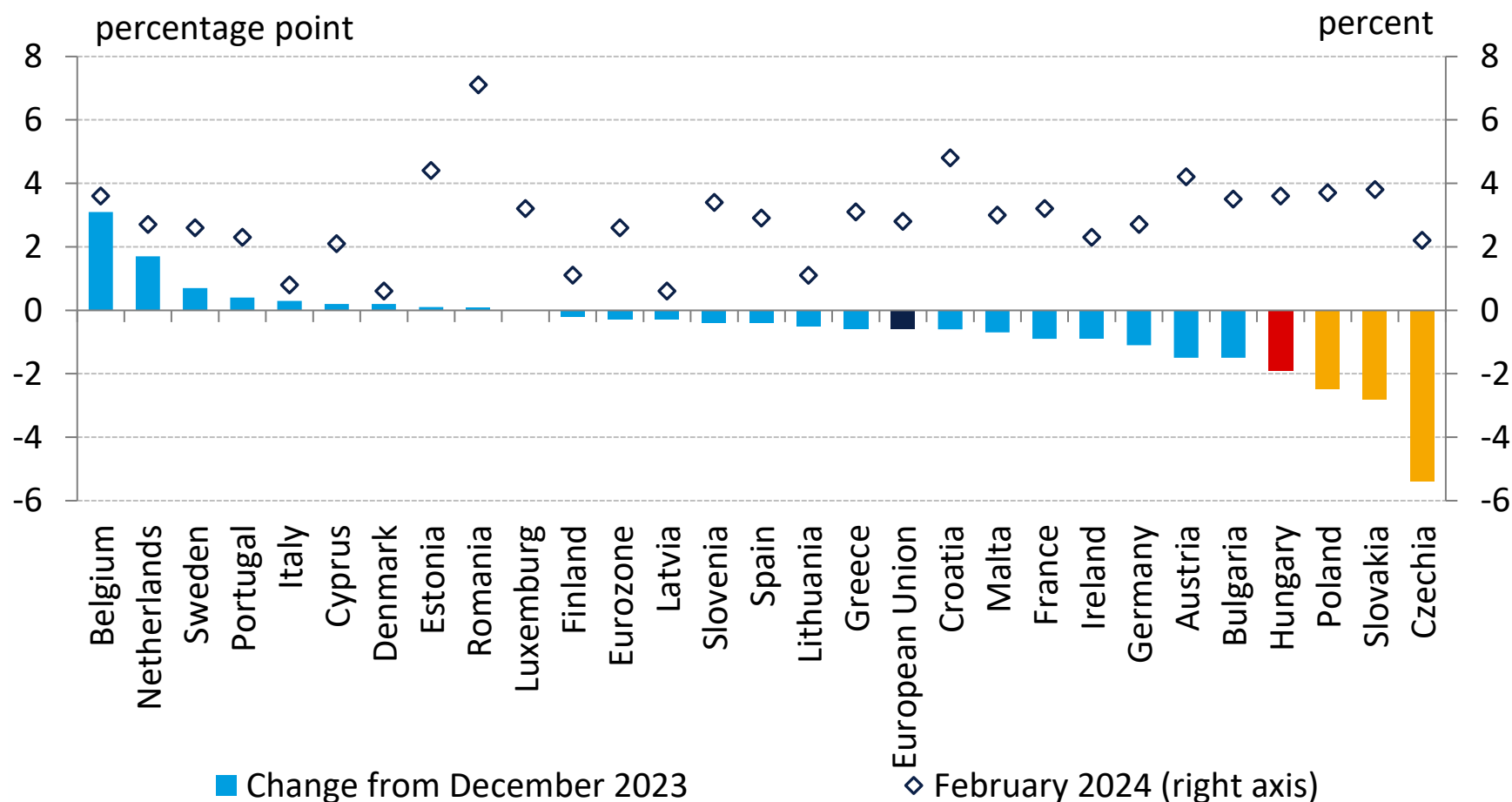


INFLATION IN THE USA, CHINA AND THE EURO AREA

Source | Eurostat, OECD



...BUT EXTERNAL DISINFLATION HAS SLOWED DOWN COMPARED TO DECEMBER

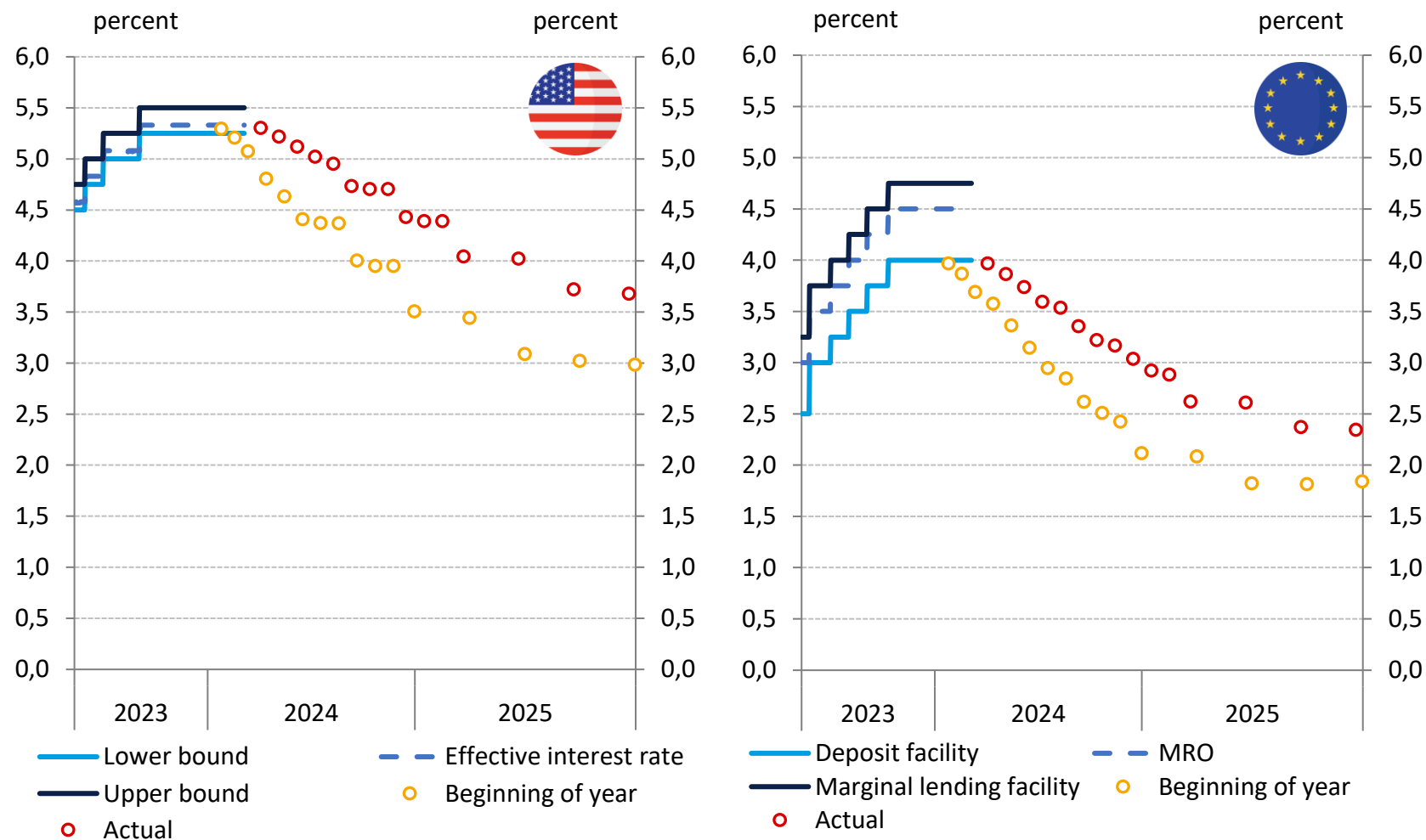


INFLATION IN FEBRUARY 2024 AND THE CHANGE IN ANNUAL INFLATION BETWEEN DECEMBER 2023 AND FEBRUARY 2024

Note | Based on HICP data.
Source | Eurostat, MNB



IN THE CASE OF THE FED AND THE ECB, EXPECTED INTEREST RATE PATHS BASED ON MARKET PRICINGS, SHIFTED UPWARDS RELATIVE TO THE BEGINNING OF THE YEAR

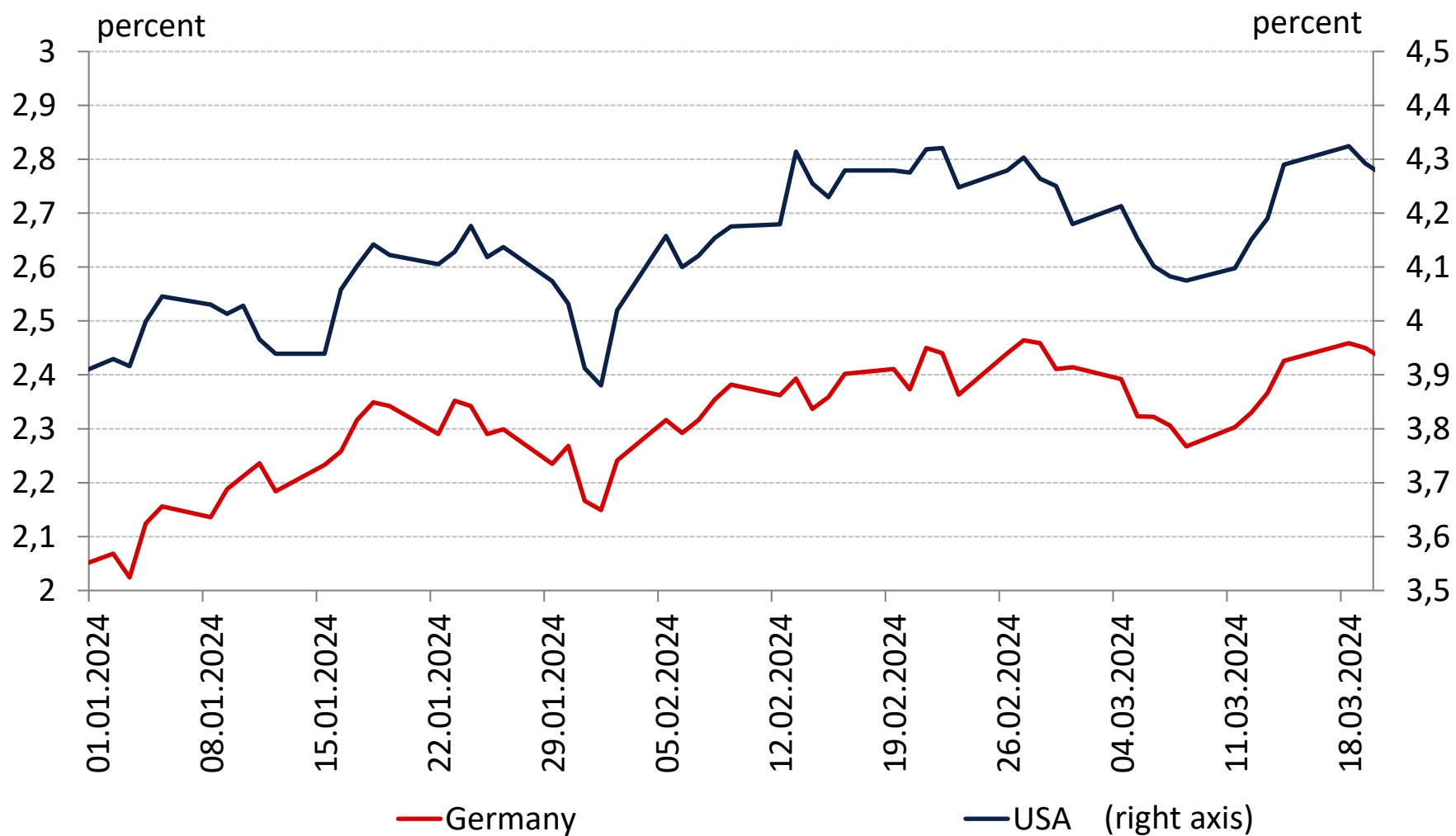


EXPECTED INTEREST RATE PATHS OF THE FED AND THE ECB BASED ON MARKET PRICINGS

Source | Bloomberg



LONG-TERM YIELDS IN DEVELOPED MARKETS ALSO INCREASED IN THE FIRST MONTHS OF 2024

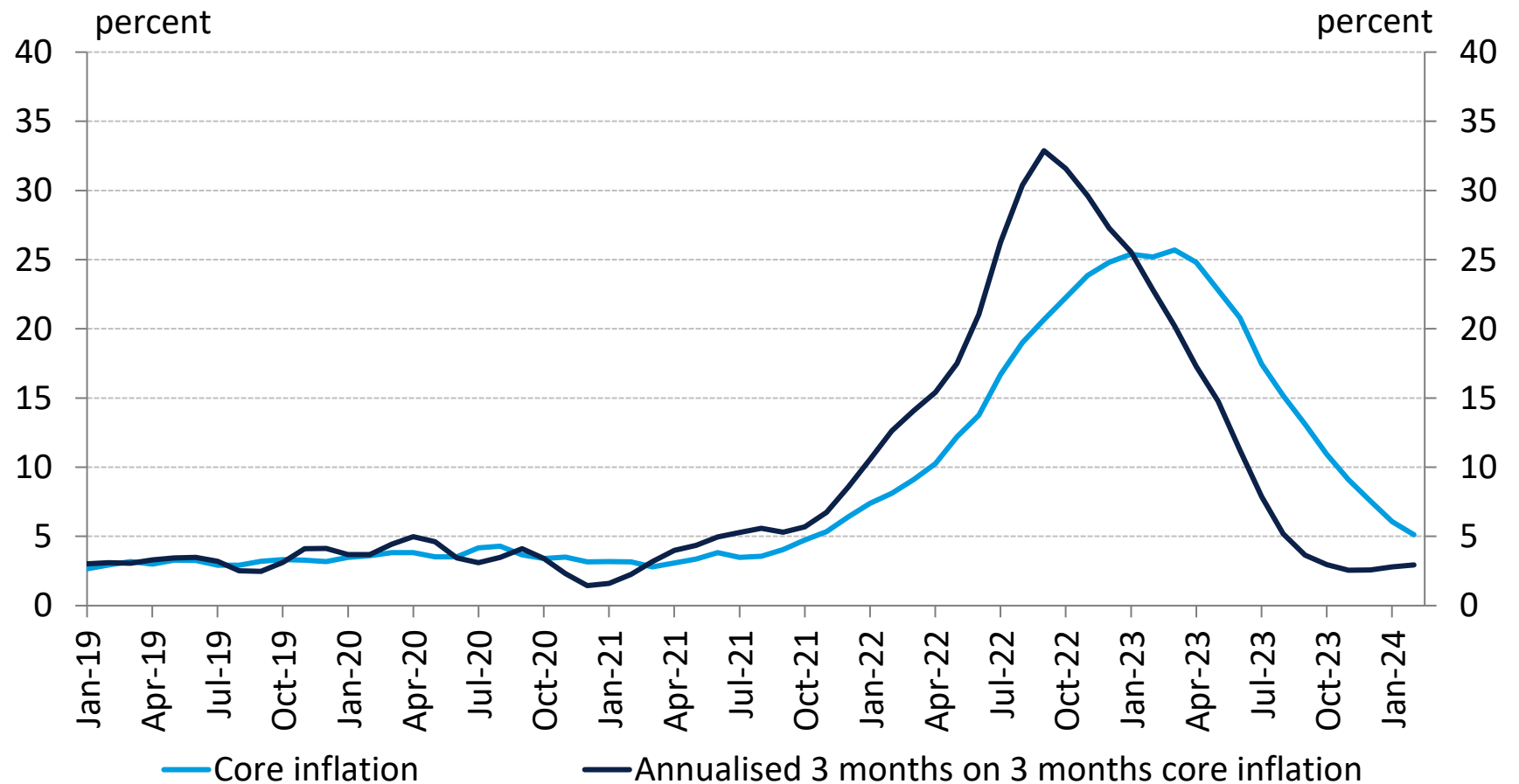


DEVELOPMENTS IN LONG-TERM GOVERNMENT BOND YIELDS

Source | Bloomberg



ANNUALISED 3 MONTHS ON 3 MONTHS CORE INFLATION HAS BEEN BELOW 3 PERCENT SINCE OCTOBER



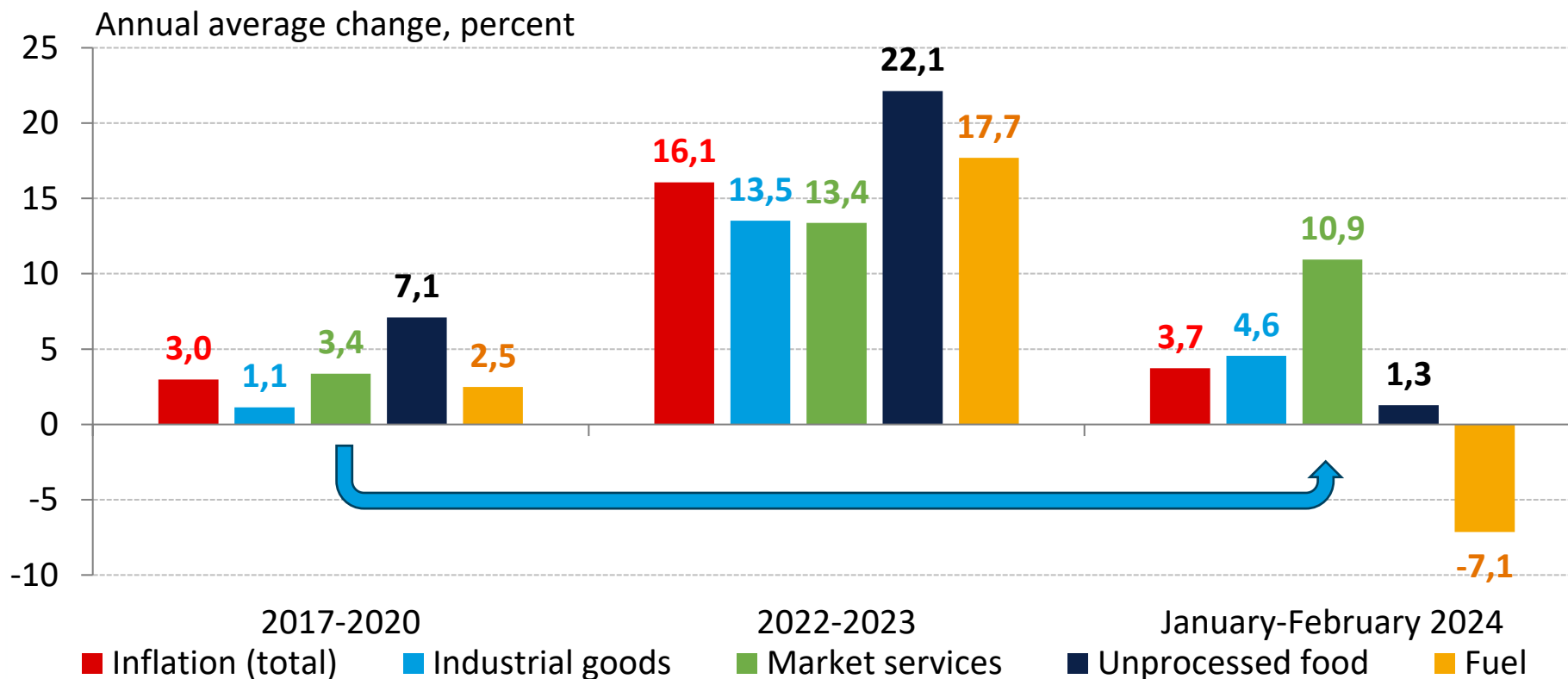
DEVELOPMENTS OF CORE INFLATION AND ANNUALISED 3 MONTHS ON 3 MONTHS CORE INFLATION

Note | Based on seasonally adjusted data.
Source | HCSO, MNB



THE STRUCTURE OF INFLATION HAS CHANGED, AS SERVICES INFLATION HAS INCREASED SIGNIFICANTLY

Lower imported inflation than previously is key to achieving the inflation target.

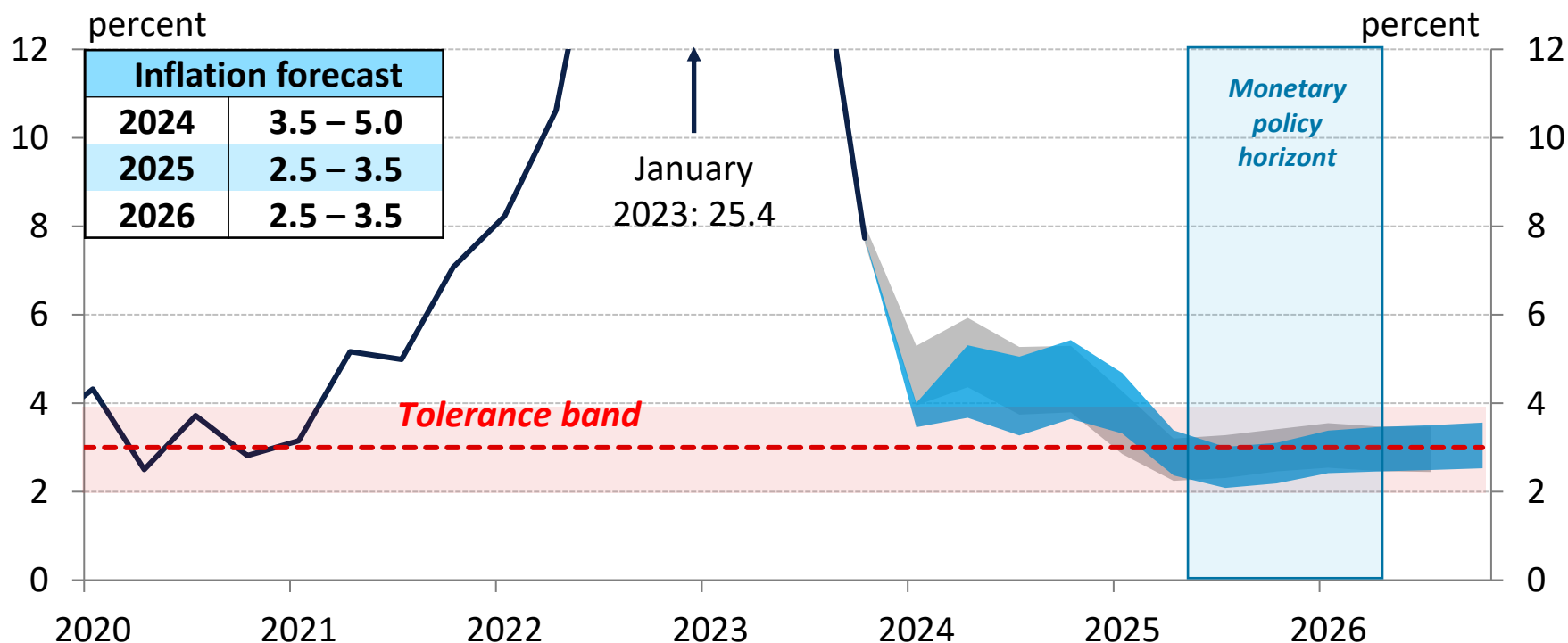


THE AVERAGES OF ANNUAL PRICE INCREASES OF CERTAIN MAIN INFLATION GROUPS IN RECENT YEARS

Source | HCSO, MNB



THE INFLATION TARGET WILL BE REACHED IN A SUSTAINABLE MANNER IN 2025



Forecast range in December
 Actual forecast range
 Inflation
 Inflation target

INFLATION FORECAST

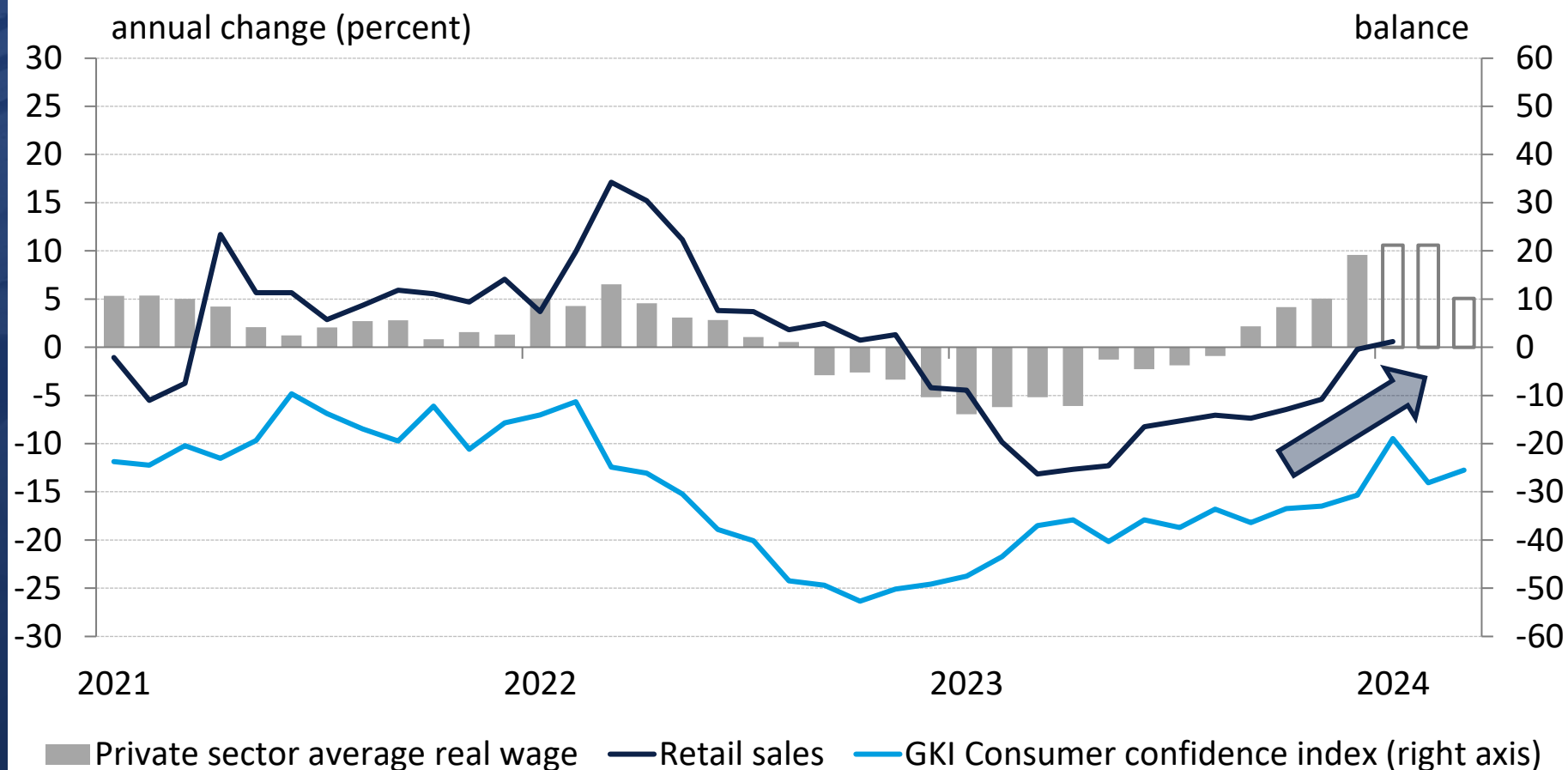
Source | HCSO, MNB

Crucial conditions of price stability:

- Anchored inflation expectations
- Maintenance of financial market stability
 - Disciplined monetary policy



AS PUBLIC CONFIDENCE IMPROVED, CONSUMPTION BEGAN TO EXPAND, BUT CAUTION ONLY GRADUALLY DISSIPATES



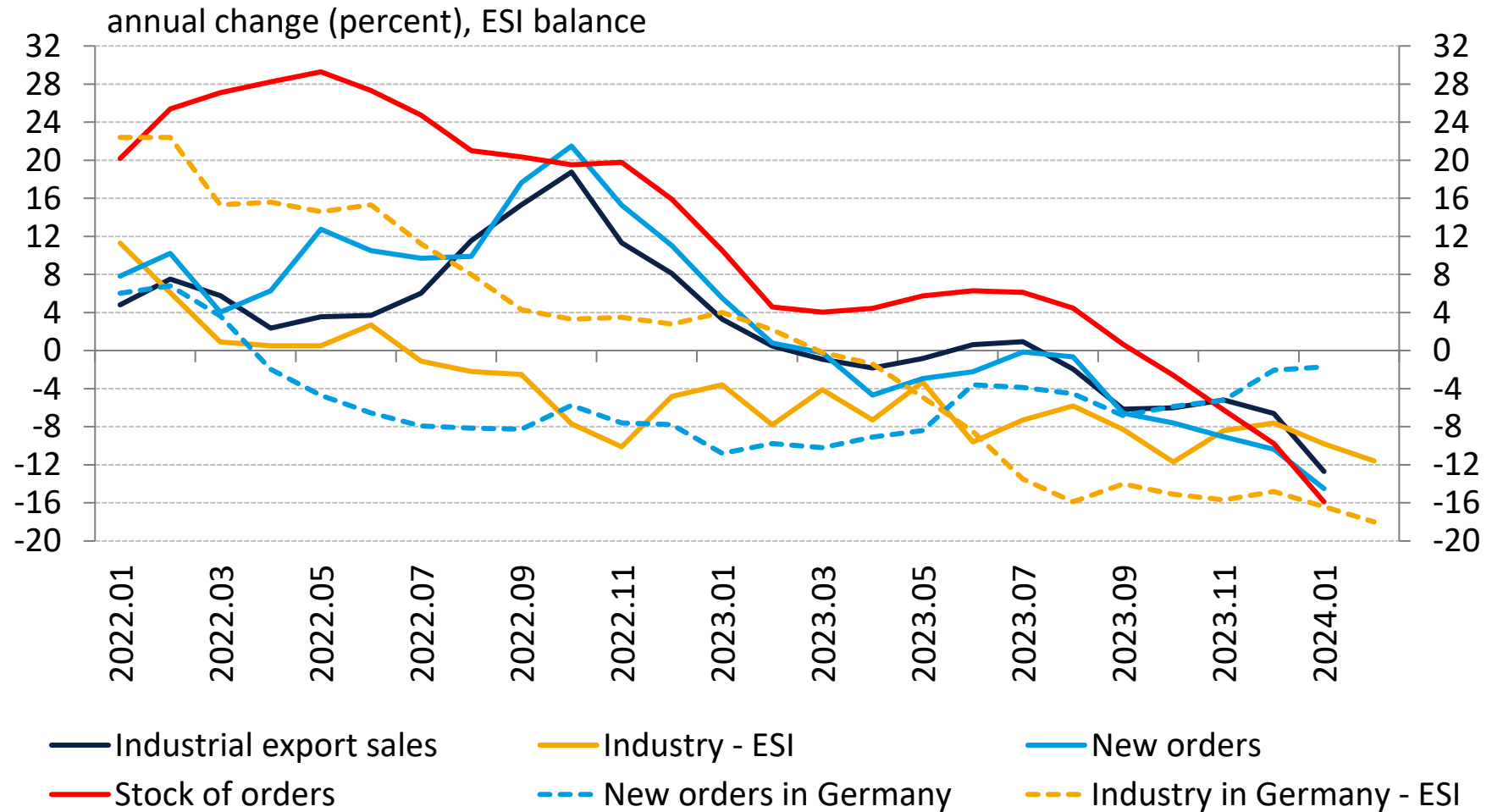
DEVELOPMENTS IN THE RETAIL SALES, PRIVATE SECTOR AVERAGE REAL WAGE AND THE GKI CONSUMER CONFIDENCE INDEX

Note | Retail sales with calendar-adjusted data, consumer confidence index with seasonally and calendar-adjusted data. The private sector average real wage data for 2024 Q1 based on the midpoint of our forecast in the March 2024 Inflation Report.

Source | HCSO, MNB, GKI Gazdaságkutató Zrt.



THE FORWARD-LOOKING INDICATORS SUGGEST A LASTING WEAKNESS OF EXTERNAL DEMAND



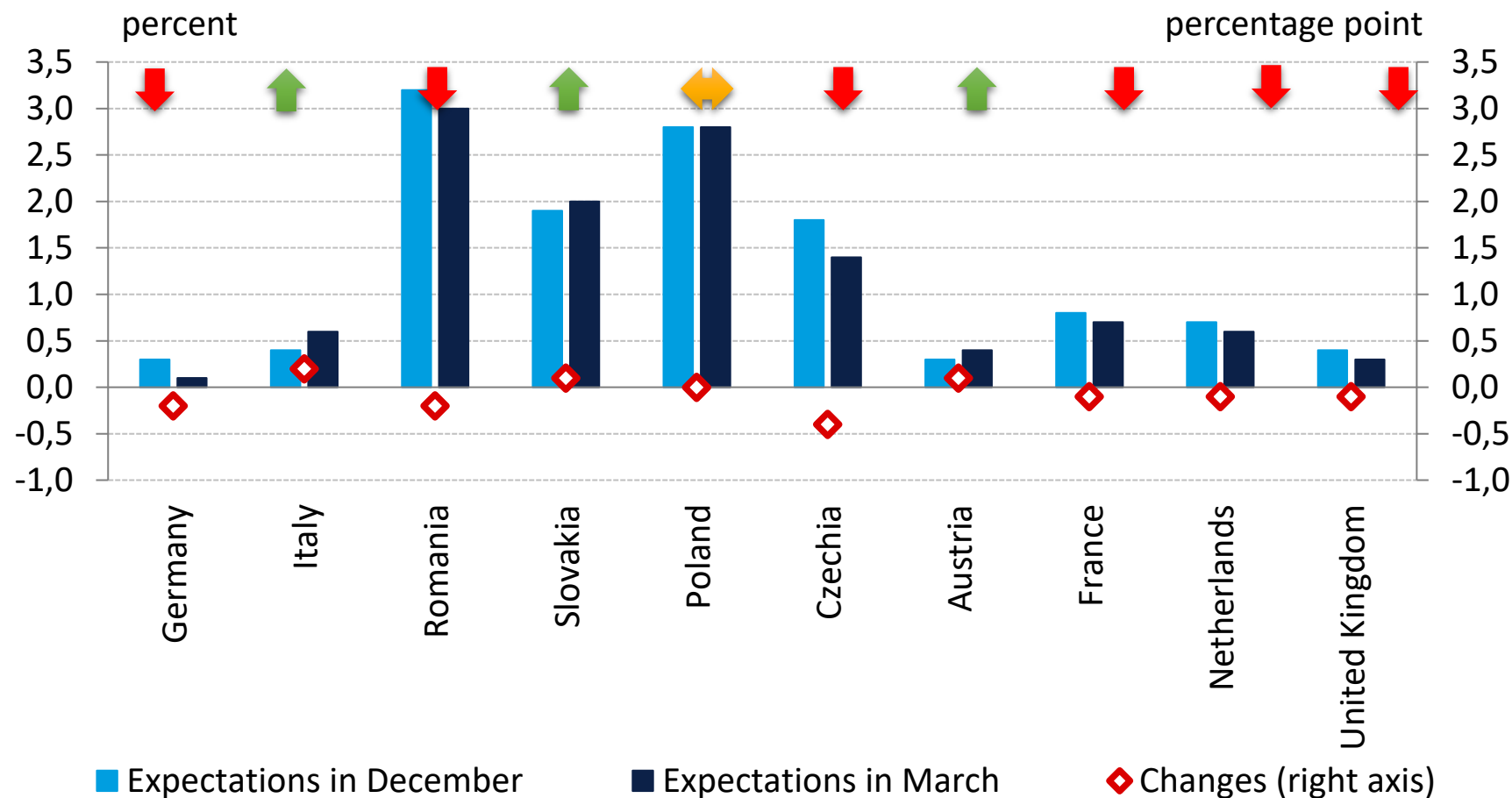
DEVELOPMENT OF INDICATORS DETERMINING THE INDUSTRIAL AND EXTERNAL ECONOMY

Note | New orders, stock of orders, and sales are based on a 3-month moving average.

Source | Destatis, European Commission, HCSO



GROWTH EXPECTATIONS HAVE DETERIORATED IN THE MAJORITY OF OUR MOST IMPORTANT EXPORT PARTNERS

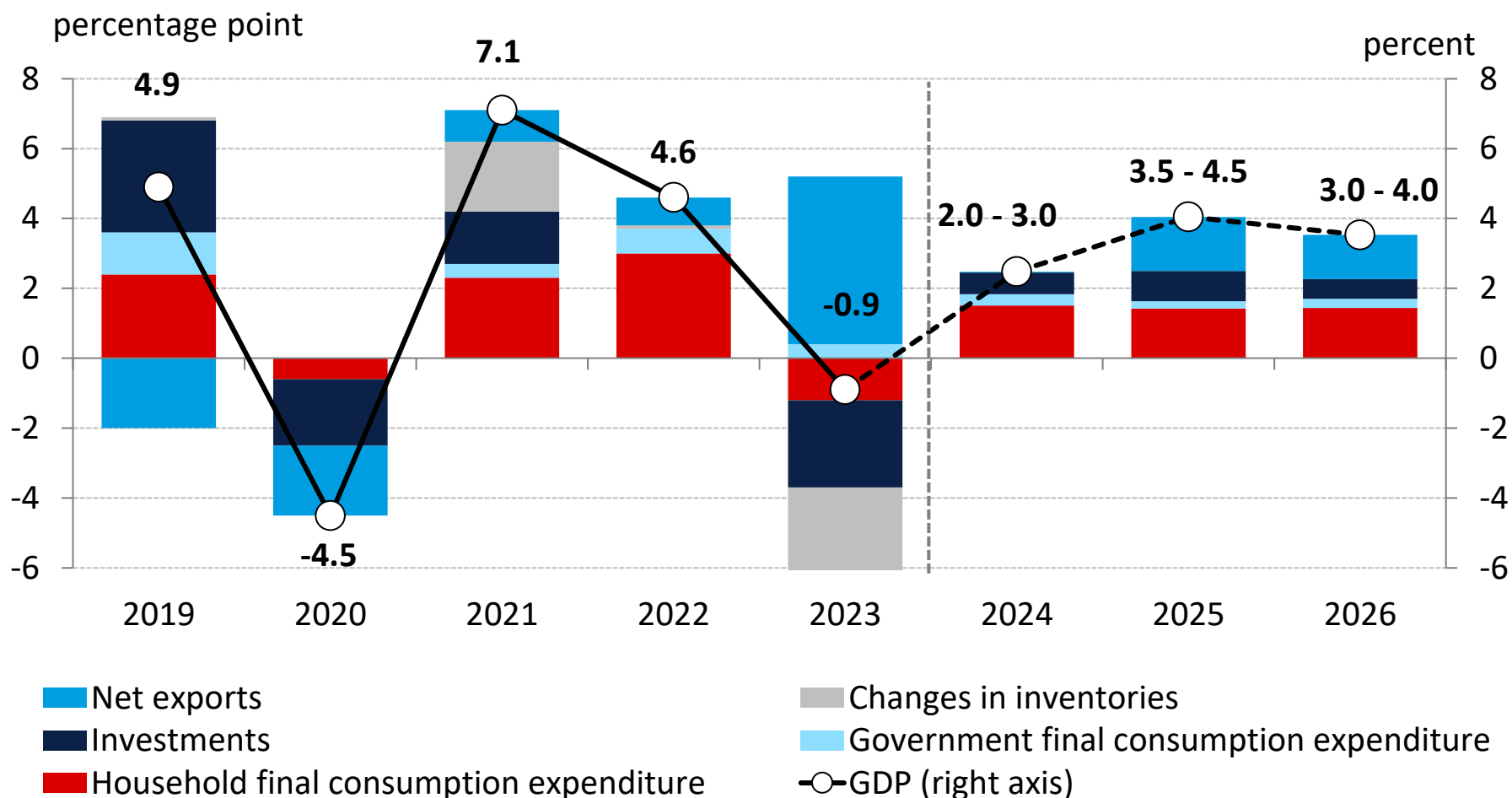


ECONOMIC GROWTH OF OUR FOREIGN MARKETS IN 2024 ACCORDING TO MARKET EXPECTATIONS

Source | Bloomberg



INTERNAL EXPENDITURE WILL INCREASE GDP THIS YEAR, AND NET EXPORTS MAY BE POSITIVE AGAIN FROM 2025



EXPENDITURE SIDE DECOMPOSITION AND FORECAST OF GDP

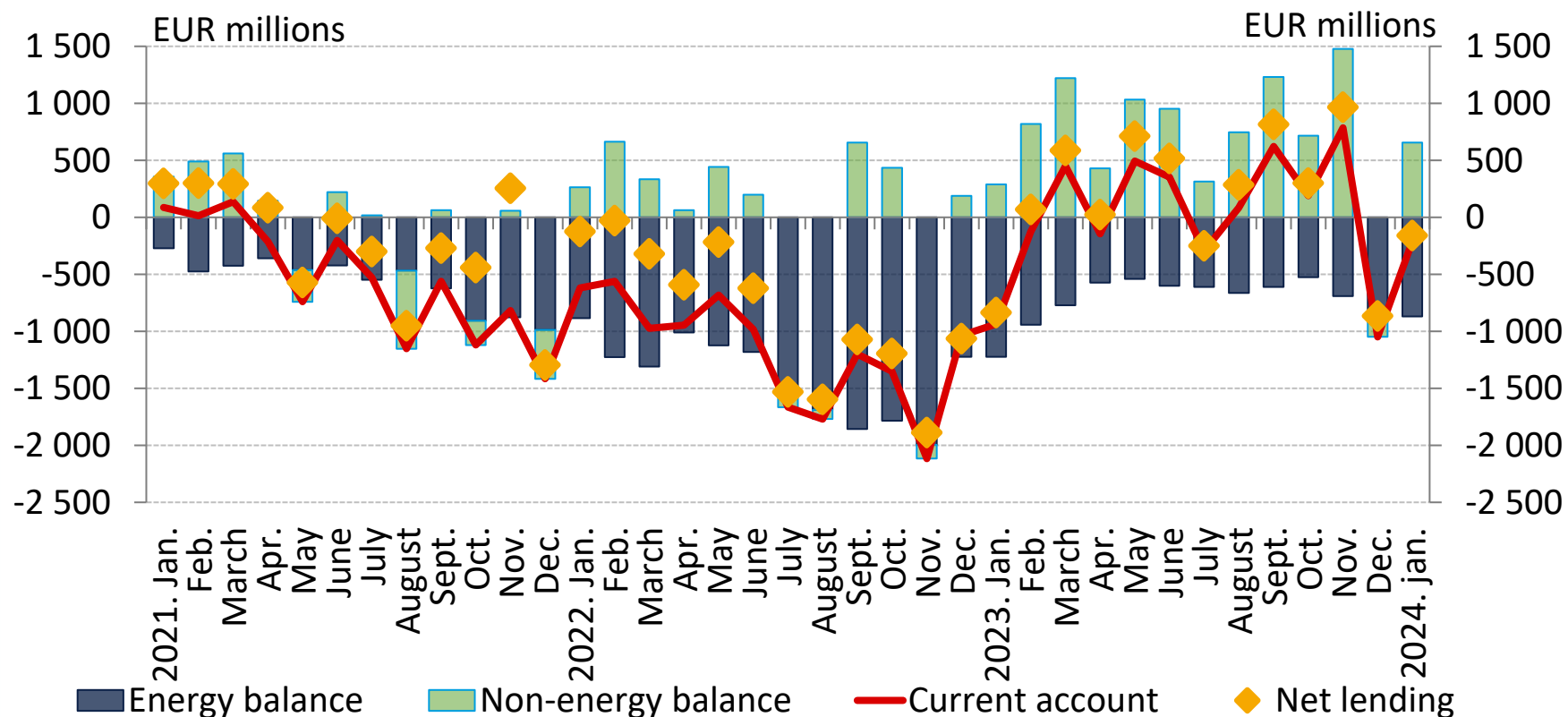
Note | Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.

Source | HCSO, MNB



IN 2023, THE CURRENT ACCOUNT DEFICIT DECREASED SIGNIFICANTLY COMPARED TO BOTH LAST MONTH AND THE SAME PERIOD LAST YEAR

The current account balance relative to GDP is expected to improve slightly in 2024 and to a greater extent in the coming years. The net lending position of the economy, which also takes into account the capital balance, continues to improve this year.



DEVELOPMENTS IN CURRENT ACCOUNT, NET LENDING AND ENERGY BALANCE

Note | The last monthly value of the energy balance is estimated.

Source | HCSO, MNB



MONETARY POLICY

DOMESTIC DISINFLATION IS STRONG AND BROAD-BASED, HOWEVER THE DEVELOPMENT IN THE RISK ENVIRONMENT WARRANTS CAUTION

INTERNATIONAL FACTORS



External disinflation has continued, albeit at a slower pace.



The risk perception of emerging markets is volatile.



The MNB is closely monitoring geopolitical tensions in the Middle East and their potential inflationary risks.



The expected interest rate paths of the world's leading central banks have shifted upwards relative to the beginning of the year, which have been accompanied by rises in long-term yields in developed markets.

DOMESTIC DEVELOPMENTS



Domestic disinflation is strong and broad-based.

Inflation is lower than analysts' expectations.

Short-base inflation indicators already show pre-2020 patterns.



Following last year's improvement, the current account surplus will continue to increase over the forecast horizon.



The risk premium on Hungarian assets has also risen recently.



Favourable news have appeared in connection with EU cohesion funds.



THE MONETARY COUNCIL'S MARCH INTEREST RATE DECISION

Central bank instrument	Interest rate	Previous interest rate (percent)	New interest rate (percent)
Central bank base rate		9.00	8.25
O/N deposit rate	Central bank base rate minus 1.00 percentage points	8.00	7.25
O/N collateralised lending rate	Central bank base rate plus 1.00 percentage points	10.00	9.25



THE MNB PAYS SPECIAL ATTENTION TO A NUMBER OF FACTORS WHEN SHAPING THE INTEREST RATE POLICY

INFLATION

Inflation **will temporarily increase in the middle of this year** due to the retrospective pricing of market services, and base effects.

The question is **how inflation will develop in the second half of the year**. In this a **key element is the anchoring of expectations**.

RISK PERCEPTION

From the point of view of the country's risk assessment, the **credible fulfillment of budget deficit targets** is of particular importance.

Another key factor in risk assessment is this year's **external balance developments**.

INTERNATIONAL MONETARY POLICY ENVIRONMENT

Looking ahead, it is still a question of **when the first interest rate cuts will be scheduled in the case of the globally important central banks and what kind of interest rate paths can be expected after that**.

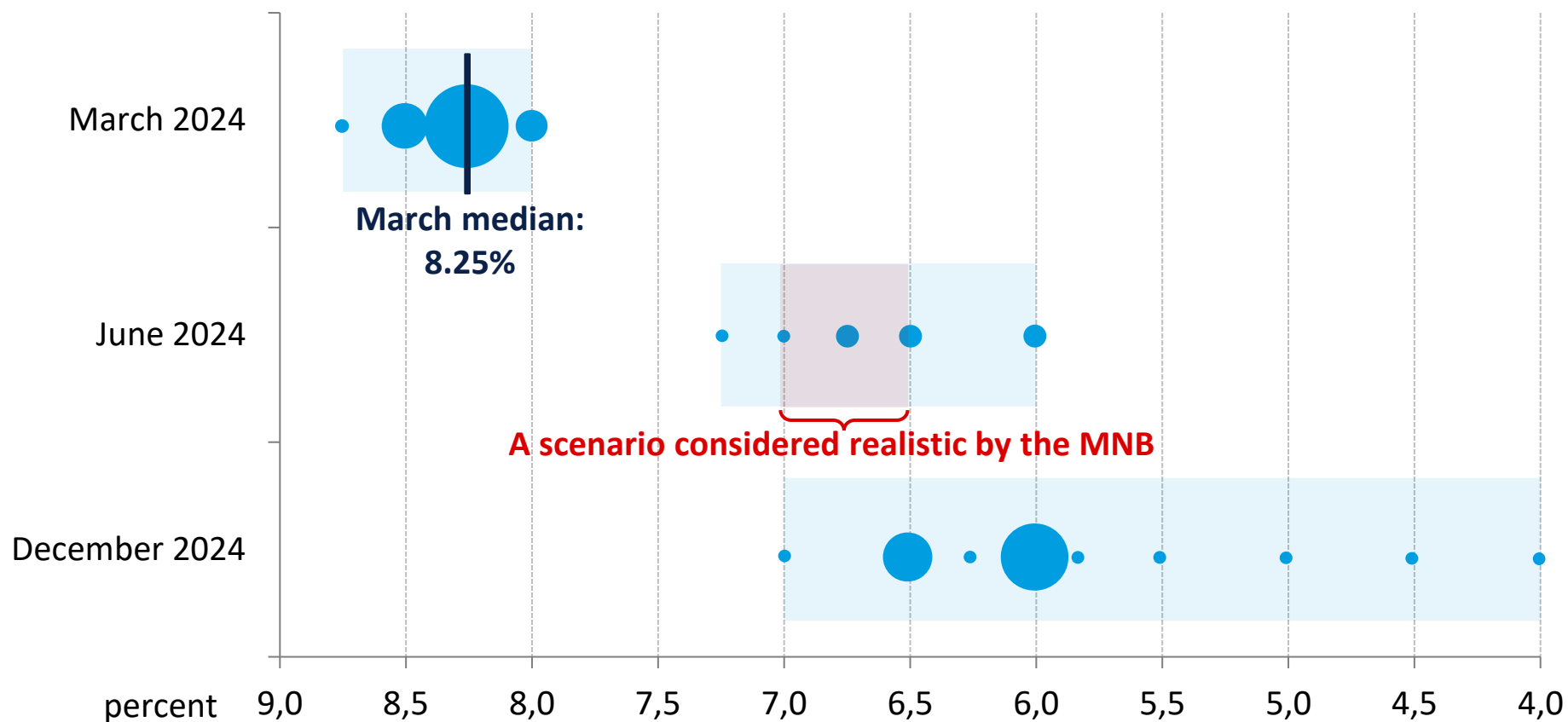
FINANCIAL MARKET STABILITY

In a volatile international sentiment, a key question is **whether risks will appear that could threaten the development of the forint exchange rate or domestic yields**.

Looking ahead, all of these justify a cautious monetary policy.



CURRENT INTEREST RATE EXPECTATIONS OF 6.5-7 PERCENT BY THE END OF THE FIRST HALF OF THE YEAR ARE REALISTIC.



DEVELOPMENT OF ANALYSTS' EXPECTATIONS FOR THE COMING PERIOD

Note | The light blue bands are the range of interest rate expectations, and the circles are proportional to the frequency of the given expectation.

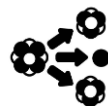
Source | Investment banking analyses, Bloomberg, Portfolio.hu, Reuters



FINANCIAL MARKET STABILITY IS KEY FROM THE VIEWPOINT OF INFLATION, THE ASSESSMENT OF DOMESTIC ASSETS AND STATE BUDGET



Exchange rate pass-through has strengthened in Hungary.



The structure of inflation has changed, lower imported inflation than previously is key to achieving the inflation target.



The share of foreign debt has risen recently, stability helps mitigate risks related to the state budget.



Financial market stability increases trust in Hungarian assets, which is key to the financing of the domestic economy and the state.



A stable, predictable financial market environment is in the interest of the Hungarian economy.



THE MONETARY COUNCIL'S FORWARD GUIDANCE

*„Risks surrounding global disinflation, volatility in international investor sentiment and the temporary rise in domestic inflation, expected in the middle of the year **warrant a careful approach to monetary policy in the coming months.** 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.**”*

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