INFLATION REPORT

2024
MARCH

'... wise is the man who can put purpose to his desires.'

Miklós Zrínyi: The Life of Matthias Corvinus

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Pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the primary objective of Hungary's central bank is to achieve and maintain price stability. Low inflation ensures higher long-term economic growth and a more predictable economic environment, and moderates the cyclical fluctuations that impact both households and companies.

In the inflation targeting system in use since August 2005, the Bank has sought to attain price stability by ensuring an inflation rate near the 3-per cent medium-term target. The Monetary Council, the supreme decision-making body of the Magyar Nemzeti Bank, performs a comprehensive review of expected developments in inflation every three months, in order to establish the monetary conditions consistent with achieving the inflation target. The Council's decision is the result of careful consideration of a wide range of factors, including an assessment of prospective economic developments, the inflation outlook, financial and capital market trends and risks to stability.

In order to provide the public with a clear insight into how monetary policy works and to enhance transparency, the Bank publishes the information available at the time of making its monetary policy decisions. The Report presents the inflation forecasts prepared by the Directorate Economic Forecast and Analysis, the Directorate Monetary Policy and Financial Market Analysis, the Directorate for Fiscal Analysis and the Directorate Financial System Analysis, as well as the macroeconomic developments underlying these forecasts. The forecast is based on the assumption of endogenous monetary policy. In respect of economic variables exogenous to monetary policy, the forecasting rules used in previous issues of the Report are applied.

The analyses in this Report were prepared under the general direction of the acting Director Responsible for Economic and Fiscal Analyses and Statistics. The Report was prepared by staff at the MNB's Directorate Economic Forecast and Analysis, Directorate Monetary Policy and Financial Market Analysis, Directorate for Fiscal Analysis, Directorate Financial System Analysis and Directorate for International Monetary Policy Analysis and Training of Economic Sciences. The Report was approved for publication by Barnabás Virág, Deputy Governor responsible for Monetary Policy, Financial Stability and International Relations.

The Report incorporates valuable input from other areas of the MNB and the Monetary Council's comments.

The projections are based on information available for the period ending 21 March 2024.

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The Monetary Council's key findings related to the Inflation Report

The primary objective of the Magyar Nemzeti Bank (MNB) is to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserves financial stability and supports the Government's economic policy, as well as its policy on environmental sustainability.

The short-term outlook for economic growth in Europe is still exposed to downside risks, which is further exacerbated by the generally tense geopolitical situation.

In 2023 Q4, the economy in the European Union expanded by 0.2 percent compared to the same period last year. The subdued growth was mainly due to uncertain consumer sentiment and the lingering effects of the previous energy crisis. Output in Germany, Hungary's main trading partner, fell by 0.2 percent year-on-year. In the same period, US GDP grew by 3.1 percent year-on-year, while in China an annual growth of 5.2 percent was recorded. In China, the fall in the real estate sector and fragile consumer confidence continue to dampen domestic demand, while the government takes measures to support growth.

In the European Union, the steady disinflation that has been ongoing since the inflation peak in October 2022 came to a halt at the end of last year.

Inflation in the euro area fell further in February and stood at 2.6 percent. At the same time, the rapid disinflation seen earlier at the European level slowed. Inflation rose in 9 of the 27 EU member states between December 2023 and February 2024. Inflation continued to fall in the region's countries, with prices rising in February by 3.8 percent in Slovakia, 3.7 percent in Poland and 2.2 percent in the Czech Republic year-on-year. In the United States, inflation continues to exceed the central bank's target and fluctuates above 3 percent; it was 3.2 percent in February.

Based on market pricing, world's leading central banks have reached the peak of their interest rate paths, while in the region, the Czech central bank cut its base rate and the Polish and Romanian central banks kept it unchanged over the past quarter.

In the United States, the Federal Reserve (Fed) maintained the target range of the federal funds rate at 5.25–5.50 percent. According to the central bank's communication, the interest rate path may have peaked, and interest rate cuts may start still this year. In addition, the Fed continued the gradual reduction of its balance sheet. The European Central Bank (ECB) did not change its policy rates over the past quarter. According to the President of the ECB, interest rate cuts may start in the summer. The central bank aims to reduce the PEPP portfolio by an average of EUR 7.5 billion per month in 2024 H2 and to close reinvestments completely by the end of 2024.

In the region, the Czech central bank continued the interest rate cut, started by 25 basis points in December last year, by 50 basis points in March, the same pace as in February, reducing the policy rate to 5.75 percent. The central bank of Poland kept its policy rate unchanged at 5.75 percent and the central bank of Romania at 7.0 percent over the past quarter. In line with the previous quarter's steps, the Magyar Nemzeti Bank cut the base rate by 75 basis points also in January, and then reduced it temporarily by a larger pace of 100 basis points, to 9 percent by the end of February.

Overall, global investor sentiment has been volatile over the past quarter.

Over the past period, asset price developments in international markets have been driven mainly by expectations of interest rate policies of the world's leading central banks. Market participants have postponed their expectations for the start of the rate cut cycles, based on statements from central bank decision makers and higher-than-expected inflation data in the US and euro area.

Geopolitical conflicts in the Middle East remain a major risk. Attacks on merchant ships in the Red Sea have threatened the continuity of production chains, increased delivery times and raised freight cost. Market participants also paid particular attention to macroeconomic data publications and concerns about the Chinese economy.

Oil prices have been fluctuating around USD 85 per barrel recently, while European gas prices, after a steady decline from mid-October last year, rose slightly in March but remained at a low level. The rise in oil prices was caused on the one hand by the OPEC+'s extended production cut until the middle of the year, and on the other hand by the ongoing conflict in the Middle East. The moderation in gas prices in recent months has been supported by high filling levels of the gas storage facilities in Europe, while the moderate price increase in March was mainly driven by uncertainties surrounding global supply.

The dollar strengthened against developed market currencies. The strengthening of the dollar was driven by statements made by the Fed's decision makers with a tighter tone than before, which moderated market expectations regarding the start of interest rate cuts. Developed market long-term bond yields and stock market indices rose. Bond yields in emerging markets were mixed but rose in the region.

Over the past quarter, sentiment in domestic financial markets has been less favourable, with the exchange rate of the forint weakening in several waves.

The exchange rate of the forint weakened in several waves over the period. The strengthening in late December and early January was followed by a weakening in the second half of January, and in the following weeks the forint exchange rate against the euro remained broadly unchanged, with minor fluctuations. From the end of February, the exchange rate of the forint weakened again, partly reflecting the upward shift in interest rate paths expected from the world's leading central banks and partly due to country-specific factors.

The 3-month section of the government bond market yield curve moderately shifted upwards, the section shorter than 3 years downwards, and the longer maturities upwards. The rises in long-term yields were mainly driven by international developments, the 5-year credit default swap (CDS) spread continued to decline over the period. Short-term interbank interest rates declined at all maturities, following the decline in the effective interest rate in submarkets.

At the beginning of 2024, inflation was back within the central bank's tolerance band again. Annual average inflation is expected to range between 3.5 and 5.0 percent this year and between 2.5 and 3.5 percent in both 2025 and 2026.

In February 2024, inflation continued to decline in Hungary. Consumer prices rose by 3.7 percent year-on-year. Inflation continues to decelerate broadly, reflecting a combination of the disciplined monetary policy, government measures to strengthen competition, a subdued demand, base effects and a significantly lower external cost environment than in the previous year.

The pace of price increases will temporarily rise in Hungary in the middle of this year due to the backward-looking pricing of market services and base effects. In addition, underlying developments will be shaped by two opposing effects. The weakening of the forint exchange rate in recent weeks points to a rise in imported inflation. On the other hand, the weaker cyclical position of the domestic real economy in the short term has a disinflationary impact. As a result of these two effects, the decline in core inflation, capturing underlying developments, will stop in the second quarter and it is expected to fluctuate between 4.5 and 5.0 percent in the remainder of the year. Subdued food price changes are supported by declining global food commodity prices, as well as government measures generating stronger competition. Annual inflation is expected to be between 3.5 and 5.0 percent this year, indicating lower inflation path compared to the December projection. According to the projection of the MNB, inflation may be between 2.5 and 3.5 percent in 2025 and 2026. Anchoring inflation expectations, preserving 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.

Domestic GDP decreased by 0.9 percent on an annual basis in 2023, while it is expected to expand 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.

Following growth in 2023 Q3, domestic economic output stagnated in Q4. As disinflation continued and real wage dynamics turned positive, household consumption decreased at a more moderate pace at the end of the year compared to the previous quarters. Investment also declined less than in previous quarters, mainly supported by rising public development projects. Corporate investments continued to decrease, with a decline in volumes recorded in sectors producing for domestic and export markets as well. Agriculture reached significantly higher output last year after the drought in 2022, dampening the contraction of the GDP. Last year, domestic exports stagnated while imports declined as domestic demand fell, resulting in a positive net exports contribution to growth in 2023. Labour market tightness has eased in the last months. With a high level of employment, the unemployment rate rose slightly to 4.5 percent in January.

Following the downturn in 2023, a slow recovery began at the beginning of 2024. Economic growth in Hungary may accelerate in the second half of the year. In 2024, with persistently moderating inflation, continuously rising real wages and strengthening confidence, the gradual expansion in Hungary's GDP will be mainly supported by domestic demand components. Export performance is affected by opposing trends. Persistently weak European economic activity is holding back domestic exports, but ongoing and newly announced, significant capacity-enhancing foreign direct investment projects are stimulating them over time. Reflecting weak demand in external markets, the Bank's expectation for this year is lower overall compared to the December projection and is consistent with a growth path of 2.0–3.0 percent. With the pick-up in the production of new export capacities built recently, a balanced economic growth is expected from 2025, and Hungary's export market share is likely to increase. Hungary's GDP is expected to rise by 3.5–4.5 percent in 2025 and by 3.0–4.0 percent in 2026.

The annual growth rate of corporate loan portfolio moderately accelerated in the fourth quarter, while household loans expanded at a slower pace. Demand is expected to recover in both markets in 2024.

The annual growth rate of corporate loans in the total financial intermediary system accelerated by 0.5 percentage points compared to the previous quarter, reaching 6.2 percent at the end of 2023. The annual credit dynamics for micro, small and medium-sized enterprises, which better captures underlying trends, was lower at 3.8 percent at the end of last year. In the fourth quarter, 29 percent of all new disbursements of corporate loans (excluding current account loans) were subsidised. This is lower than the 46 percent share recorded in the first half of the year, which included the intensive contracting period of the Baross Gábor Reindustrialisation Loan Programme. Based on the responses to the Lending Survey, overall corporate lending conditions did not change significantly in the fourth quarter, while around a fifth of banks continued to indicate tightening in commercial real estate loans. In terms of loan demand, 6 percent of banks reported a decline in demand in 2023 Q4, but looking ahead to 2024 H1, the net 23 percent of banks expect demand to increase. Given the still uncertain growth outlook, the annual growth rate of corporate lending may reach 6 percent at the end of 2024, while from the beginning of 2025, the rate of growth may stabilise at around 8–9 percent.

In 2023 Q4, the growth rate of annual household lending slowed slightly from the pace of the previous quarter to 2.4 percent. The value of housing loans contracted by credit institutions in 2023 Q4 was 21 percent higher than the low base in the same period of the previous year, while personal loan issuance was 43 percent higher. HPS Plus, launched in January, and the raised credit amount of the Village HPS and baby support loans have supported credit growth from the beginning of 2024. Based on the responses to the Lending Survey, banks reported rising demand for both housing loans and consumer loans in the fourth quarter, and looking ahead, they expect demand to continue to grow in both segments. The annual growth rate of household lending may reach about 8 percent at the end of 2024, and it is expected to range between 9 and 10 percent from the beginning of 2025.

The current account surplus is expected to rise further.

In 2023, the annual current account balance turned to slight surplus, improving by over 8 percentage points due to lower energy prices, the adjustment of energy consumption and a decline in domestic demand. Exports and imports are expected to grow at nearly the same rate this year, and as a result, the improvement in the trade balance will be driven mainly by an improvement in the terms of trade due to lower energy prices. Overall, the current account balance as a share of GDP is expected to improve slightly in 2024 and to a greater extent in the coming years in parallel with an increase in Hungary's export market share. As a result, the current account surplus will continue to rise over the forecast horizon.

Based on preliminary financial accounts data, the accrual-based deficit of general government was 6.7 percent of GDP in 2023. According to the MNB's projection, the government deficit may decline in 2024 compared to 2023, substantially supported by a fall in energy prices. At the same time, tax revenues may fall short of the Budget Act's target, similar to

2023. The high inflationary environment over the past two years has led to a significant increase in government interest expenditures, which will continue to place a heavy burden on the budget this year as well. Based on preliminary data, gross government debt fell to 73.4 percent of GDP by the end of 2023. For the debt ratio to decline continuously in 2024 and Hungary's risk perception to improve, it is also necessary to achieve the set deficit targets in a credible manner.

Based on the Monetary Council's risk assessment, the baseline projection is surrounded by two-way risks to inflation and downside risks to growth.

The Monetary Council highlighted three alternative scenarios around the baseline projection in the March Inflation Report. In the scenarios which assume deceleration in global economic activity and a slower recovery in consumption, both economic growth and inflation may be lower compared to the baseline. In the third alternative scenario, as a result of the slowdown in global disinflation, the monetary policies of the world's leading central banks may remain tight for longer than in the baseline scenario.

SUMMARY TABLE OF THE BASELINE SCENARIO

(Data show annual changes and the forecast is based on endogenous monetary policy.)

	2023	2024	2025	2026
	Actual		Forecast	
Inflation (annual average)				
Core inflation	18.2	4.0 – 5.6	2.8 - 3.4	2.7 - 3.3
Core inflation excluding indirect tax effects	18.1	4.0 – 5.6	2.8 - 3.4	2.7 - 3.3
Inflation	17.6	3.5 - 5.0	2.5 - 3.5	2.5 - 3.5
Economic growth				
Household final consumption expenditure	-2.5	2.8 - 3.5	2.6 - 3.6	2.7 - 3.7
Government final consumption expenditure[1]	1.6	0.9 - 2.0	0.4 - 1.6	0.7 - 1.8
Gross fixed capital formation	-8.7	0.8 - 3.8	1.8 - 4.7	0.7 - 3.6
Domestic absorption	-5.4	2.1 - 3.1	2.0 - 3.2	1.8 - 3.0
Exports	-0.1	1.3 - 2.7	6.1 - 7.9	4.6 - 6.4
Imports	-5.1	1.5 - 2.9	4.3 - 6.3	3.1 – 5.1
GDP	-0.9	2.0 - 3.0	3.5 - 4.5	3.0 - 4.0
Labour productivity[2]	-1.1	2.4 - 3.2	3.4 - 4.7	2.8 - 4.2
External balance[3,6]				
Current account balance	0.2	0.0 - 1.2	1.2 - 2.6	2.1 - 3.7
Net lending	1.2	1.9 - 3.1	3.1 - 4.5	4.0 - 5.6
Government balance[3]				
ESA balance	-6.7	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Labour market				
Whole-economy gross average earnings[4]	14.3	11.4 - 12.3	7.0 - 8.2	7.4 - 8.7
Whole-economy employment	0.6	(-0.3) - 0.1	(-0.3) - 0.4	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	10.0 - 11.0	7.1 - 8.2	6.5 - 7.6
Private sector employment	1.0	(-0.1) - 0.3	0.0 - 0.5	0.0 - 0.5
Unemployment rate	4.1	4.2 - 4.3	3.5 - 4.0	3.2 - 4.1
Private sector nominal unit labour cost	18.0	8.2 - 9.4	2.7 - 4.3	2.7 - 4.5
Household real income[5]	1.1	2.8 - 3.7	2.0 - 3.2	2.1 - 3.3

[1] Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.

[2] Whole economy, based on national accounts data.

[3] As a percentage of GDP.

[4] For full-time employees.

[5] MNB estimate.

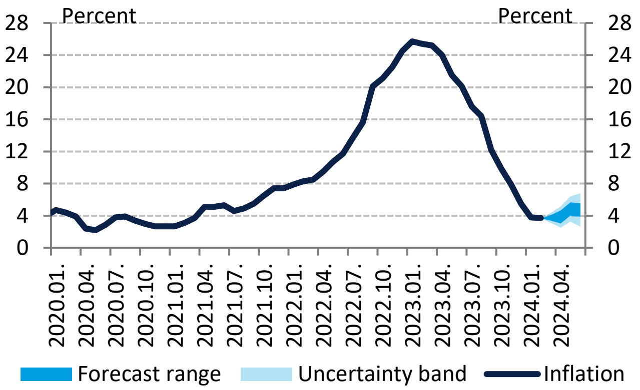
[6] In the case of the current account balance and net lending, only the preliminary data for October–December 2023 was available during the preparation of the Inflation Report.

1 Inflation and real economy outlook

1.1 Inflation forecast

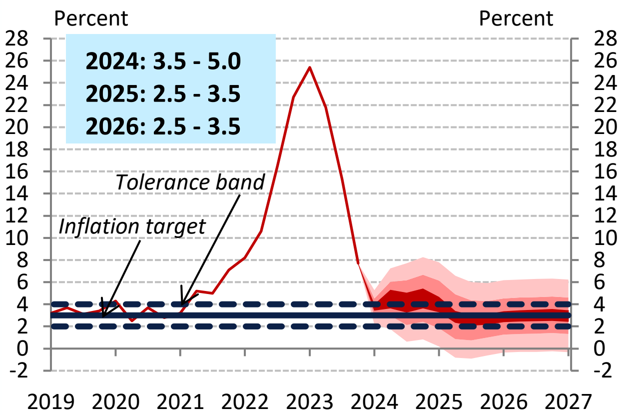
Domestic inflation has continued to fall in recent months, with the consumer price index at 3.7 percent in February. According to the short-term forecast, inflation will rise temporarily in the middle of the year, due to the retrospective repricing of telecommunication services and base effects. Over the medium term, the underlying processes are shaped by two contrasting effects. The weakening of the forint exchange rate that has been observed in recent weeks has an increasing effect on inflation. By contrast, the weaker cyclical position of the real economy in the short term has a disinflationary effect. As a result of these two effects, the decline in core inflation, which better reflects underlying processes, will come to an end in the second quarter, with the rate possibly ranging from 4.5–5.0 percent for the rest of the year. Annual inflation is expected to be between 3.5–5.0 percent this year which, based on the incoming data, means a lower inflation path compared to the December forecast. Inflation is expected to return to the central bank's inflation target on a sustained basis in 2025. Inflation may average between 2.5–3.5 percent annually in both 2025 and 2026. Annual core inflation adjusted for taxes is projected to be between 4.0–5.6 percent in 2024, 2.8–3.4 percent in 2025 and 2.7–3.3 percent in 2026.

Chart 1-1: Monthly evolution of the near-term inflation forecast



Note: Annual change. The uncertainty band shows the uncertainty around the forecast range with regards to the root mean squared error of previous years' near-term forecasts.
Source: HCSO, MNB

Chart 1-2: Fan chart of the inflation forecast



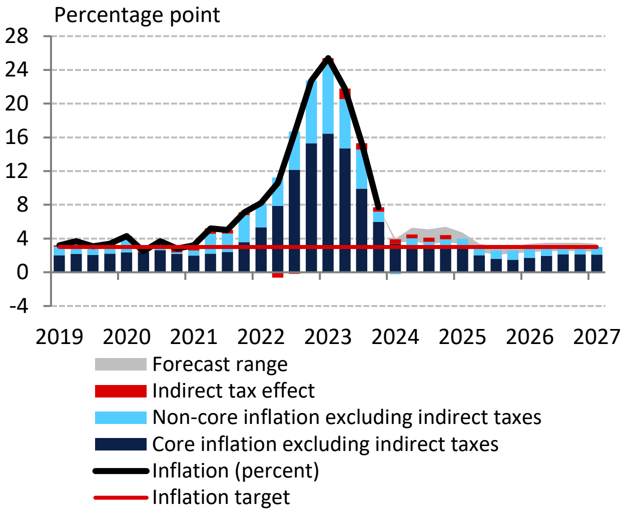
Note: Based on seasonally unadjusted data.
Source: HCSO, MNB

Inflation is forecast to rise temporarily in the middle of the year, due to the retrospective repricing in the market services sector and base effects (Chart 1-1). The retrospective repricing of telecommunications and banking services, as well as the base effect of fuel prices, will lift the consumer price index, as a result of which inflation will temporarily leave the central bank's tolerance band. In addition, the underlying dynamics are shaped by two contrasting factors. The weakening of the forint exchange rate that has been observed in recent weeks has an upward effect on inflation. By contrast, the weaker cyclical position of the real economy in the short term has a disinflationary effect. As a result of these two effects, the decline in core inflation, which better reflects underlying processes, will come to an end in the second quarter and the rate may range between 4.5–5.0 percent for the rest of the year.

Inflation will return to the central bank's inflation target on a sustained basis in 2025. Compared to our December forecast, both the lower and upper bounds of our forecast band for inflation this year have been lowered by 0.5 percentage point, while our projections for 2025 and 2026 remain unchanged. **Inflation may range between 3.5-5.0 percent in 2024 and between 2.5–3.5 percent in both 2025 and 2026** (Chart 1-2).

We forecast that annual core inflation net of indirect taxes, which captures the underlying processes, may range between 4.0–5.6 percent in 2024, between 2.8-3.4 percent in 2025 and between 2.7–3.3 percent in 2026 (Chart 1-3). Our forecast for core inflation adjusted for taxes has been lowered versus the December forecast, reflecting the impact of incoming data (faster-than-expected disinflation in food and industrial goods). Our assumption for world oil

Chart 1-3: Decomposition of our inflation forecast



Note: The decomposition is based on the midpoint for the forecast range. Source: HCSO, MNB

Table 1-1: Details of the inflation forecast

		2024	2025	2026
Core inflation excluding indirect tax effects		4.0 - 5.6	2.8 - 3.4	2.7 - 3.3
Core inflation		4.0 - 5.6	2.8 - 3.4	2.7 - 3.3
Non-core inflation	Unprocessed food	2.0	3.8	4.0
	Fuel and market energy	2.4	2.5	2.5
	Regulated prices	3.4	2.4	2.2
	Alcohol and tobacco	4.7	3.6	3.4
Inflation		**3.5 - 5.0**	**2.5 - 3.5**	**2.5 - 3.5**

Note: Percent. Based on seasonally unadjusted data. The table is based on the midpoint of the forecast range. Source: MNB

prices in US dollar rose slightly compared to our December assumption. The world price of Brent crude oil is at around USD 85/barrel, with considerable volatility. European gas and electricity prices remained below the levels seen in the months before the outbreak of the Russia-Ukraine war. The TTF gas price fell below EUR 30/MWh in February 2024, but rose slightly overall during the last month.

The moderate change in food inflation is supported by the decline in global food commodity prices, as well as government measures that foster stronger competition. Global food commodity prices continue to fall, supporting further moderation in food inflation. In the case of unprocessed food products, the subdued repricing observed in recent months is likely to persist over the short term, with annual price increases for this product group forecast at around 2.0 percent this year, 3.8 percent in 2025 and 4.0 percent in 2026.

Annual inflation in the vehicle fuel and market energy product group is expected to be around 2.4 percent this year and 2.5 percent in next year and in 2026 (Table 1-1). Inflation for goods and services with regulated prices is forecast to average around 3.4 percent in 2024. Our analysis is based on the technical assumption that the measures affecting retail energy prices remain unchanged over the entire forecast horizon. In 2024, several tax and regulatory measures (increase in excise duty on fuels, increase in road tolls, increase in special retail sales tax, extended producer responsibility (EPR) charge) will have a temporary impact on inflation.

Box 1-1: Assumptions applied in our forecast

As Hungary is a small open economy, our forecasts for the most important macroeconomic variables are fundamentally influenced by developments in external factors. To make the forecast more transparent, the changes in external assumptions are presented below (Table 1-2).

Table 1-2: Main external assumptions of our forecast

Technical assumptions	2024		2025		2026		Change		
	Previous	Current	Previous	Current	Previous	Current	2024	2025	2026
EUR/USD	1.09	1.09	1.09	1.09	1.09	1.09	0.0%	0.1%	0.1%
Oil (USD/barrel)	80.0	82.5	76.9	77.8	76.7	76.9	3.2%	1.1%	0.3%
Oil (EUR/barrel)	73.4	75.7	70.6	71.3	70.4	70.5	3.2%	1.0%	0.2%
Gas (EUR/MWh)	42.6	28.8	41.0	30.0	39.1	29.2	-32.4%	-26.8%	-25.4%
Euro area inflation (%)	2.7	2.3	2.1	2.0	1.9	1.9	- 0.4 pp.	- 0.1 pp.	0.0 pp.
Euro area real GDP (%)	0.8	0.6	1.5	1.5	1.5	1.6	- 0.2 pp.	0.0 pp.	0.1 pp.
GDP growth of Hungary's main export partners* (%)	1.5 - 2.3	1.1 - 1.9	1.9 - 2.7	1.9 - 2.7	1.1-2.0	1.3 - 2.2	-0.4 pp.	0.0 pp.	0.2 pp.

Source: Bloomberg, Consensus Economics, MNB, ECB

Overall, GDP growth forecasts for 2024 for Hungary's main trading partners have moderated somewhat. The output of the European Union economy expanded slightly in the fourth quarter of the year. GDP growth in the United States continued to accelerate on an annual basis at the end of last year. China's annual growth rate in 2023 Q4 was in line with expectations, with output rising by 5.2 percent, higher than in the third quarter, while output expanded by 1.0 percent on a quarterly basis. In 2023 Q4, global industrial production remained subdued and world trade also stagnated, amidst attacks on transport vessels in the Red Sea. External developments are mainly driven by the unfavourable industrial production outlook in Europe and the generally tense geopolitical situation. However, in recent months, global economic activity has been supported by the ongoing tight labour market conditions in developed economies. The global and European growth outlook for this year has deteriorated somewhat compared to the December forecast. International business activity indices show that consumer confidence and business sentiment in EU economies remain at moderate levels, and this is underpinned by low levels of global new orders.

The ECB expects lower growth and inflation in the euro area compared to its December forecast. The ECB projects euro area GDP growth in 2024 to be 0.2 percentage point lower than previously forecast, predicting a growth rate of 0.6 percent for this year and 1.5 percent in 2025, the same as in December. According to the ECB's March forecast, inflation in the euro area may be 0.4 percentage point lower this year and 0.1 percentage point lower next year, reaching 2.3 percent in 2024 and 2.0 percent in 2025.

The price of Brent crude oil has risen moderately since end-December and is currently at around USD 85. The global Brent crude oil price has been volatile, fluctuating between USD 80 and USD 85 since mid-January, driven by OPEC+ countries' communications on oil supply cuts, attacks threatening the Red Sea transport route and fears of a slowdown in the Chinese economy. These effects could be offset by the fact that, as last year, non-OPEC+ countries' production growth could exceed global crude oil demand growth in 2024. The price differential between Brent and Russian Ural crude remained stable in the recent period.

Domestic petrol and diesel prices have risen somewhat in recent weeks. In line with international trends, the market prices of petrol and diesel decreased in Hungary until December of last year, but from January onwards a moderate increase was observed for both fuel prices.

European gas and electricity prices remained below the levels seen in the months before the outbreak of the Russia-Ukraine war. The evolution of domestic and European gas purchase prices follows the Dutch TTF gas price, which reached its historic peak at over EUR 300 in August 2022. Gas prices then started to decline in December 2022 and continued to do so last year. There were several price spikes over the summer caused by news of uncertainties surrounding LNG supplies, but the further decline in gas prices was also driven by high filling levels of European gas storage facilities, the mild winter weather, low residential consumption and reduced demand for gas from recession-hit European industry. While the gas price was around EUR 40 at the beginning of December, in February 2024 the world gas price fell below EUR 30/MWh and then increased slightly in March. Changes in gas prices also affect electricity prices through gas-fired power plants. In line with the low gas prices, electricity prices have also fallen, with the 7-day moving average of the German Phelix electricity price below EUR 70, substantially lower than the average of almost EUR 100 for 2023.

According to preliminary data for the financial accounts, the accrual-based deficit of the general government amounted to 6.7 percent of GDP in 2023. We forecast the budget deficit to be between 4.5–5.0 percent of GDP in 2024, 3.5-4.5 percent in 2025 and 2.8–3.8 percent in 2026, depending on macroeconomic developments and the degree of fiscal discipline. Based on preliminary data, gross government debt fell to 73.4 percent of GDP by the end of 2023. For the reduction of the debt ratio to continue in 2024 and the improvement of country risk assessment, it is also necessary to achieve the set deficit targets in a credible manner.

Adoption of the judicial reform and recovery plan mitigated the uncertainty surrounding EU funds. The European Commission has accepted that the horizontal eligibility criteria for judicial reform and two sectoral eligibility criteria have been met, giving Hungary access to a total of EUR 12.2 billion from the 2021–2027 cohesion funds. Prior to this, after the European Commission and ECOFIN both approved the REPowerEU chapter of the Hungarian Recovery and Resilience Plan, Hungary received an RRF pre-financing of EUR 920 million in total in recent months. The majority of the still unavailable recovery and cohesion funds (nearly EUR 20 billion) can be released by fulfilling the 27 super milestones selected by the Commission.

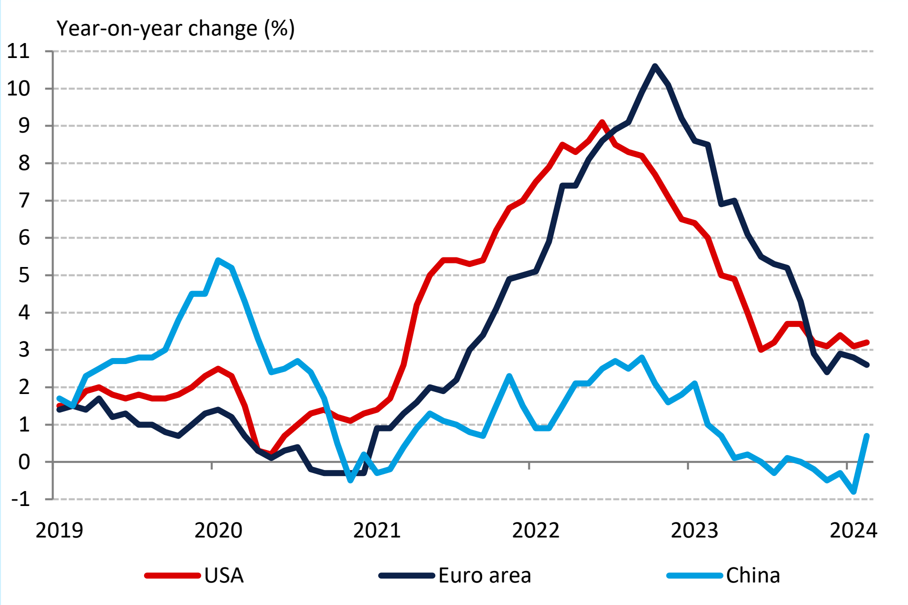
Box 1-2: Impact of international factors on domestic inflation

The risks around the external inflation path are currently symmetric, but geopolitical conflicts are fuelling uncertainty. Hungary is a small, open economy, and thus international developments have a significant impact on domestic macroeconomic indicators. The slowdown in disinflation in the advanced economies and rising transport costs are hampering domestic disinflation, while the moderation in Chinese consumer prices and global food prices are supporting it.

Disinflation in advanced economies has slowed down, while deflation was recorded in China for some months. Inflation in the euro area eased to 2.4 percent in November last year, but disinflation then stalled. Since January, the rate of price increases has been slowing down again, reaching 2.6 percent in February (Chart 1-1). While disinflation continued unabated for manufactured goods and food, the decline in market services inflation has come to a halt. The fading out of the base effects that pulled down energy price inflation in the autumn also contributed to the interruption of disinflation. The broad-based slowdown in disinflation at the European level is also reflected in the fact that 9 of the 27 EU countries saw inflation rise from December to February. The underlying inflation processes have also not yet fully normalised, with core inflation in February in 24 EU countries even higher than inflation as a measure of the total consumer basket.

Inflation in the United States fell dynamically until mid-2023, but has since remained above the central bank's target, fluctuating between 3 and 3.7 percent. The main contributor to the stalling of disinflation was volatile energy inflation, while food price increases continued to moderate. However, in addition to the continued above-target inflation, the historically tight labour market, a higher level of services price dynamics and an increase in 3-month price changes for services may also point to persistent inflationary pressures. In contrast to Western countries, consumer prices in China have fallen year-on-year for several months since the autumn of 2023, posing a downside risk to domestic price increases. Chinese consumer prices rose again on an annual basis in February, which is due to the base effect of the Chinese Lunar New Year, as the price-inflating holiday fell in February this year, and in January last year.

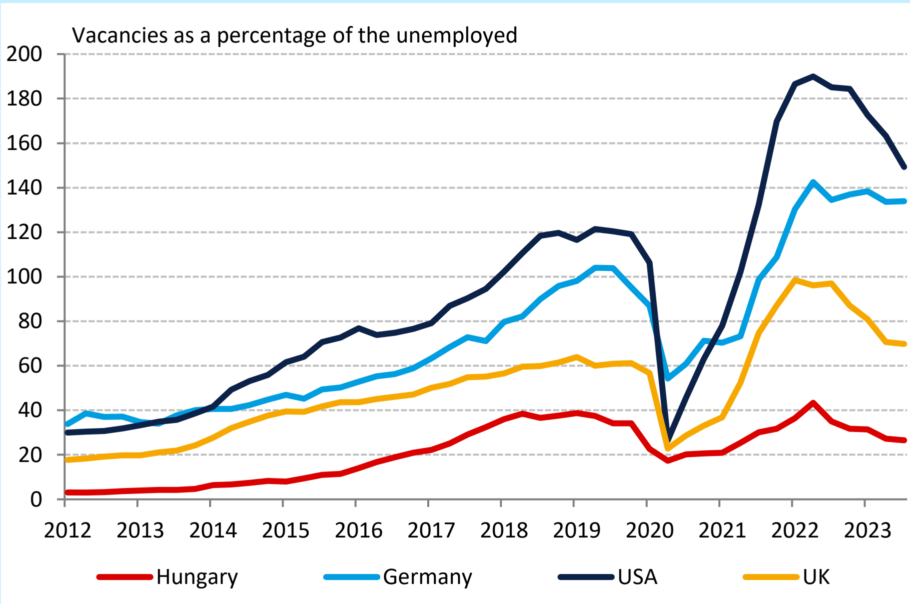
Chart 1-4: Inflation developments in the US, the euro area and China



Source: Eurostat, Trading Economics, U.S. Bureau of Labor Statistics

The tight global labour market in Western countries is contributing to a slowdown in disinflation. Although labour market tightness indicators in the major Western economies have eased in recent quarters, they remain at historically high levels (Chart 1-5). In the US, the labour market has not been as tight as it is now since the 2000s, and in Germany since the 1980s. Tighter labour supply relative to demand could lead to higher labour costs for companies, which could raise international inflation rates. The significance of the impact is also indicated by the IMF's 2023 study, which shows that the Phillips curve has steepened again in some Western European countries and the euro area since the COVID-19 crisis.[1]

Chart 1-5: Changes in tightness indicator



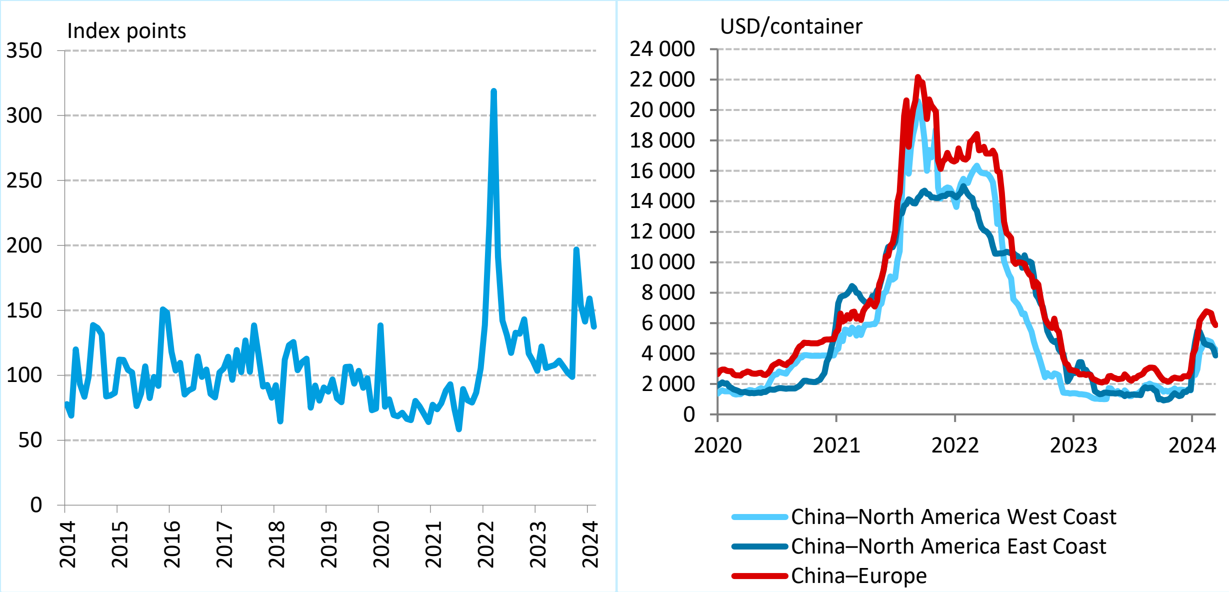
Note: Seasonally adjusted quarterly data, DeStatis data for 2020 for Germany.
Source: Eurostat, DeStatis, FRED, ONS, HCSO

The ongoing geopolitical turmoil is creating considerable uncertainty and increasing volatility in financial and commodity markets, while also raising transport costs by disrupting global value chains. The geopolitical risk indices have eased since

[1] Ari, A., Garcia-Macia, D., and Mishra, S. (2023). Has the Phillips Curve Become Steeper? IMF Working Paper, WP/23/100

the outbreak of the Russia-Ukraine war in 2022 and the escalation of the Israeli-Palestinian conflict in October, but remain significant compared to the previous period of peace (Chart 1-6, left panel). The attacks by Yemen's Houthi rebels in the Red Sea have disrupted global supply chains, as some container ships have switched from the risky crossing to safer but longer and more expensive routes. As a result, the cost of sea freight from China has more than doubled since last December (Chart 1-6, right panel). However, despite the significant price increase, the cost of maritime transport remains substantially below the 2021–2022 peaks.

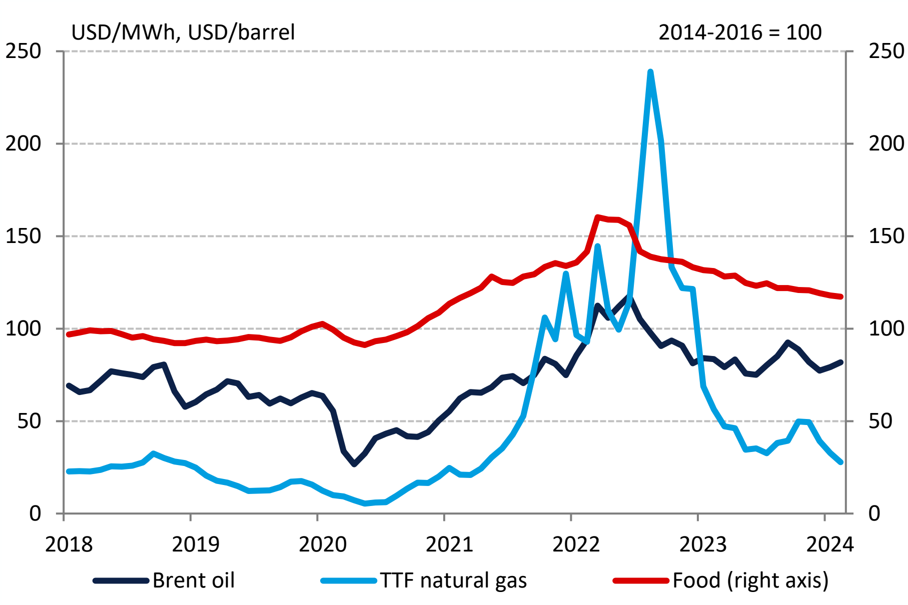
Chart 1-6: Evolution of the GPR Geopolitical Risk Index (left panel) and the Freightos Baltic Index (right panel)



Note: The GPR Index is a text analytics model by Fed researchers based on articles from 10 leading newspapers.
The Freightos Baltic Index only includes shipments from China.
Source: Bloomberg, matteoiacoviello.com/gpr.htm

The increasingly uncertain geopolitical situation has had a minor impact on global commodity prices so far. The decline in world food prices since mid-2022 continued in early 2024. The price of Brent crude oil has fluctuated at around USD 85 per barrel, while European exchange traded gas prices rose slightly in March from a moderate level, after a steady decline starting in mid-October last year (Chart 1-7). The decrease in gas prices was supported by the high filling levels of European gas storage facilities, the mild winter weather, low residential consumption and reduced demand for gas from European industry, which is struggling with recession; the slight price increase in March was mainly due to uncertainties surrounding global supply.

Chart 1-7: Trends in oil and gas prices and the nominal FAO food price index

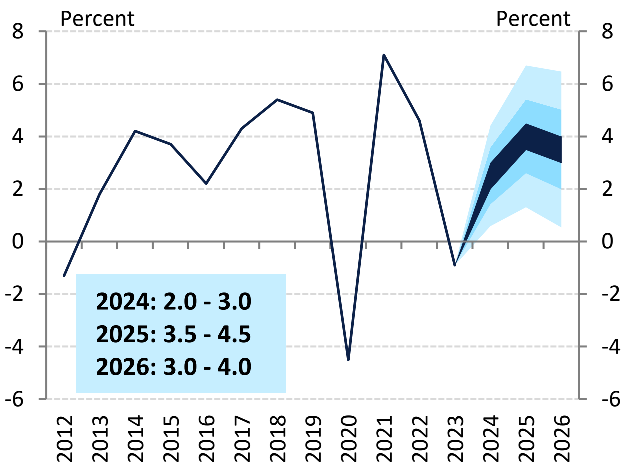


Note: Data is shown until February 2024. For gas, the Dutch TTF exchange prices.
Source: Bloomberg, FAO

1.2 Real economy forecast

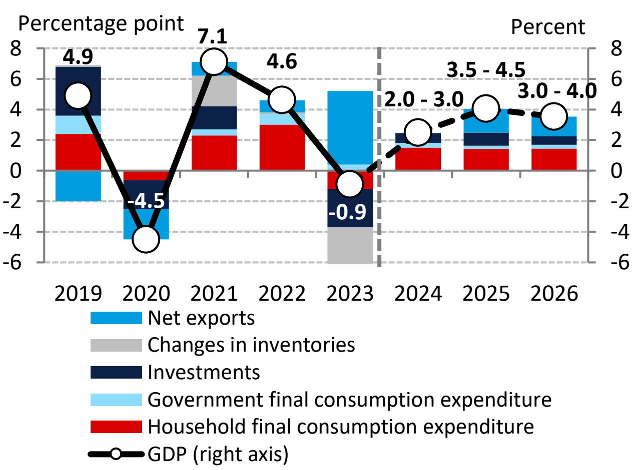
After stagnating in 2023 Q4, the economy is expected to expand gradually in 2024, with domestic GDP growth for the year as a whole expected to amount to between 2.0 and 3.0 percent. The weaker-than-forecast incoming data for the fourth quarter also has a negative impact on our expectations for this year. Over the past year, agriculture made a substantively positive contribution to the annual change in GDP, while the value added of industry, construction and services declined. Consumption and investment fell at the end of the year, but at a slower pace than in previous quarters. Looking ahead, market services in particular may support growth in the first half of the year, while the expansion of GDP may be restrained by industry, due to weaker confidence indices and falling new orders, and construction, due to the number of contracts and housing permits issued. We expect that household consumption in particular, along with business and household investment, will support gradual GDP growth from this year onwards, while from 2025 onwards, dynamic external demand should foster balanced growth. We forecast that the economy will return to its long-term growth trend in 2025, with GDP growth in 2025 expected to continue at 3.5–4.5 percent and in 2026 at 3.0–4.0 percent.

Chart 1-8: Fan chart of the GDP forecast



Note: Based on unadjusted data.
Source: HCSO, MNB

Chart 1-9: Expenditure side decomposition and forecast of GDP



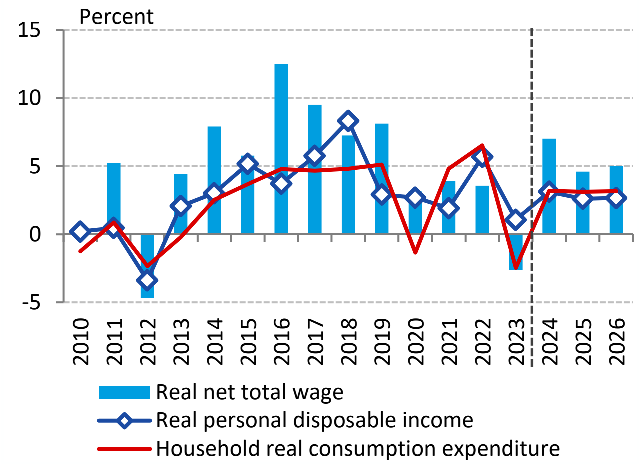
Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.
Source: HCSO, MNB

In 2023 Q4, domestic GDP stagnated on an annual and quarterly basis. Growth was restrained by industry, construction and services, while agriculture was a strong contributor, by historical standards as well. The significant growth contribution of the agricultural sector is explained by the low base from the drought-affected 2022, as production last year was around the historical average. Most domestic demand items restrained economic growth. Household consumption fell by 0.2 percent, a smaller decline than in previous quarters, while the 3.0-percent decline in investment was less pronounced than expected at the end of 2023. However, despite the moderate improvement in the recent period, the household confidence index still points to persistent cautiousness. The contribution of net exports to growth was 4.1 percentage points, but this was due to the fact that weak domestic demand caused the volume of imports (–9.0 percent) to fall more than exports (–4.7 percent).

After stagnating in 2023 Q4, the economy is expected to expand gradually in 2024. In the first half of the year, rising household incomes and improving consumer sentiment supported a recovery in demand for market services. Industrial production fell by 3.6 percent in January versus the same period a year earlier, marking more than one year of year-on-year declines in the sector. Based on new orders and business confidence indices, industry may continue to hold back economic growth in the first half of the year, before resuming its upward trend from the second half. Based on the orders book and permits issued, construction output is expected to remain subdued this year, despite double-digit growth in January, according to the statistics.

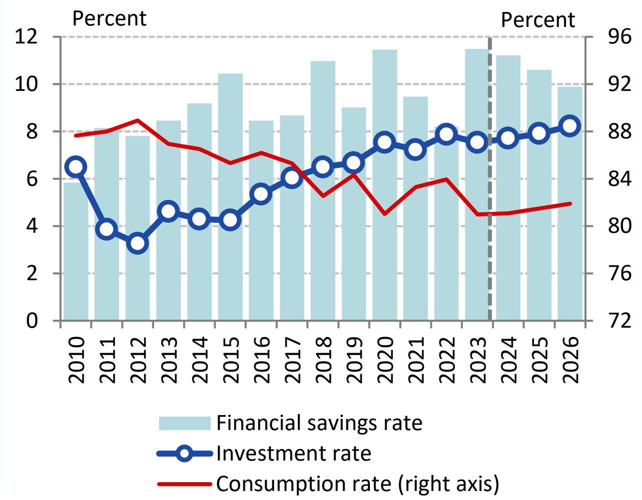
We forecast that the Hungarian economy will expand by 2.0–3.0 percent this year, supported mainly by domestic demand. The incoming Q4 GDP data were weaker than expected in the December Inflation Report, which also negatively affect annual growth in 2024 via a lower carry-over effect, Consequently, our growth expectations for this

Chart 1-10: Annual changes in net total wages, personal disposable income and household consumption expenditure in real terms



Source: HCSO, MNB

Chart 1-11: Evolution of households' consumption, investment and financial savings rates as a percentage of disposable income



Source: HCSO, MNB

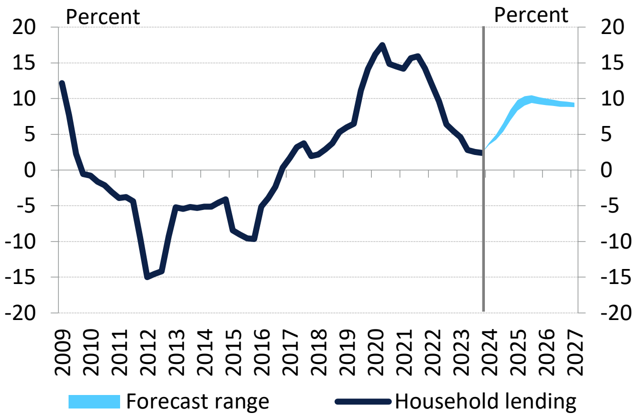
year have been lowered by 0.5 percentage point compared to December. The carry-over effect in 2023 is 0.4 percentage point, instead of the 1.2 percentage point previously expected, which could thus restrain GDP growth by 0.8 percentage point this year, assuming the same underlying trends as in the December Inflation Report forecast. With economic performance picking up from mid-2024, we forecast GDP to return to its long-term growth trend in 2025, with **GDP growth in 2025 expected to continue at 3.5–4.5 percent and in 2026 at 3.0-4.0 percent** (Chart 1-8 and 1-9).

In 2024, positive real wage dynamics could lead to renewed annual growth in household consumption. Household demand may be boosted by more favourable credit conditions and improvement in consumer confidence. The value of housing loans contracted by credit institutions in 2023 Q4 rose 21 percent year-on-year, while personal loan issuance was 43 percent higher. Household loans growth may gradually accelerate from the beginning of 2024, supported by falling interest rates and the HPS Plus scheme starting at the beginning of the year (Chart 1-12). The continued disinflation at the beginning of the year and favourable wage developments could lead to a renewed increase in the real income of households this year, which should also support household consumption growth. Consumption may expand by 2.8–3.5 percent this year, 2.6-3.6 percent in 2025 and 2.7–3.7 percent in 2026 (Chart 1-10).

Over the forecast horizon, we expect a gradual unwinding of the savings rate, in line with an increase in the household investment rate and the consumption rate. In 2023, as a result of the uncertain economic environment and high inflation, households accumulated substantial savings, while their investment rate declined slightly, and consumption rate decreased significantly. As consumer confidence improves, the savings rate should start to fall from this year, leading to an increase in household investment and consumption rates (Chart 1-11).

From 2024, investments may support economic growth. After a decline of 8.7 percent last year, investments are set to expand again from this year, but the structure of this growth is twofold: private sector investments are expanding, while public investments are expected to decrease, in line with government plans. Investment growth is expected to be 0.8–3.8 percent in 2024, 1.8-4.7 percent in 2025 and 0.7–3.6 percent in 2026. The nominal investment rate may be around 26 percent and the real investment rate, calculated at 2015 prices, around 22 percent over the forecast horizon (Table 1-3).

Chart 1-12: Forecast for lending to households



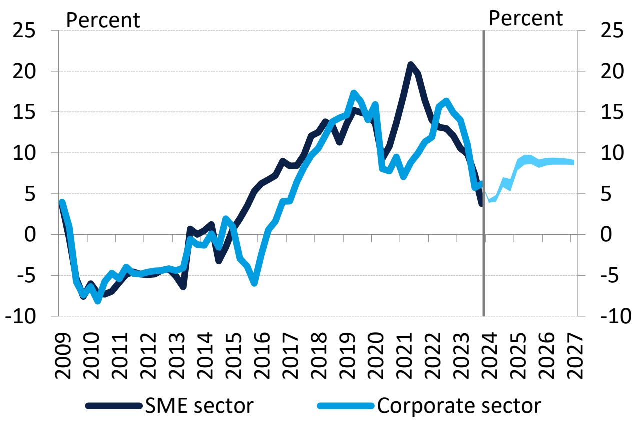
Note: Transaction-based, year-on-year data. 2019 Q3 data adjusted for transactions of lombard loans.
Source: MNB

Table 1-3: Evolution of gross fixed capital formation and investment rate

	2023	2024	2025	2026
Gross fixed capital formation	-8.7	2.3	3.3	2.2
Government investments	-7.5	-7.7	-3.0	-3.8
Private investments	-9.0	4.7	4.6	3.4
Investment rate	26.5	26.4	26.4	26.3

Note: The values represent the middle of the forecast range. Year-on-year growth for gross fixed capital formation and investment rate as a percent of GDP. Source: MNB

Chart 1-13: Annual changes in lending to non-financial corporations and SMEs



Note: Transaction-based, year-on-year data. The SME sector does not include the self-employed. The growth rate of the overall corporate sector is based on the total amount of outstanding credit to the entire financial intermediary system. Source: MNB

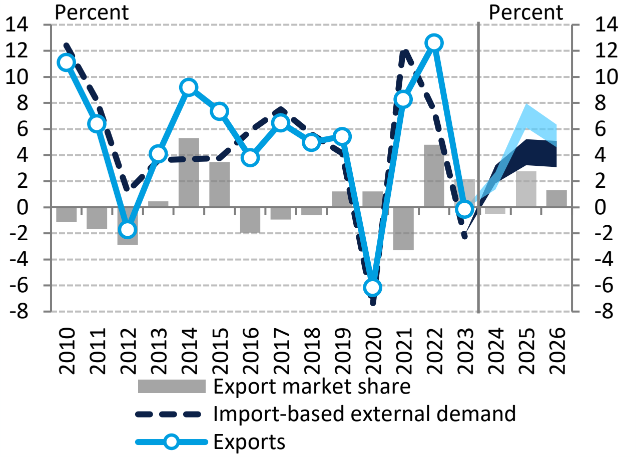
The gradually recovering internal demand, the parallel improvement in confidence and the development of lending processes contribute to the expansion of corporate investments. The increase in the volume of new investments is substantially supported by the implementation of previously announced major industrial investments (e.g. in battery production). The improvement in corporate confidence is reflected in the moderate increase in corporate investment expectations in recent months, according to the MNB's survey on economic activity. The growth rate of corporate loans at the end of 2023 exceeded our previous expectation, thanks to a higher share of large transactions. Looking ahead, one fifth of banks are forecasting an increase in demand, based on Trends in Lending survey. Dynamic lending processes and more favorable conditions may support the revival of corporate investments. The dynamics of corporate lending may reach 6 percent at the end of 2024, and may stabilize at the level of 8-9 percent from 2025 (Chart 1-13).

The volume of household investments will increase over the forecast horizon. The development of retail lending, the HPS Plus loan programme, improving confidence, the reduction of the savings rate and favourable residential construction trends in the fourth quarter suggest an increase in household investment.

After nearly stagnating last year, domestic exports may expand somewhat this year. In the first half of the year, the performance of the export-producing industrial sectors and new industrial orders from abroad point to a further decline in exports, but as European economic activity improves, domestic exports could expand substantially from the second half of the year. The slowdown in exports is essentially a cyclical phenomenon, with exports falling in 2023 H2, reflecting a weakening European economic activity and the resulting slowdown in external demand. However, the competitiveness of domestic exports has not been damaged, and thus exports will support GDP growth again over the medium term. Over the medium to long term, the expansion of domestic exports will be supported by greenfield FDI investments in the manufacturing sector, mainly related to battery production and the automotive industry, which are primarily export-oriented.

In line with strengthening domestic demand, imports are also expected to expand in 2024, and thus net exports should only support economic growth from 2025 onwards. Rising imports offset rising exports as domestic demand picks up, and accordingly on the whole net exports should make a neutral contribution to GDP growth in 2024. However, the medium-term outlook suggests that the

Chart 1-14: Changes in export market share



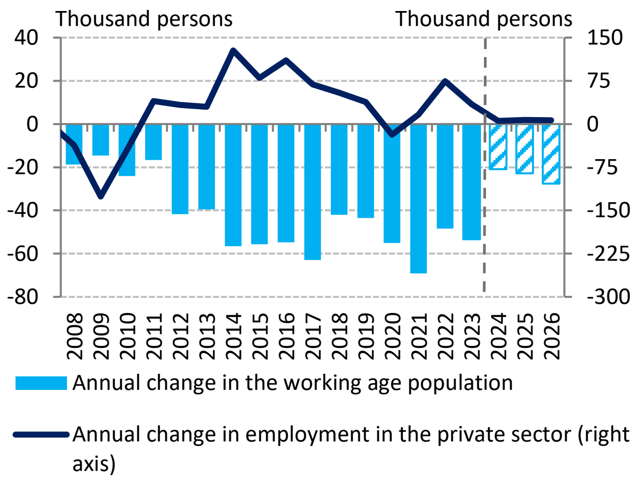
Note: Export market share based on the average of the forecast range.
Source: HCSO, MNB

contribution of net exports to growth might be positive again from 2025. In line with this, Hungary's external market share is expected to decline temporarily this year, before rising again from next year, so that the recovery in external demand should lead to balanced growth and a return to the economy's long-term growth trend (Chart 1-14).

1.3 Labour market forecast

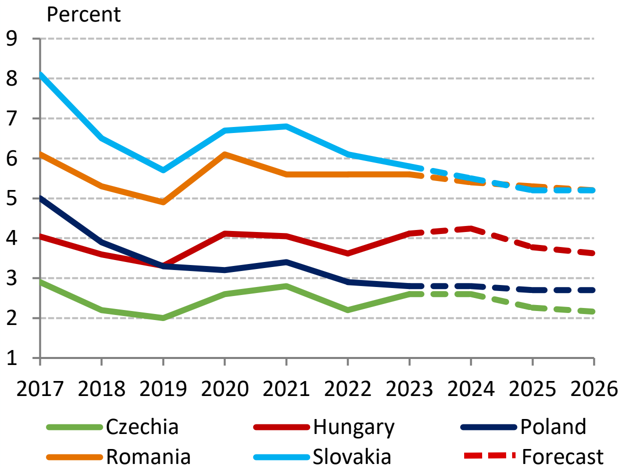
In 2023, employment continued to grow and remains at historically high levels. Given the moderation in labour demand in recent quarters and the slow recovery in economic activity, we do not expect a significant change in employment levels this year. The unemployment rate may range between 4.2 and 4.3 percent this year and between 3.5 and 4.0 percent in 2025. Wage dynamics in 2024 will be mainly driven by easing labour market tightness and a decrease in inflation expectations. In the private sector, average wages are expected to increase by 10.0–11.0 percent in 2024 and by 7.1–8.2 percent in 2025.

Chart 1-15: Annual change in the working age population and the number of persons employed in the private sector



Note: The number of persons employed refers to those aged 15-74, but the projection for the working age population refers to those aged 15-64. The number of employed persons is based on the midpoint of the forecast range.
Source: Eurostat, HCSO, MNB

Chart 1-16: Change in the unemployment rate



Note: Data on Hungary based on the midpoint of the forecast range.
Source: Eurostat, HCSO, NBP, NBS, IMF, MNB

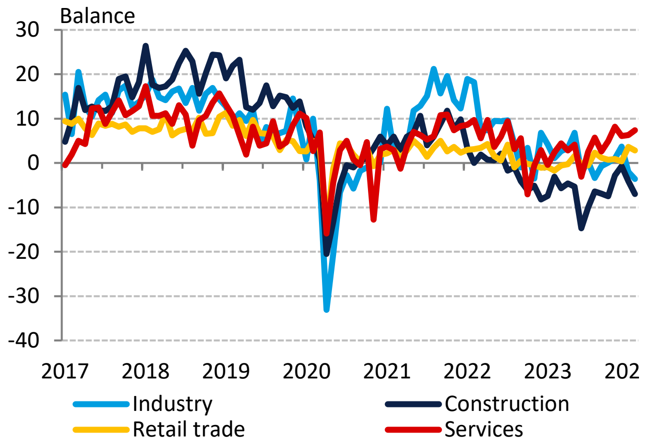
The number of persons employed in the national economy is historically high, and no further increase in employment is anticipated this year. We do not expect a significant change in the number of persons employed in 2024, given the impact of moderating labour demand and the slow recovery of economic activity. Demographic trends are also a constraint to further substantial employment growth. With the recovery in economic performance, growth in employment is expected to remain slow over the rest of the forecast period (Chart 1-15). According to our current forecast, employment in the private sector is expected to change between –0.1 and 0.3 percent in 2024, and to grow between 0.0–0.5 percent in 2025 and 2026.

The unemployment rate may decrease in the second half of the year and next year. The number of unemployed has been rising since 2022 H2 due to the slowdown in economic activity. The seasonally adjusted unemployment rate stood at 4.4 percent in 2023 Q4, an increase of 0.2 percentage point (10,000 persons) compared to the previous quarter. Given the slow recovery in economic output, we do not expect unemployment to fall significantly in the first two quarters. Our current forecast for the unemployment rate is 4.2–4.3 percent for this year. In 2025, the rate may be between 3.5 and 4.0 percent, and in 2026 between 3.2 and 4.1 percent (Chart 1-16).

Labour market tightness is easing, and labour demand is declining. The tightness of the labour market has eased in recent quarters. The number of job vacancies has been falling across a wide range of sectors of the economy on an annual basis, with the largest declines recorded in information and communication, manufacturing, construction and transportation and storage. According to the latest ESI survey, employment prospects have deteriorated in construction and manufacturing, with the majority of companies expecting a decrease in their workforce in the coming months. In services and trade, the majority of firms expect their employment to increase in the next three months, but the extent of this remains small in the trade sector (Chart 1-17).

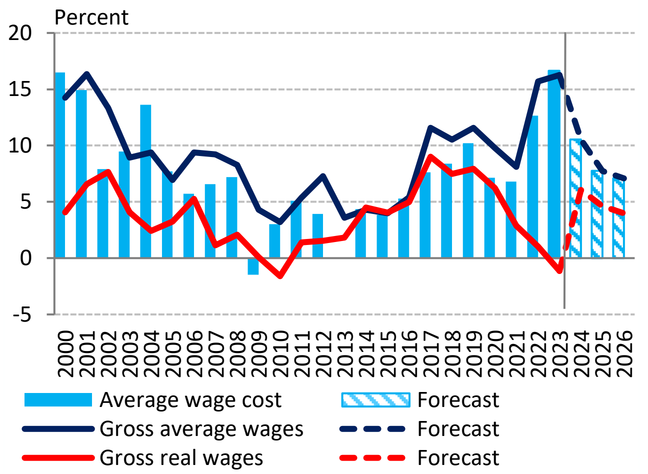
In 2024, nominal wage dynamics will be more moderate than last year, but real wages will rise. Real wages have been increasing since September 2023, following a

Chart 1-17: Employment expectations in the ESI business survey



Note: The balance is positive (negative), if the majority of companies plans to hire (lay off). Seasonally adjusted data.
Source: European Commission

Chart 1-18: Annual changes in gross average wages and average labour cost in the private sector



Note: Based on the midpoint of the forecast range.
Source: HCSO, MNB

significant reduction in inflation in 2023 H2. In December 2023, the minimum wage increased by 15 percent and the guaranteed minimum wage by 10 percent. The easing of labour market tightness, weak domestic demand and wage increases announced by large firms earlier this year point to more subdued wage growth than in 2023. Wages in the private sector may rise by 10.0–11.0 percent this year. For 2025, our forecast is between 7.1 and 8.2 percent, and for 2026 between 6.5 and 7.6 percent. Real wages may rise between 5.7–6.5 percent in 2024, between 4.1–5.1 percent in 2025 and 3.4–4.6 percent in 2026 in the private sector (Chart 1-18).

Table 1-4: Changes in projections compared to the previous Inflation Report

	2023	2024		2025		2026	
	Actual	Forecast					
		Previous	Current	Previous	Current	Previous	Current
Inflation (annual average)							
Core inflation	18.2	4.4 - 6.0	4.0 – 5.6	3.0 - 3.5	2.8 - 3.4	3.0 - 3.5	2.7 - 3.3
Core inflation excluding indirect tax effects	18.1	4.4 - 6.0	4.0 – 5.6	3.0 - 3.5	2.8 - 3.4	3.0 - 3.5	2.7 - 3.3
Inflation	17.6	4.0 - 5.5	3.5 - 5.0	2.5 - 3.5	2.5 - 3.5	2.5 - 3.5	2.5 - 3.5
Economic growth							
Household final consumption expenditure	-2.5	2.8 - 3.5	2.8 - 3.5	2.6 - 3.6	2.6 - 3.6	2.7 - 3.7	2.7 - 3.7
Final consumption of government[1]	1.6	0.4 - 1.6	0.9 - 2.0	0.8 - 1.9	0.4 - 1.6	0.8 - 1.9	0.7 - 1.8
Gross fixed capital formation	-8.7	1.5 - 4.5	0.8 - 3.8	1.8 - 4.7	1.8 - 4.7	0.8 - 3.7	0.7 - 3.6
Domestic absorption	-5.4	2.1 - 3.1	2.1 - 3.1	2.1 - 3.3	2.0 - 3.2	1.8 - 3.0	1.8 - 3.0
Exports	-0.1	2.7 - 4.3	1.3 - 2.7	5.8 - 7.6	6.1 - 7.9	4.6 - 6.4	4.6 - 6.4
Imports	-5.1	2.3 - 3.9	1.5 - 2.9	4.1 - 6.1	4.3 - 6.3	3.1 - 5.1	3.1 – 5.1
GDP	-0.9	2.5 - 3.5	2.0 - 3.0	3.5 - 4.5	3.5 - 4.5	3.0 - 4.0	3.0 - 4.0
Labour productivity[2]	-1.1	2.8 - 3.7	2.4 - 3.2	3.4 - 4.7	3.4 - 4.7	2.8 - 4.2	2.8 - 4.2
External balance[3, 6]							
Current account balance	0.2	0.4 - 1.6	0.0 - 1.2	1.6 - 3.0	1.2 - 2.6	2.5 - 4.1	2.1 - 3.7
Net lending	1.2	2.2 - 3.4	1.9 - 3.1	3.4 - 4.8	3.1 - 4.5	4.3 - 5.9	4.0 - 5.6
Government balance[3]							
ESA balance	-6.7	(-3.9) - (-2.9)	(-5.0) - (-4.5)	(-2.9) - (-1.9)	(-4.5) - (-3.5)	(-2.4) - (-1.4)	(-3.8) - (-2.8)
Labour market							
Whole-economy gross average earnings[4]	14.3	10.6 - 11.6	11.4 - 12.3	7.7 - 9.0	7.0 - 8.2	7.4 - 8.7	7.4 - 8.7
Whole-economy employment	0.6	(-0.3) - 0.1	(-0.3) - 0.1	(-0.3) - 0.4	(-0.3) - 0.4	(-0.2) - 0.6	(-0.2) - 0.6
Private sector gross average earnings[4]	16.3	10.0 - 11.0	10.0 - 11.0	7.1 - 8.2	7.1 - 8.2	6.5 - 7.6	6.5 - 7.6
Private sector employment	1.0	(-0.1) - 0.3	(-0.1) - 0.3	0.0 - 0.5	0.0 - 0.5	0.0 - 0.5	0.0 - 0.5
Unemployment rate	4.1	3.6 - 3.9	4.2 - 4.3	3.2 - 3.8	3.5 - 4.0	2.9 - 3.9	3.2 - 4.1
Private sector nominal unit labour cost	18.0	7.2 - 8.6	8.2 - 9.4	4.7 - 6.4	2.7 - 4.3	4.1 - 5.8	2.7 - 4.5
Household real income[5]	1.1	2.8 - 3.7	2.8 - 3.7	2.5 - 3.7	2.0 - 3.2	2.3 - 3.5	2.1 - 3.3

[1] Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.
[2] Whole economy, based on national accounts data.
[3] As a percentage of GDP.
[4] For full-time employees.
[5] MNB estimate.
[6] In the case of current account balance and net lending during the preparation of the Inflation Report only the preliminary data for the period October-December 2023 was available.

Table 1-5: MNB baseline forecast compared to other forecasts

	2024	2025	2026
Consumer Price Index (annual average growth rate, %)			
MNB (March 2024)	3.5 - 5.0	2.5 - 3.5	2.5 - 3.5
Consensus Economics (March 2024)[1]	3.2 - 4.0 - 5.5	3.0 - 3.6 - 5.0	
European Commission (February 2024)[2]	4.5	4.1	
IMF (October 2023)	6.6	4.3	3.8
OECD (November 2023)	4.6	3.3	
Reuters survey (March 2024)[1]	3.5 - 4.3 - 5.5	3.0 - 3.8 - 5.0	2.1 - 3.3 - 4.5
GDP (annual growth rate, %)			
MNB (March 2024)	2.0 - 3.0	3.5 - 4.5	3.0 - 4.0
Consensus Economics (March 2024)[1]	1.3 - 2.4 - 3.0	2.3 - 3.4 - 4.6	
European Commission (February 2024)[2]	2.4	3.6	
IMF (October 2023)	3.1	3.3	3.4
OECD (November 2023)	2.4	2.7	
Reuters survey (March 2024)[1]	1.7 - 2.3 - 2.7	2.9 - 3.4 - 3.8	3.2 - 3.4 - 3.8
Current account balance[3,4]			
MNB (March 2024)	0.0 - 1.2	1.2 - 2.6	2.1 - 3.7
European Commission (November 2023)[2]	0.1	-0.4	
IMF (October 2023)	-1.6	-0.8	-0.3
OECD (November 2023)	0.8	0.5	
Budget balance (ESA 2010 method)[3]			
MNB (March 2024)	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Consensus Economics (March 2024)[1]	(-5.9) - (-4.7) - (-4.1)	(-4.2) - (-3.7) - (-3.1)	
European Commission (November 2023)[2]	-4.3	-3.8	
IMF (October 2023)	-3.8	-2.8	-2.1
OECD (November 2023)	-4.1	-3.4	
Reuters survey (March 2024)[1]	(-5.9) - (-5.0) - (-4.7)	(-4.5) - (-4.0) - (-3.2)	(-4.3) - (-3.2) - (-1.4)
Forecasts on the GDP growth rate of Hungary's trade partners (annual growth rate, %)			
MNB (March 2024)	1.1 - 1.9	1.9 - 2.7	1.3 - 2.2
ECB (March 2024)	0.6	1.5	1.6
Consensus Economics (March 2024)[1]	1.2	1.9	
European Commission (February 2024)[2]	0.9	1.5	1.6
IMF (January 2024)[2]	1.4	2.1	2.2
OECD (February 2024)[2]	1.0	1.6	

[1] For Reuters and Consensus Economics surveys, in addition to the average value of the analysed replies, we also indicate the lowest and the highest values to illustrate the distribution of the data.

[2] Values calculated by the MNB; the projections of the named institutions for the relevant countries are adjusted with the weighting system of the MNB, which is also used for the calculation of the bank's own external demand indices. Certain institutions do not prepare forecast for all partner countries.

[3] As a percentage of GDP.

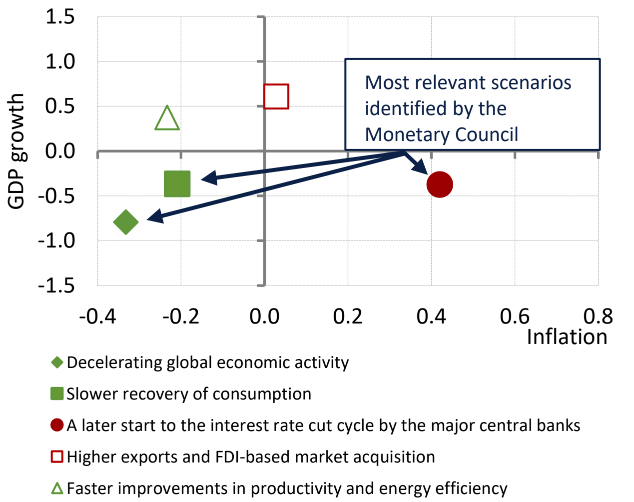
[4] In the case of the current account balance and net lending, only the preliminary data for October–December 2023 was available during the preparation of the Inflation Report.

Source: Consensus Economics, ECB, European Commission, IMF, OECD, Reuters poll, MNB

2 Effects of alternative scenarios on our forecast

The Monetary Council highlighted three alternative scenarios around the baseline projection in the March Inflation Report. In the scenarios which assume a deceleration in global economic activity and a slower recovery in consumption, both economic growth and inflation may be lower compared to the baseline. At the same time, a later start to the interest rate cut cycle by the major central banks is consistent with a higher inflation path. In addition to the highlighted scenarios, the Monetary Council discussed alternative scenarios including paths with higher exports and FDI-based market acquisition, as well as faster improvements in productivity and energy efficiency.

Chart 2-1: Risk map: effect of alternative scenarios on the baseline forecast



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

Decelerating global economic activity

In 2023 Q4, the economies of the United States and China grew strongly, while the euro area's economic output stagnated and the output of Hungary's main trading partner, Germany, declined by 0.3 percent on a quarterly basis. In Germany, the level of vehicle production stagnated in the second half of the year, with a decline in energy-intensive industrial sub-sectors. Based on new orders, industrial exports in Hungary continue to face a shortage of demand.

Based on indicators capturing future economic developments, the outlook in Europe has improved somewhat, but remains subdued and only a gradual recovery is expected, especially from the second half of the year. Industrial expectations remain unfavourable. In Germany, which is Hungary's main trading partner, both industrial and household prospects are significantly weaker than in other European economies.

In the latest institutional forecasts, the outlook for growth in the euro area has been lowered due to the prevailing risks. Some international institutions point to the weak European economic activity and industrial production, as well as geopolitical risks and the expected slowdown in China, as the main risks.

Market analysts' growth expectations for the United States and China have improved somewhat. In the United States, GDP growth is not expected to decelerate in 2024 Q1, while growth in China is expected to slow in the first quarter.

In the **risk scenario featuring decelerating global economic activity**, global growth and, in line with it, EU growth are more moderate than in the baseline scenario. The subdued performance of Hungary's external markets is reducing domestic export performance through lower external demand, thus contributing to a slowdown in GDP growth.

In addition, lower external inflation also contributes to a lower domestic inflation path compared to the baseline scenario.

Slower recovery of consumption

A rapid turnaround in real wages occurred in 2023 H2 as inflation declined. Real earnings have been rising on an annual basis since September. At the same time, the development of retail sales continued to lag behind wage dynamics. The labour market remains historically tight, but labour demand has declined moderately.

High price levels have significantly eroded the income and wealth of the population. The real values of wages and net wealth have fallen back to the level from 2.5–3 years earlier, and Hungarian households have increased their savings significantly to recover this trend. This may explain why, despite the strong disinflation, the value of households' real net savings continued to rise in December as well. In parallel with the increase in savings, the population has cut back on consumption expenditure.

Consumer confidence is the main determinant of consumption and savings: despite the recent moderate increase, the consumer confidence indicator still suggests an attitude of cautiousness, which is holding back the recovery in domestic consumption.

In our alternative path, we expect domestic consumption to recover more slowly, despite the strong disinflation. This is mainly due to the persistent effects of inflation (higher price levels) and international experience. Subdued consumption is consistent with a lower growth and inflation path compared to the baseline.

A later start to the interest rate cut cycle by the major central banks

In recent months, the disinflationary process has slowed down in Western countries, while the price index in China remains low. Annualised inflation in the United States rose from 3.1 percent in January to 3.2 percent in February 2024, exceeding the expectations. In addition, continuously high US services inflation may point to persistent inflationary pressures. Euro area inflation was 2.6 percent year-on-year in February. Consumer prices in China rose by 0.7 percent on an annual basis in February.

The prolonged war and further increase in geopolitical tensions may lead to rising transport, commodity and energy prices again. Increasing geopolitical risks – rising war tensions in the light of the Middle East conflict and the resulting disruption to supply chains – are putting upward pressure on prices. In addition, the protraction of the Red

Sea conflict may also cause disruption to global value chains and a renewed, sustained rise in transport costs.

The Federal Reserve (Fed) and the European Central Bank (ECB) may have both reached the top of their interest rate paths. Over the past quarter, the interest rate path expected by market participants has shifted upwards for both central banks. For the Fed, decision-makers expect a substantially higher interest rate path than market expectations.

Both the US and the euro area have seen a turnaround in inflation, but the potential for disinflation to stall may lead both central banks to ease monetary conditions more slowly.

In the alternative path, we expect a higher external inflation environment as global disinflation moderates, while the monetary policy of the major global central banks may remain tight for a longer period relative to the baseline, resulting in relatively looser monetary conditions for Hungary. In this environment, risk aversion towards emerging markets, including Hungary, is rising, which may be exacerbated by uncertainty stemming from the ongoing geopolitical tensions. This might result in significant capital outflow and a rise in inflation.

Further risks

In addition to the highlighted scenarios, the Monetary Council considered two other alternative paths.

In our alternative path, which assumes higher exports and FDI-driven market acquisition, we expect that with improving external economic activity, FDI inflows will be high, allowing for more investment and creating additional export capacity. FDI-based greenfield investments directly boost investment activity, while new capacity building increases Hungary's exports. In addition, the export market share of already established foreign (and domestic) companies is also increasing, which also boosts Hungary's export performance. This scenario is consistent with higher growth and a temporarily somewhat higher inflation path, due to a tighter labour market.

In our alternative path with a faster improvement in productivity and energy efficiency, improved competitiveness will further stimulate growth in the domestic economy, mainly on the supply side, through the shift to an intensive growth model. Productivity may be improved at a higher degree than assumed in the baseline scenario if **more of the 330 steps to improve competitiveness are carried out**, and energy efficiency improvements are enhanced by implementing the

144 points of the discussion paper 'Sustainable Balance and Convergence', thus accelerating a green transition. Completion of the targeted measures will significantly improve productivity, leading to a lower cyclical position in the domestic economy. This is consistent with a lower inflation path and higher economic output.

3 Macroeconomic overview

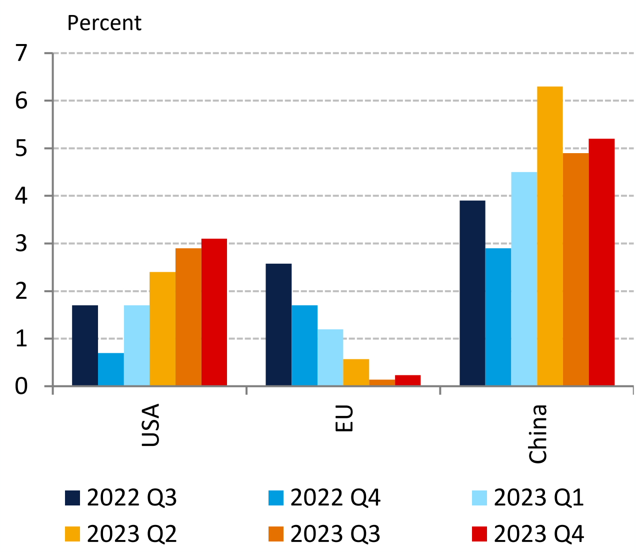
3.1 Evaluation of the international macroeconomic developments

In the fourth quarter, output in the European Union economy expanded somewhat, in line with expectations, while the labour market remained tight, despite continued subdued economic activity. Growth in the US economy continued to accelerate, while China's economy met the forecasts, despite the continued housing market turmoil, with retail sales and industrial production growing steadily. One major risk to external economic activity is the unfavourable outlook for industrial production in Europe and the generally tense geopolitical situation. In the United States, the Federal Reserve left the target range for the federal funds rate unchanged in January and in March. The Fed also continued the balance sheet tightening it commenced in June 2022, but may slow down the pace soon. The European Central Bank kept interest rates unchanged in January and March, and plans to begin reducing the PEPP portfolio in 2024 H2, with reinvestments scheduled to be fully completed by the end of 2024. In the region, the Czech central bank cut its policy rate by 25 basis points to 6.75 percent in January, by 50 basis points to 6.25 percent in February and by 50 basis points to 5.75 percent in March. The Polish and Romanian central banks left interest rates unchanged in the last quarter.

3.1.1 International economic trends

In 2023 Q4, the output of the EU economies expanded mildly on average (Chart 3-1). Overall, the performance of the European economies was in line with the preliminary expectations, with the EU economy expanding by 0.2 percent in 2023 Q4 and the euro area economy by 0.1 percent year-on-year, both in terms of seasonally and calendar-adjusted data. Output in Germany, Hungary's main trading partner, fell by 0.2 percent on an annual basis in 2023 Q4. Among the countries in the region, GDP shrank in the Czech Republic (–0.2 percent) and expanded in Poland (+1.7 percent) and Slovakia (+1.2 percent) in year-on-year terms. GDP contracted in 7 of the 27 countries in the European Union on a quarterly basis.

Chart 3-1: GDP growth in the world's leading economies



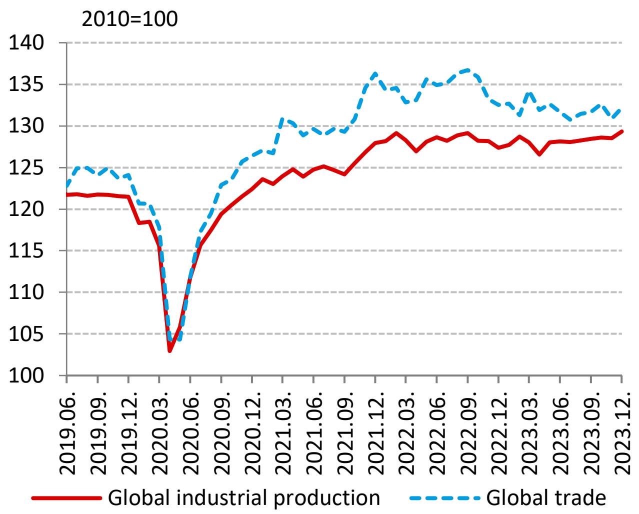
Note: In case of the EU, the calculation is based on seasonally and working day adjusted data.
Source: Trading Economics, FRED, Eurostat

GDP growth in the US continued to accelerate on an annual basis, at a rate above the expectations, in line with previous quarters. The US economy grew by 3.1 percent on an annual basis, the highest rate since 2022 Q1, while on a quarterly basis it grew by 0.8 percent. Growth was supported by continued strong expansion in household consumption, as well as by investment and net exports.

China's annual growth rate in 2023 Q4 was in line with expectations, with output rising by 5.2 percent, higher than in Q3, while on a quarterly basis output expanded by 1.0 percent. Retail sales and industrial production showed stable year-on-year growth, while exports expanded significantly in the first months of this year. However, with housing market turmoil, the still low consumer confidence and the slowdown in the external economy, forecasts point to a slowdown in growth for this year.

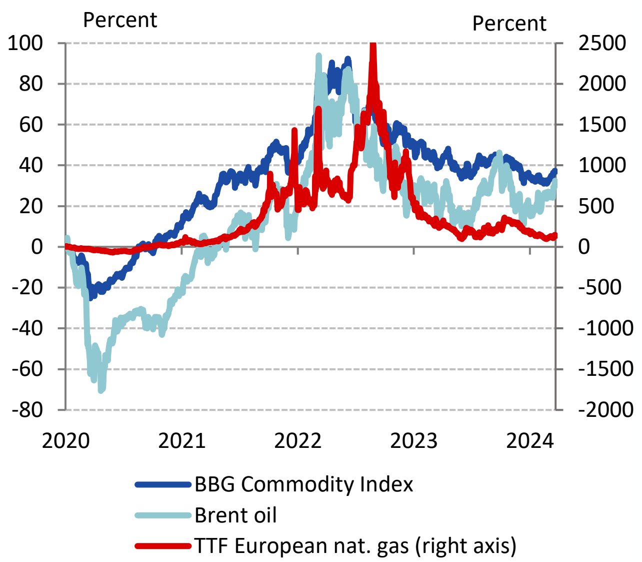
From the aspect of external economic activity, the unfavourable outlook for industrial production in Europe

Chart 3-2: Development of global industrial production and global trade



Note: Based on seasonally adjusted data.
Source: CPB

Chart 3-3: Commodity prices



Source: Bloomberg

and the generally tense geopolitical situation pose significant risks. In 2023 Q4, global industrial production remained subdued and world trade also stagnated, with attacks on transport vessels in the Red Sea (Chart 3-2). In recent months, global economic activity has been supported by the lower level of energy prices than in December and a still tight labour market in advanced economies. At the same time, significant risks remain in the form of higher-than-expected interest rate paths, the weak growth outlook in Europe and the generally tense geopolitical situation. The global and European growth outlook for this year has deteriorated slightly versus the December forecast. International business activity indices show that consumer confidence and business sentiment in the EU economies remain at moderate levels, and this is also confirmed by the low levels of global new orders.

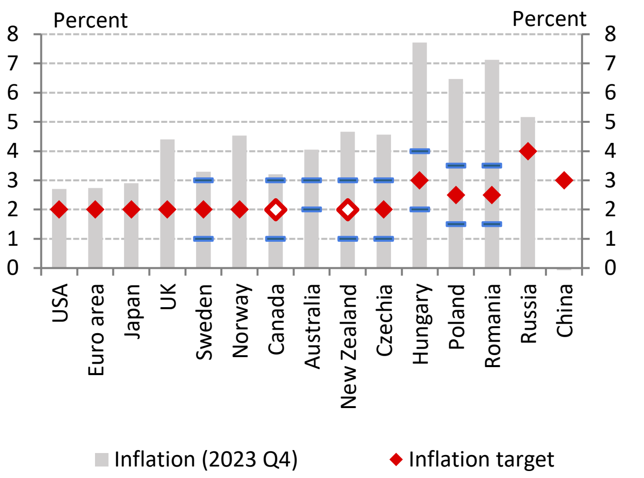
3.1.2 International monetary policy, inflation and financial market trends

Global inflation continued to fall in 2023 Q4, with rates approaching the central bank target in several countries (Chart 3-4). In most advanced economies, however, core inflation remains at higher levels.

In the United States, inflation has fluctuated in recent months. CPI inflation rose from 3.1 percent in November to 3.4 percent in December, before falling again to 3.1 percent in January and then rising to 3.2 percent in February. Core inflation dropped from 4.0 percent in November to 3.9 percent in December and remained unchanged at that level in January, before declining to 3.8 percent in February. The PCE inflation index fell from 3.0 percent in October to 2.7 percent in November, 2.6 percent in December and 2.4 percent in January. In terms of the structure of inflation, services continue to make the largest contribution.

In the United States, the Federal Reserve left the federal funds target range unchanged at 5.25–5.5 percent in January and in March. Following the January interest rate decision, Fed Chairman Jerome Powell said that the key policy rate had probably peaked and that the Federal Reserve is not far from having the confidence it needs to start cutting interest rates. Based on the March forecasts, policymakers have kept their expectations unchanged for the policy rate at the end of this year at 4.6 percent, while at the end of 2025 they expect the policy rate to be 3.9 percent, instead of 3.6 percent, and at the end of 2026 they expect the policy rate to be 3.1 percent, instead of 2.9 percent. The liquidity-providing measures introduced in March 2023 in response to the financial turmoil led to a temporary increase of USD 300 billion in the Fed's balance sheet, which then gradually dropped again to

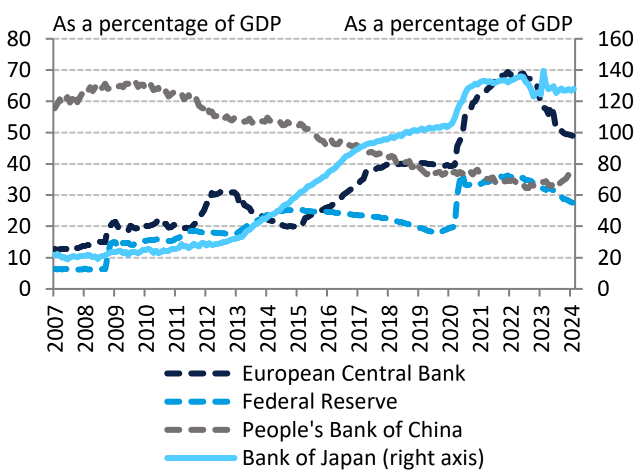
Chart 3-4: Inflation targets of central banks and actual inflation



Note: The blue lines represent the inflation control range in Australia, Canada and New Zealand, while in other countries they mark a permissible fluctuation band. In Canada and New Zealand the mid-point of the target band is accentual, which is marked by empty diamond.

Source: OECD, FRED, National Institute of Statistics Romania, Statistics Sweden, Federal State Statistics Service

Chart 3-5: Central bank balance sheet totals in developed countries



Source: Databases of central banks, Eurostat, FRED

USD 7,589 billion – i.e. 27.2 percent of GDP – at the beginning of March 2024 (Chart 3-5). Following the March interest rate decision, Powell said that it will be appropriate to slow the pace of quantitative tightening soon.

Inflation in the euro area rose from 2.4 percent in November to 2.9 percent in December, before falling to 2.8 percent in January and then to 2.6 percent in February. Core inflation dropped from 3.6 percent in November to 3.4 percent in December, declining further to 3.3 percent in January and then to 3.1 percent in February. According to the central bank's March forecast, annual inflation may reach 2.3 percent in 2024, 2.0 percent in 2025 and 1.9 percent in 2026.

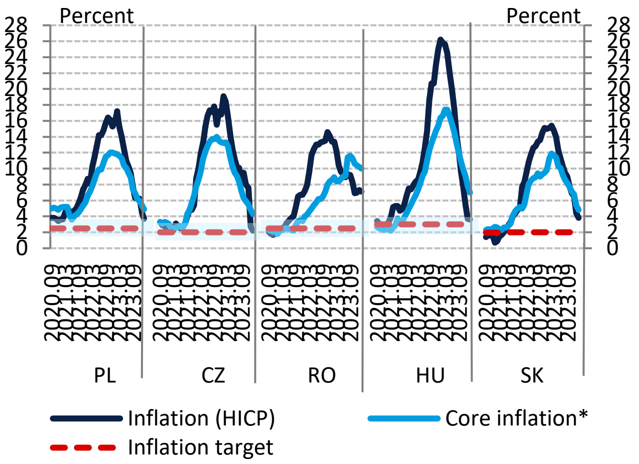
The ECB kept policy rates unchanged in its January and March interest rate decision. Council members noted that underlying inflation may have peaked. Following the interest rate decision, ECB President Christine Lagarde said that there will be more information available in June to assess the start of interest rate cuts. In setting the appropriate level of interest rates, it will continue to adopt a data-dependent approach. In December, the central bank announced its intention to reduce the PEPP portfolio by EUR 7.5 billion per month on average in 2024 H2. The ECB intends to fully stop the reinvestments at the end of 2024. The ECB's balance sheet total stood at EUR 6,813 billion at the beginning of March 2024, or 48.4 percent of GDP (Chart 3-5).

In its March decision, the Bank of Japan ended its target for the 10-year government bond market yield of 0 percent, and also – after 8 years – increased the interest rate on excess reserves from –0.1 to 0-0.1 percent. The Bank of Japan decreased the volume of some of its asset purchases and ended its purchases of ETFs and real estate investment trusts. Inflation eased from 3.3 percent in October to 2.8 percent in November, 2.6 percent in December and 2.2 percent in January.

China's central bank maintained the medium-term lending facility at 2.5 percent. The 1-year reference lending rate was left unchanged at 3.45 percent, while the 5-year reference lending rate was cut from 4.2 percent to 3.95 percent in February. Inflation rose from –0.5 percent in November to –0.3 percent in December, before falling to –0.8 percent in January and then rose to 0.7 percent in February.

The National Bank of Poland held its policy rate unchanged at 5.75 percent at its January, February and March rate-setting meetings. Looking ahead, the central bank will decide on further measures based on incoming data on

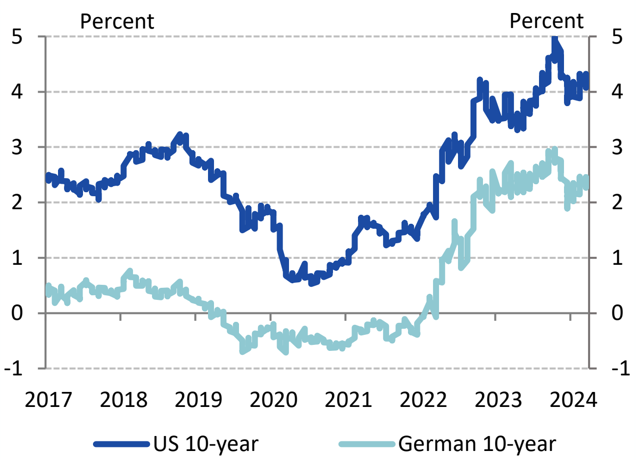
Chart 3-6: Inflation and core inflation in the region



Note: Annual change, percent. *In the case of core inflation, we use the definition of the Eurostat (inflation excluding energy, food, alcohol and tobacco). The blue area indicates the tolerance band around the inflation targets.

Source: Eurostat

Chart 3-7: US and German 10y-government bond yields



Source: Bloomberg

inflation and economic activity. Central bank governor Adam Glapinski said he does not expect any interest rate cuts this year. Inflation eased from 6.6 percent in November to 6.2 percent in December, 3.9 percent in January and 2.8 percent in February. The Harmonised Index of Consumer Prices was 3.7 percent in February (Chart 3-6).

The Czech National Bank cut its policy rate by 25 basis points to 6.75 percent in January, by 50 basis points to 6.25 percent in February and by a further 50 basis points to 5.75 percent in March. Aleš Michl, governor of the Czech central bank, said that further interest rate cuts would also depend on the exchange rate of the koruna, and added that the key was to maintain constant caution. Inflation fell from 7.3 percent in November to 6.9 percent in December, 2.9 percent in January and 2.0 percent in February. The Harmonised Index of Consumer Prices was 2.2 percent in February (Chart 3-6).

The policy rate of the Romanian central bank remained unchanged at 7.0 percent. Inflation eased from 6.7 percent in November to 6.6 percent in December, before rising to 7.4 percent in January, then declining to 7.2 percent in February. The Harmonised Index of Consumer Prices was 7.1 percent in February (Chart 3-6). Romanian central bank governor Mugur Isărescu said after the February interest rate decision that the rise in inflation in January meant the central bank would have to wait at least two more months before considering cutting interest rates.

On the whole, investor sentiment deteriorated moderately in the last quarter. The geopolitical conflict in the Middle East remains a major risk. During the past period, asset price developments were influenced by expectations about the interest rate policies of the developed market central banks. Market expectations postponed the expected start of the interest rate cut cycle, based on statements by the major central banks' decision-makers, as well as higher-than-expected inflation data in the US and inflation data in the euro area that proved to be more "persistent". In addition to these, market participants paid particular attention to macroeconomic data publications and news on risks in the Red Sea, as well as concerns about the Chinese economy.

Oil prices have fluctuated around USD 85, while gas prices have increased slightly from a low level in March (Chart 3-3). Developed stock indices rose 4–8 percent in the Americas and 4–7 percent in Europe. The MSCI stock index for emerging economies showed a moderate rise of 2.7 percent. The US dollar strengthened against the currencies of developed economies, appreciating by 0.6 percent against the euro, 1.1 percent against the Swiss franc and 0.3 percent against the British pound sterling. The US dollar strengthened by 5.7 percent versus the Japanese yen. Developed market long bond yields rose, with the US 10-year yield up 39 basis points to 4.3 percent and the German 10-year yield up 44 basis points to 2.5 percent (Chart 3-7). The Japanese 10-year yield did not change substantially compared to the previous quarter, while emerging market bond yields were mixed in the region, with the Polish 10-year yield rising by 33 basis points and the Czech yield falling by 4 basis points.

Based on market pricing, the advanced central banks have reached the peak of their interest rate paths and are expected to start cutting interest rates in the middle of this year. The Fed left interest rates unchanged at its last five rate-setting meetings and the ECB at its previous four. Market pricing suggests that none of the advanced central banks will change their interest rate conditions at their next two rate-setting meetings. For the Fed, 53 percent expect a 25-basis point cut in June, while for the ECB this ratio is 74 percent, also in June.

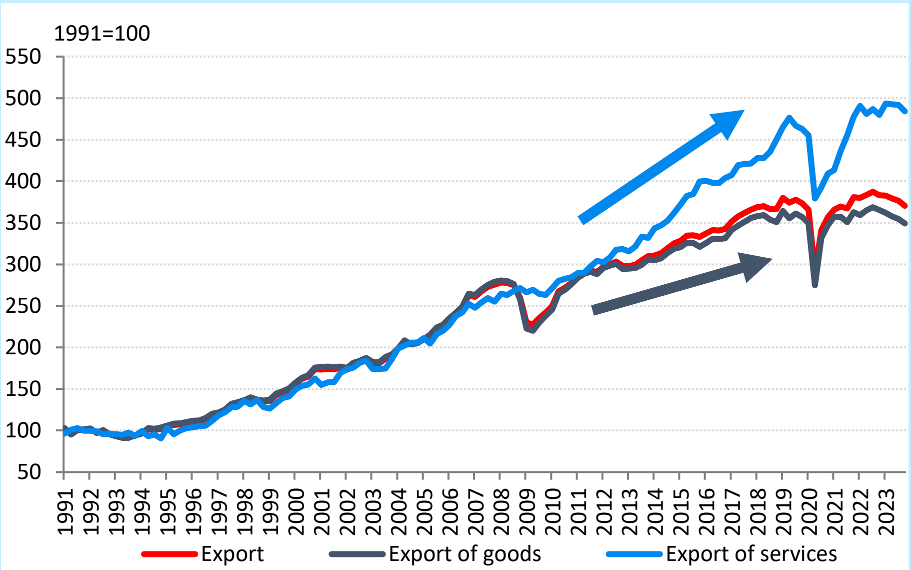
Box 3-1: Trends in German exports

Germany is Hungary's most important foreign trade partner, accounting for 26 percent of Hungarian exports in 2023. Domestic exports to Germany are not exclusively destined for final use, and Hungarian companies are linked to the German automotive industry mainly as suppliers through international production chains. It is therefore of particular importance for the domestic and European economy to examine the phenomena behind the slowdown in German industry and exports.

Germany is a large, export-oriented economy, with manufacturing products accounting for a significant share of total exports. Exports accounted for 47.1 percent of GDP in Germany last year, which is high among developed economies, with an average of around 32 percent in the G7 countries in 2022, according to OECD data. The trade surplus, a key feature of the German economic model, decreased from the average level of 6.4 percent of GDP measured in the 2010s to 4.2 percent by 2023, in parallel with the slowdown in exports.

German export growth dynamics already slowed after the 2008 financial crisis and at the end of 2023 level of exports was only somewhat above its 2019 value (Chart 3-8). Between 1991 and 2008, total exports grew by 172 percent, but after that the earlier trend in exports was broken, with further growth of just 38 percent recorded until 2023. The structural problems of the German economy and industry are reflected in the fact that the growth of goods exports already slowed down significantly in the 2010s. The weight of low-performing goods exports declined steadily since 2008, while the weight of services exports within total exports increased from an average of 15 percent in the years before the crisis to almost 20 percent. However, following a rapid recovery after the COVID-19 crisis, exports of services no longer grew significantly in 2023 as global economic activity slowed, while the export of goods decreased.

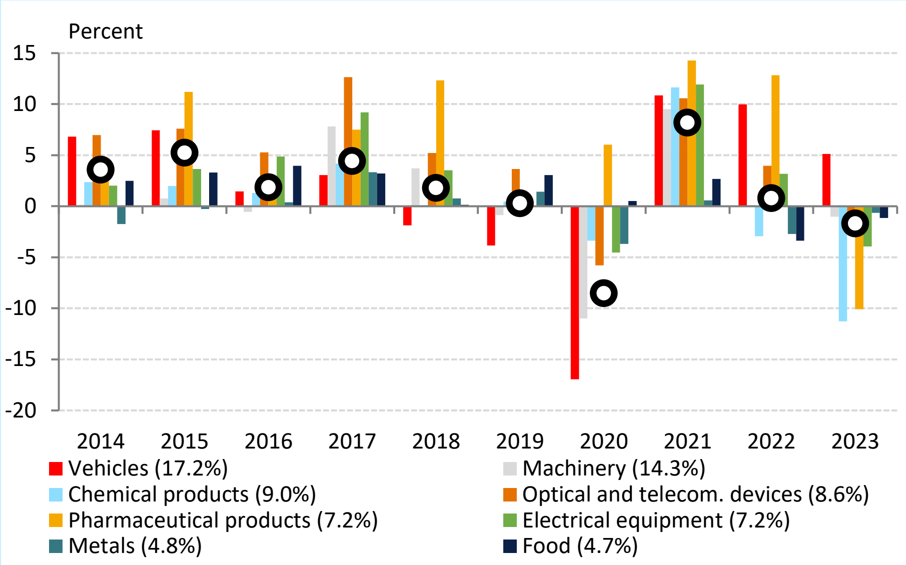
Chart 3-8: Export trends in Germany



Note: Based on seasonally and calendar adjusted national accounts data.
Source: Eurostat

Of the major product groups within goods exports, only exports of motor vehicles were able to expand in 2023 (Chart 3-9). Total goods exports expanded significantly in 2021 as tensions in international supply chains eased and manufacturing orders fell during the COVID-19 shutdown. Thereafter, the volume of goods exports grew by only 0.8 percent in 2022, before falling by 1.7 percent in 2023. The structural breakdown shows that the decline last year was broad-based, with only vehicle exports (+5.1 percent) among the major product groups showing an increase in volume in 2023, while the largest declines were recorded in the case of chemical products (–11.8 percent) and pharmaceutical products (-10.1 percent). However, despite the dynamic growth in vehicle exports in recent years, significant sector-specific problems in the German vehicle industry were already evident before the COVID-19 crisis, causing the volume of vehicle exports to fall by 1.9 percent in 2018 and by 3.8 percent in 2019, while overall exports grew at a slower pace.

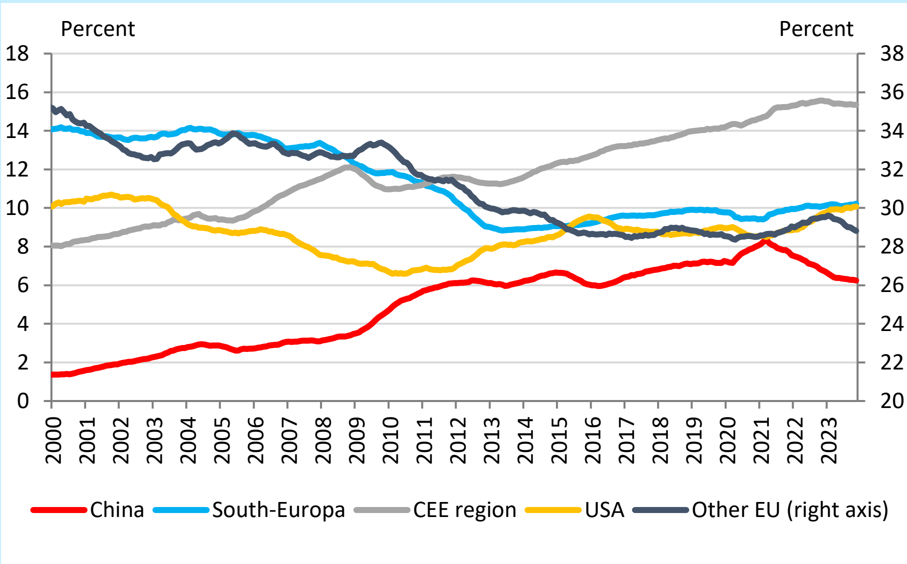
Chart 3-9: Annual change in the volume of German goods exports by product groups



Note: The weight of each product group within the total goods export in 2023 is shown in brackets. Source: Destatis

After an earlier increase, China's weight in German goods exports has decreased since 2021 (Chart 3-10). In 2002, 2.2 percent of German exports went to China, making China Germany's 12th largest export partner. In 2020, China accounted for 8 percent of total German goods exports, making the Asian economy Germany's second largest goods export partner behind the United States. In 2023, however, only 6.2 percent of German goods exports were directed towards China, while the share of the United States increased from 8.6 percent to 10.1 percent in three years. The rise in Chinese vehicle production may also play a significant role in the decline. The German market loss caused a drop of 20.9 percent in vehicle exports to China in 2023. Between 2002 and 2023, the weight of the CEE countries in German exports increased from 9.1 percent to 15.4 percent, which is close to the combined weight of the United States and China. Poland was the largest market for German products in the CEE region, accounting for 5.7 percent of goods exports in 2023, making Poland the 5th most important destination in the ranking, while Hungary was Germany's 13th largest export partner, with 2.0 percent of exports.

Chart 3-10: Geographical distribution of German goods exports between certain priority regions



Note: Southern Europe: Cyprus, Greece, Malta, Italy, Portugal, Spain. CEE region: Bulgaria, Czech Republic, Estonia, Croatia, Poland, Latvia, Lithuania, Hungary, Romania, Slovakia, Slovenia. Other EU: Austria, Belgium, Denmark, Finland, France, the Netherlands, Ireland, Luxembourg, Sweden. Based on a 12-month moving average. Source: Eurostat

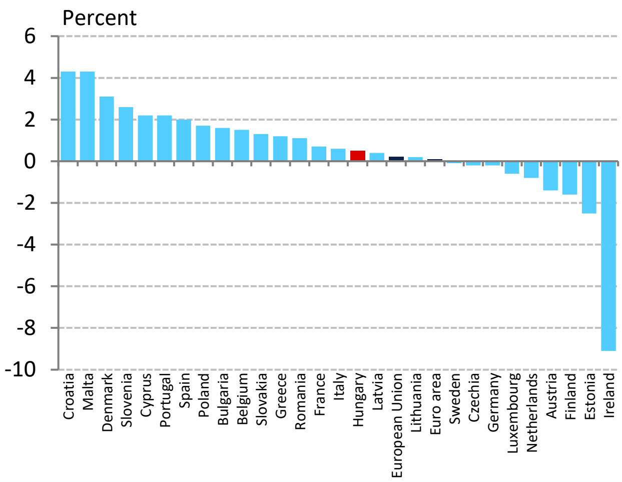
Cyclical and structural phenomena can also be identified behind the weak performance of German exports in 2023: sharply increasing energy prices have led to a significant drop in output in energy-intensive German industrial sub-sectors, while the slowdown in European economic activity has led to a contraction in external demand. The structural problems of German industry, which relies on cheap energy imports, are illustrated by the fact that industrial output was already falling before the Russia-Ukraine war. The time needed to switch to green energy and the rise of Chinese vehicle production also pose risks to German exports in the medium term.

At the same time, despite the risks, the German economy has slowly started to move away from the previous economic model. In recent years, considerable resources have been devoted to promoting the digital switchover and encouraging economic actors to adopt various advanced technologies (e.g. AI). By investing in education and sustainable energy, as well as infrastructure development, the aim is to strengthen Germany’s role as a financial and technology service centre. The changeover may further increase the weight of higher domestic value-added services exports in German exports and improve the global competitiveness of the German economy, which could also have a positive impact on economic growth.

3.2 Analysis of the production and expenditure side of GDP

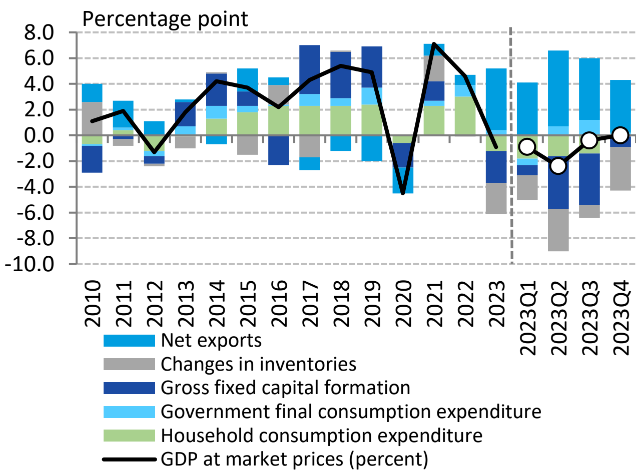
In 2023 Q4, Hungary's gross domestic product stagnated (0.0 percent) both versus the previous quarter and in year-on-year terms. On the consumption side, year-on-year declines were also registered for household consumption expenditure (–0.2 percent), gross fixed capital formation (–3.0 percent) and government collective consumption (–3.8 percent). The contribution of the change in inventories was negative, restraining growth by 3.4 percentage points. The contribution of net exports to growth (+4.1 percentage points) cushioned the decline in domestic demand items. At the end of last year, on the production side, only agriculture (+2.5 percentage points) made a positive contribution to the year-on-year volume index, while that of industry (–1.1 percentage points), construction (–0.5 percentage point) and services (–0.6 percentage point) was negative.

Chart 3-11: Annual GDP change in EU countries in 2023 Q4



Note: Seasonally and calendar adjusted data.
Source: Eurostat

Chart 3-12: Annual change in decomposition of expenditure-side GDP



Note: Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions. Changes in inventories includes acquisitions less disposals of valuables.
Source: HCSO, MNB

In 2023 Q4, Hungary's gross domestic product stagnated (0.0 percent) both versus the previous quarter and in year-on-year terms. The Hungarian economy expanded by 0.5 percent on an annual basis, according to the seasonally and calendar-adjusted data used in international comparisons. Euro area GDP grew by 0.1 percent in the fourth quarter, while EU GDP rose by 0.2 percent (Chart 3-11), meaning that Hungary's growth differential turned positive again after four quarters.

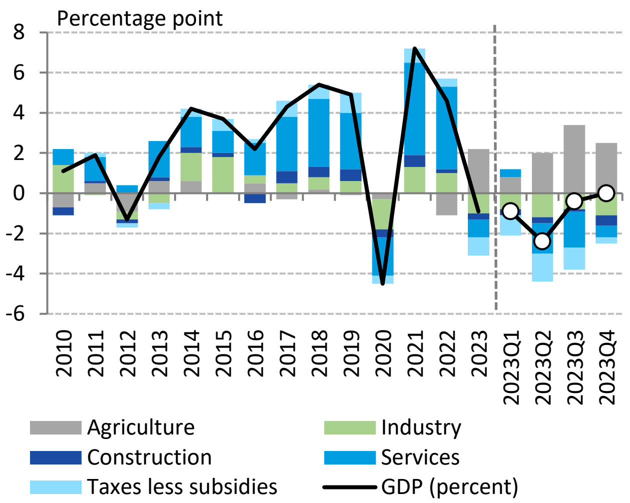
In 2023, Hungary's GDP decreased by 0.9 percent compared to the previous year, while the economy of the European Union and the euro area expanded by 0.4 percent.

Household consumption expenditure dropped by 0.2 percent compared to the same period of the previous year (Chart 3-12). Consumption of semi-durable goods fell the most (–2.1 percent), while the volume of durable goods increased by 1.5 percent and that of services by 0.9 percent. Government collective consumption fell by 3.8 percent on an annual basis.

Gross fixed capital formation decreased by 3.0 percent compared to the same period of the previous year. The four-quarter rolling average of the investment rate was somewhat lower than in the previous quarter, at 26.5 percent. Investment in machinery and equipment fell by 1.1 percent and investment in construction by 4.1 percent on an annual basis in the fourth quarter. Investment by companies producing for foreign and domestic markets also fell, while public and quasi-fiscal investment rose at the end of last year. The change in inventories made a substantially negative contribution, lowering GDP dynamics by 3.4 percentage points. The volume of imports decreased to a greater extent (-9.0 percent) than that of exports (–4.7 percent).

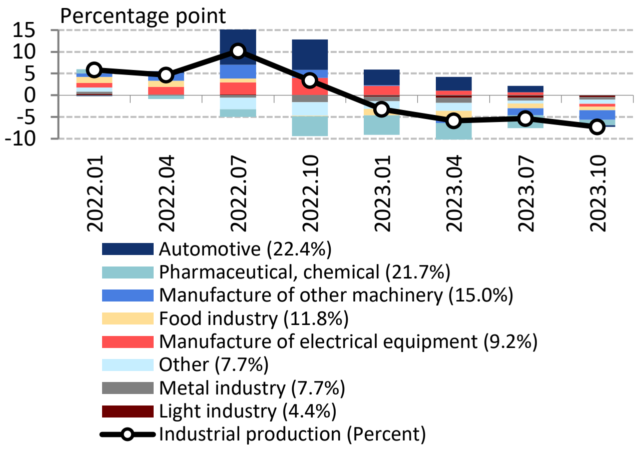
Exports of goods fell by 6.6 percent, while exports of services grew by 3.0 percent compared to the same period of the previous year. The balance of foreign trade in goods showed a surplus of EUR 2.3 billion in the fourth quarter. The terms of trade improved by 9.1 percent year-on-year in the fourth quarter, mainly driven by the correction in the

Chart 3-13: Annual change in decomposition of production-side GDP



Source: HCSO

Chart 3-14: Sectoral breakdown of annual change in domestic industrial production



Note: The 2022 weight of the sectors in industrial production is given in brackets. Excluding the water and waste management industry. Total industrial production does not include the performance of enterprises with less than five employees.
Source: HCSO, MNB

price of mineral fuels. In January 2024, the trade surplus in goods was EUR 497 million, with exports 7.4 percent lower in euro terms and imports 14.3 percent lower than in the same period of the previous year. The trade balance in goods improved by EUR 900 million in year-on-year terms.

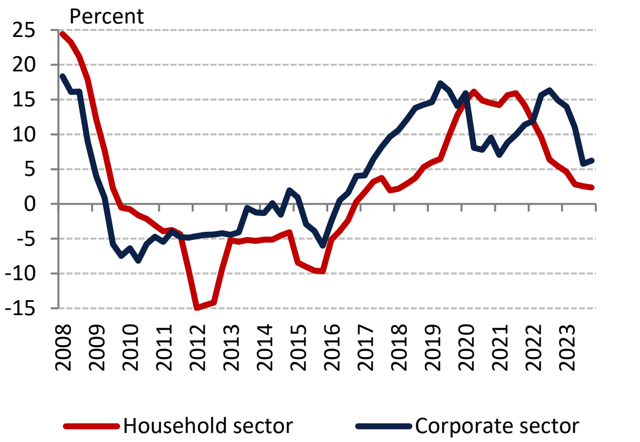
On the production side, the value added of both industry and, within it, manufacturing fell by 6.4 percent versus the same period of the previous year (Chart 3-13). Among the manufacturing sectors, automotive production, which has the biggest weight, decreased by 1.9 percent, electrical equipment production by 8.8 percent, while the food industry by 7.2 percent on average in the fourth quarter year-on-year (Chart 3-14). In January, the volume of industrial production fell by 3.6 percent on an annual basis.

Value added in the construction sector was 7.4 percent lower than in the same period of the previous year. Construction of buildings fell by 7.8 percent and other construction by 3.6 percent in the fourth quarter. The volume of construction contracts was 25.1 percent lower than in the same period of the previous year, while the volume of new contracts increased by 16.6 percent. In January 2024, a year-on-year increase of 17.2 percent was registered for the volume of construction production.

Value added in agriculture rose 81.1 percent in the fourth quarter, from a low base following the drought of 2022, resulting in a GDP growth contribution of +2.5 percentage points.

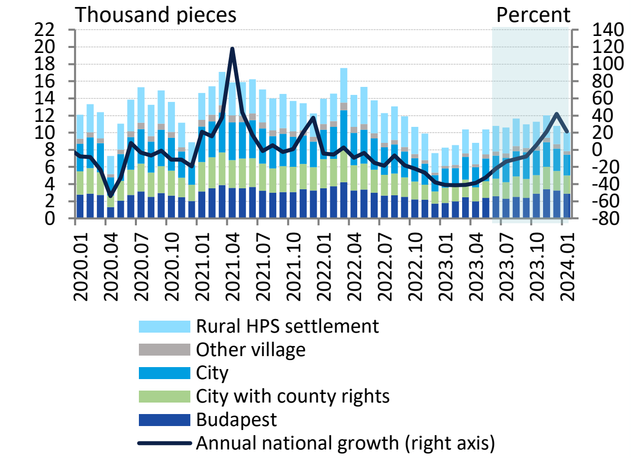
Overall value added in services fell by 1.0 percent in 2023 Q4. Output volumes fell in the heavily weighted trade sector (–8.7 percent), in professional, scientific and technical activities (–4.5 percent) and the transport and storage sectors (–4.3 percent). At the same time, the performance of the information and communication sector increased by 5.0 percent, while accommodation and catering services and arts, recreation and miscellaneous services both expanded by 3.6 percent. The value added of real estate activities increased by 2.1 percent and that of financial and insurance activities by 0.5 percent. Services linked to the government (public administration, defence, compulsory social security, education, human health, social care) increased by 2.3 percent overall. In January 2024, the volume of retail sales increased by 0.6 percent year-on-year based on calendar-adjusted data, ending a year-on-year decline since December 2022. The turnover of NTCA online cash registers increased by 7.5 percent in nominal terms, while inflation-adjusted turnover increased by 3.7 percent year-on-year in February, based on seasonally and calendar-adjusted data. This figure differs from retail trade in that it includes turnover from, among other activities,

Chart 3-15: Annual change in lending to non-financial corporates and households



Note: Data for the corporate and household sector are based on transactions with the total financial intermediary system.
Source: MNB

Chart 3-16: Number of housing market transactions by settlement type



Note: Only taking into account 50-percent and 100-percent private acquisitions. From April 2022 to June 2023, the data of the NTCA fee database are adjusted based on the estimation of the level of processing by type of settlement. Based on transactions and estimated market share of real estate agents in the months highlighted.
Source: Housing market intermediary database, MNB, NTCA

hotels and restaurants, taxi services and some accommodation services.

Banks saw a pick-up in demand for loans in the household loan market in 2023 Q4, while demand for corporate loans stagnated. The annual growth rate of household loans in the total financial intermediary system slowed by 0.2 percentage point quarter-on-quarter, amounting to 2.4 percent at end-December, while corporate loans grew by 6.2 percent in 2023 as a whole, following an acceleration of 0.5 percentage point (Chart 3-15). New contracts in the household sector in the fourth quarter were up 10 percent on the low base value of the same quarter a year earlier, while the number of contracts concluded in the corporate sector fell by 5 percent. Based on the responses to the lending survey, banks saw a pick-up in demand in the household sector in the fourth quarter, while there was no significant change in demand in the corporate sector. Looking ahead to the next six months, however, demand is likely to pick up in both sectors: 36 percent, 62 percent and 23 percent of banks, in net terms, expect an increase in demand for housing loans, consumer loans and corporate loans, respectively.

On an annual basis, housing market turnover increased substantially, especially in the capital (Chart 3-16). In 2023 Q4, the number of private housing transactions nationally was 34,100, which is - against the usual seasonal decrease at the end of the year - up 3 percent from the third quarter, and 21 percent above the very low number of transactions in the same period last year. In January 2024, the number of housing market sales increased year-on-year in all settlement types, but the 62-percent increase experienced in Budapest stood out within that. According to the MNB's house price index, following two quarters of moderate increases, house prices declined by 1.7 percent on a quarterly basis in nominal terms in 2023 Q3, followed by a nominal increase of 1.0 percent in 2023 Q4, according to preliminary data. In 2023, a total of 18,647 new homes were built, 9.2 percent fewer than in 2022. The number of residential building permits issued last year was 21,501, reflecting a 38.6-percent year-on-year decrease.

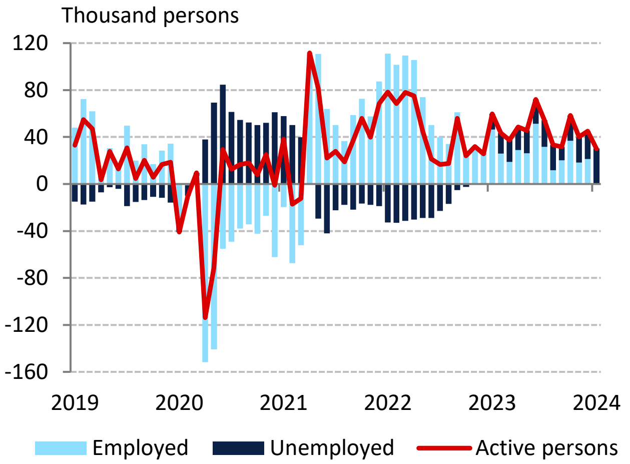
3.3 Labour market

Employment in the national economy remains at high levels. The unemployment rate rose slightly to 4.5 percent in January. With employment stagnating on a year-on-year basis in January, the rise in unemployment resulted from an increase in the number of persons active in the labour market. Labour market tightness seems to be easing, suggesting a moderate adjustment to the change in the business cycle. Wage dynamics in the private sector moderated somewhat in 2023 H2, but increased by 15.6 percent year-on-year in December, due to the minimum wage increases brought forward.

3.3.1 Employment and unemployment

Employment in the national economy remains at high levels. In January 2024, the number of employed persons aged 15–74 was 4,699,000, with the level of employment remaining unchanged compared to the same period of the previous year (Chart 3-17). Based on seasonally adjusted data, the number of persons employed increased by 7,400 compared to the previous month.

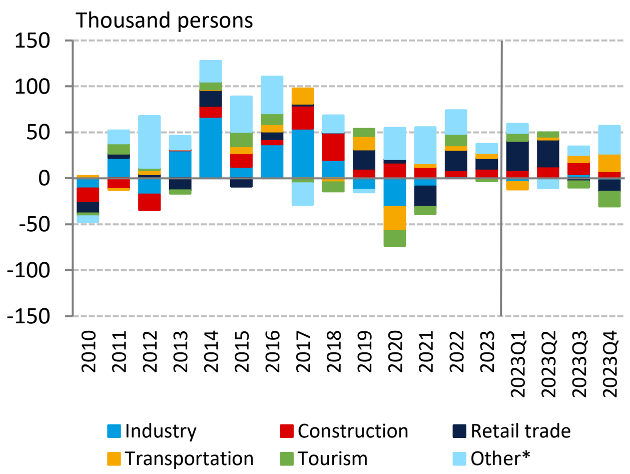
Chart 3-17: Decomposition of annual changes in whole-economy employment



Source: HCSO

Employment develops differently between individual sectors. Based on detailed sectoral data available on a quarterly basis, employment increased in construction, while remaining flat in manufacturing. Employment in the market services sector (including financial and insurance activities, administrative and support service activities, information and communication, and transportation and storage) increased (Chart 3-18), while employment in trade and tourism decreased. Within the public sector, employment increased in education and health services and decreased in public administration on an annual basis. The easing labour demand is also reflected in the underutilisation of available capacities, with the number of full-time equivalent (TME) employees falling by 5.8 percent in the fourth quarter compared to the same period last year.

Chart 3-18: Decomposition of annual changes in private sector employment

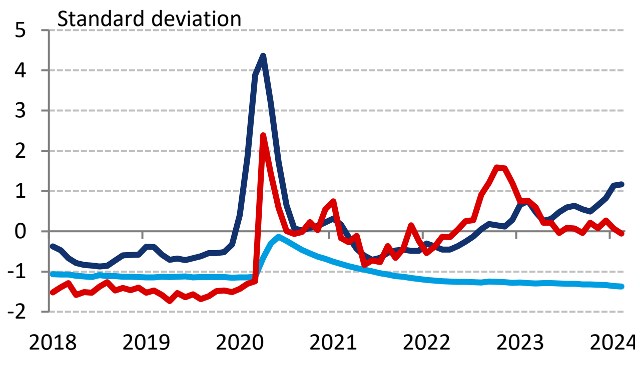


Note: *Agriculture, other industry and service sector branches.
Source: HCSO

In January 2024, the unemployment rate rose slightly to 4.5 percent. The number of unemployed rose gradually in the past period. Based on the latest data for January, the seasonally adjusted unemployment rate was 4.3 percent, while the unemployment rate calculated using the methodology of the HCSO based on a 3-month moving average, averaged 4.6 percent between November 2023 and January 2024. The domestic unemployment rate is still low in international comparison.

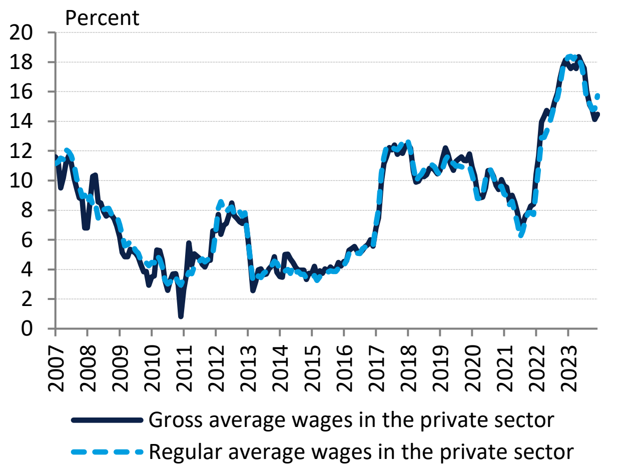
The rise in unemployment is mainly due to jobseekers returning from inactivity. The number of economically active persons continued to rise in January based on seasonally adjusted data. In January 2024, the number of economically active persons increased by 30,000 compared to the same period last year based on non seasonally adjusted data, which is due entirely to an increase in the number of unemployed persons.

Chart 3-19: Indicators capturing the short-term evolution of unemployment



Note: Standardised values.
Source: NES, ESI, Google

Chart 3-20 Annual change in gross average wages in the private sector



Note: Quarterly moving averages.
Source: HCSO

Indicators capturing short-term unemployment trends show a mixed picture (Chart 3-19). The number of registered unemployed was 235,000 in February. The seasonally adjusted data show no significant change compared to the levels observed since spring 2022. The Google Trends indicator for unemployment benefits rose in recent months after stagnating since the summer. According to the ESI consumer survey, consumers' fear of unemployment eased after autumn 2022.

3.3.2 Wages

Wage developments remain strong, but wage growth has eased since May 2023 as inflation declined. In December 2023, average gross earnings in the private sector increased by 15.6 percent on an annual basis, up from 13.3 percent in November (Chart 3-20). Average gross regular earnings in the private sector rose by 18.1 percent year-on-year in December, following a 14.2-percent increase in November, while bonus payments fell short of those in the previous years. The acceleration in wage dynamics in December can be considered temporary, as it can be linked to the base effect resulting from the timing of the minimum wage increase, which was different from 2022, and it is expected to correct in the coming months.

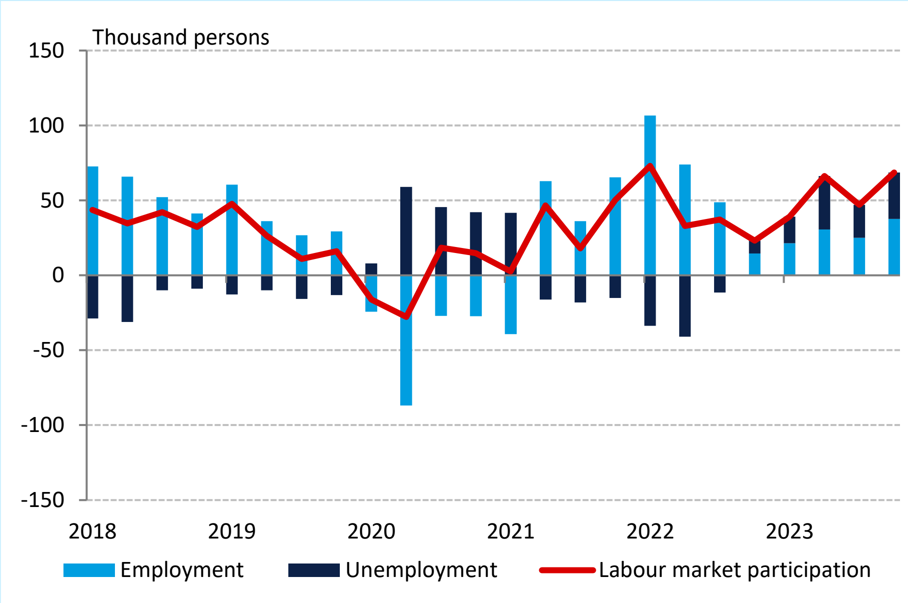
Among the countries in the region, the highest nominal wage growth was observed in Romania and in Hungary in December 2023. Wage growth in the national economy amounted to 16.4 percent in December in Hungary, while earnings grew by 16.8 percent in Romania, 10.7 percent in Slovakia and 9.6 percent in Poland in year-on-year terms. For the Czech Republic, wage data are only available at a quarterly frequency, with average wages rising by 6.3 percent in the fourth quarter. Real wages in Hungary rose at the fastest pace in the region in December. The positive real wage dynamics continued in all countries in the region except the Czech Republic.

Box 3-2: Labour market adjustment and the evolution of tightness

Employment proved resilient to last year's technical recession and remained at a historic high. However, there are channels of adjustment (number of new vacancies, hours worked) through which labour market tightness has eased, and according to our calculations, labour market tightness has fallen to 2017 levels. The cyclical easing of the labour market was also supported by an increase in labour supply (activity).

The increase in labour market activity has led to a significant rise in labour supply. Domestic labour market activity has been rising on an annual basis for more than three years, since 2020 Q3 (Chart 3-21). During the COVID-19 crisis, activity expansion was accompanied by a rise in unemployment and a fall in employment, followed by a labour market recovery with employment expanding and unemployment falling. From 2022 Q4 onwards, however, the increase in activity has been driven by a simultaneous rise in the number of employed and unemployed persons. According to the Labour Force Survey, the number of persons in employment has risen steadily over the past four quarters, in seasonally adjusted terms. On average, employment in October–December was 38,000 persons higher than in the same period of the previous year, reflecting an annual increase of 0.8 percent. This increase is mainly explained by a rise of 26,000 in the number of employees in the private sector.

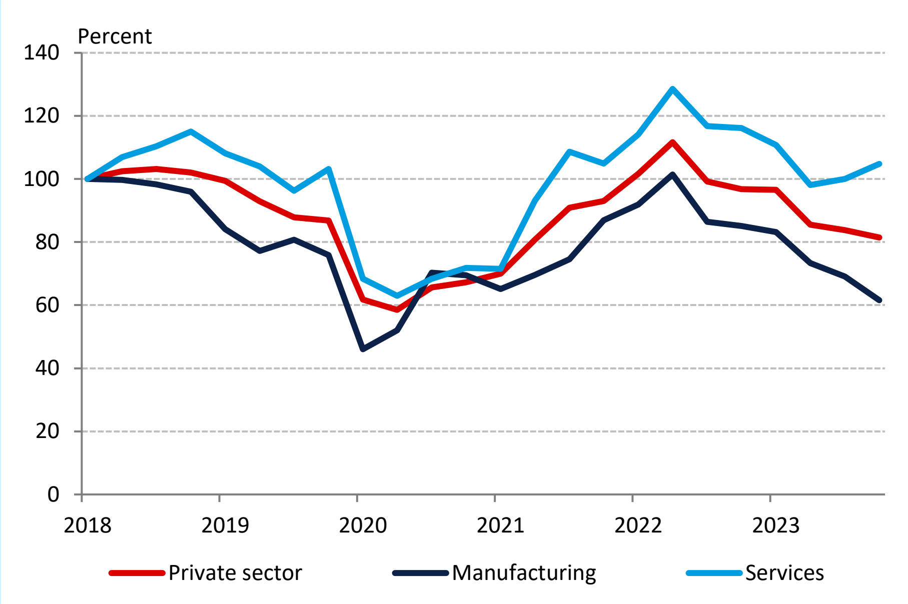
Chart 3-21: Breakdown of annual changes in labour market participation



Source: HCSO

The number of new jobs advertised decreased, according to the HCSO. In the last quarter of 2023, there were 49,000 vacancies in the private sector, down by nearly 10,000 (16.3 percent) compared to the same period of the previous year. The decline hit the manufacturing sector harder than the services sector. In the former, there were more than 6,000 fewer vacancies than this time last year, accounting for a 28.6-percent decrease, while in the latter the number of vacancies fell by 3,000, which is a 9.5-percent contraction. Seasonally adjusted data show that labour demand has been shrinking for six quarters (Chart 3-22), as weak internal and external demand has reduced the number of jobs that firms can create.

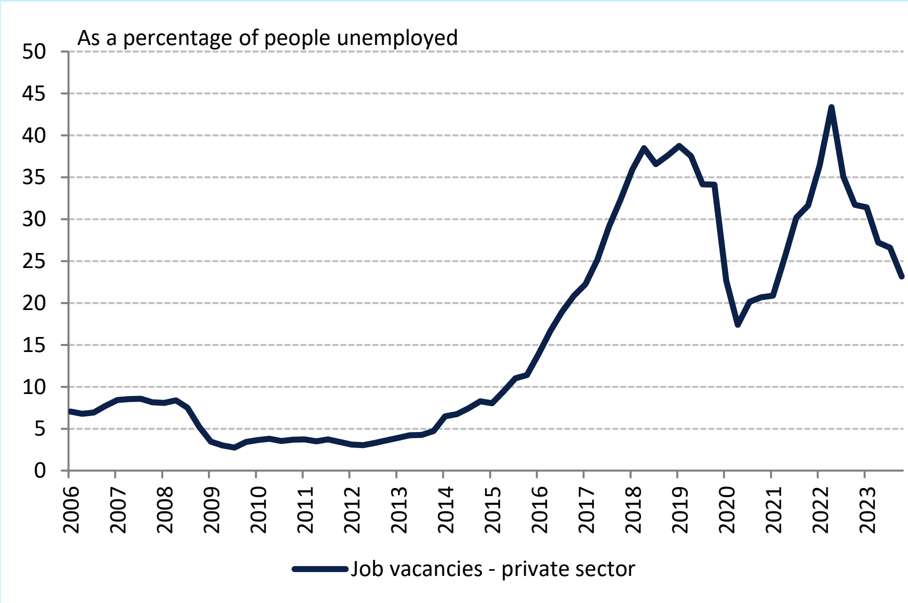
Chart 3-22: Job vacancy trends in the private sector



Note: 2018 Q1 = 100. Seasonally adjusted data.
Source: MNB, based on HCSO

As labour demand fell and labour supply increased, labour market tightness dropped to 2017 levels, but remained high by historical standards (Chart 3-23). The tightness indicator rose to unprecedented levels after the downturn during the COVID crisis, but this trend reversed at the beginning of 2022 and conditions on the labour market began to ease. Competition for workers has also eased somewhat, but in many cases employers still find it difficult to fill vacant positions.

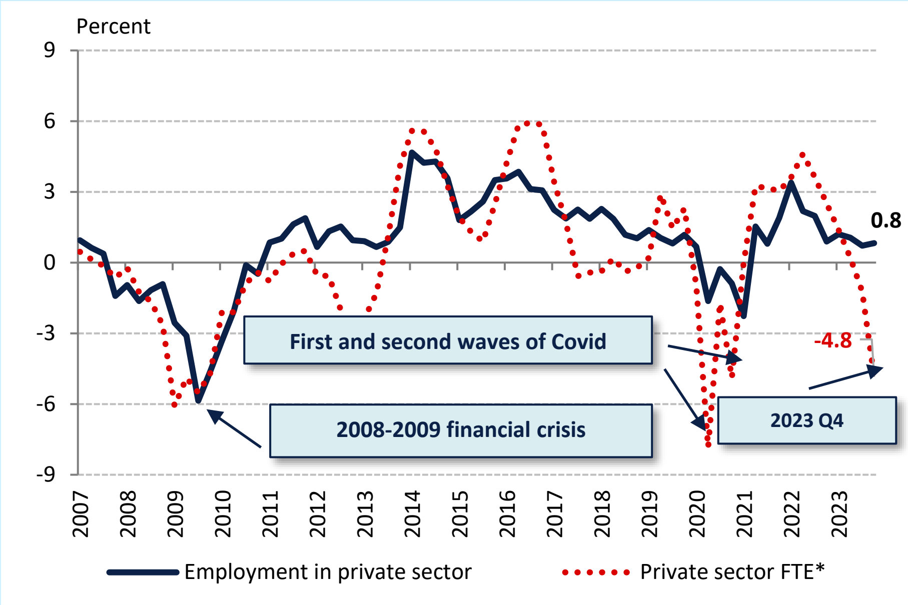
Chart 3-23: Changes in tightness indicator



Note: Seasonally adjusted data.
Source: MNB calculation based on HCSO

Companies have also adjusted the number of hours worked (intensive side). Despite the growth in employment, the total number of hours worked in the private sector has fallen, suggesting that the labour market is looser than the picture emerging from the headline statistics (Chart 3-24). The retention of employees, contrasted by weaker domestic and external demand for goods and services, has resulted in a reduction in hours worked per employee. As this decrease was larger than the moderate increase in the number of employees, the total number of hours worked also fell. The figure for full-time equivalent employment shows the total workload of a worker on the basis of hours worked expressed in full-time work, i.e. it corrects the change in the number of employees by the hours worked. This indicator decreased by 4.8 percent compared to the same prior-year period. Despite the slowdown in GDP, companies have not reduced their employment in a still tight labour market, and thus it is the under-utilisation of their labour force "behind closed doors" that is reflected in a fall in hours worked. The reduction in hours worked may also have been influenced by certain technical factors (end-of-year public holidays schedule, short holiday absences, the winter administrative break, shop closures on 24 and 31 December).

Chart 3-24: Annual change in the number of persons employed and full-time equivalent employment



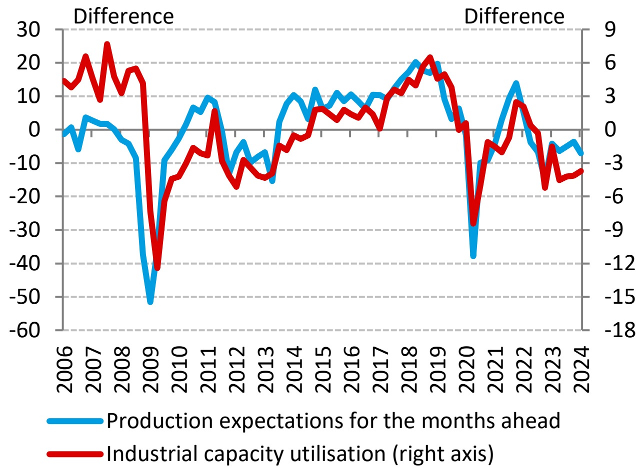
Note: Competitive data. Seasonally adjusted data.
Source: HCSO Labour Force Survey, MNB calculation

Intensive side adaptation affects a wide range of sectors. The service sectors were characterised by a larger reduction in working hours. According to the HCSO's Institutional Labour Statistics, the decrease in hours worked was lower than average in manufacturing and construction, while an increase was recorded in mining.

3.4 Cyclical position of the economy

In 2023 Q4, the Hungarian economy stagnated (0.0 percent) compared to both the previous quarter and the same period of the previous year. The subdued economic performance in recent quarters was largely due to negative contributions from industry and market services. In parallel with this, the cyclical position of the economy is disinflationary. The capacity utilisation and production expectations of manufacturing companies remain below the historical average.

Chart 3-25: Capacity utilisation and production expectations in manufacturing



Note: Deviation from historical average.
Source: MNB based on ESI

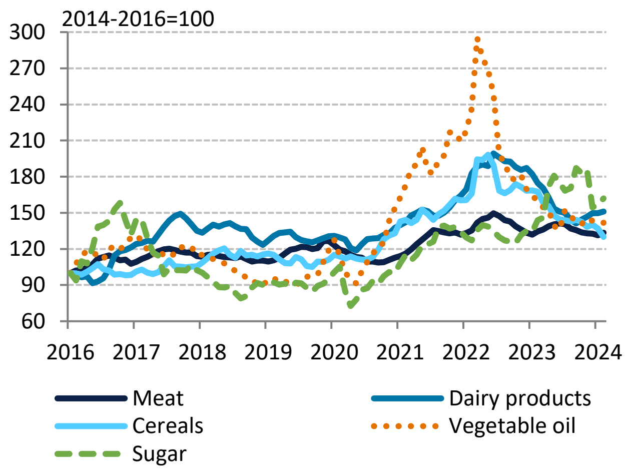
The cyclical position of the economy is estimated to have been negative since the end of 2022 and thus has a disinflationary effect. In 2022 H1, the cyclical position of the economy was positive, driven by buoyant demand and frictions in supply chains, which resulted in a cyclical position with an inflationary effect. Subsequently, however, the cyclical position of the economy gradually turned negative in parallel with the deceleration in economic performance. Agriculture contributed 2.2 percentage points to economic growth last year. If the volatile performance of agriculture is excluded from GDP, the output gap would currently be even more negative. Both the slowdown in demand and the expected unwinding of supply-side constraints resulted in disinflationary effects from the real economy.

According to questionnaire surveys, the capacity utilisation and production expectations of manufacturing companies remain below the historical average (Chart 3-25). Production expectations for the coming months have not changed significantly over the past period, with capacity utilisation slowly improving over the past year.

3.5 Costs and inflation

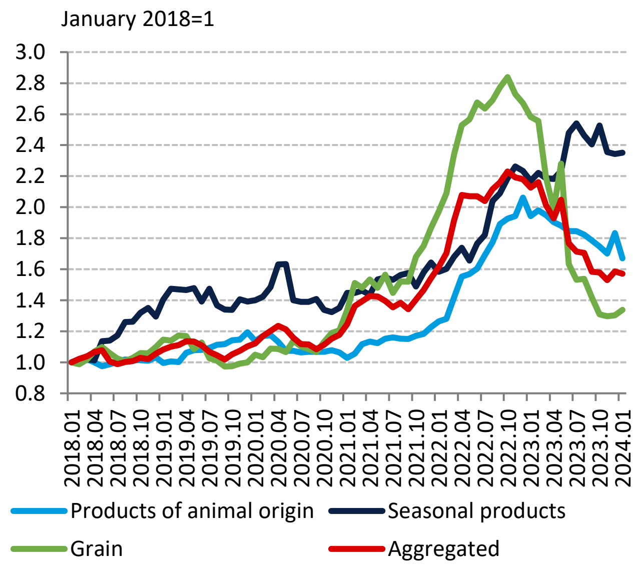
Inflation continued to fall in early 2024. The consumer price index was 3.8 percent in January and 3.7 percent in February, bringing it back into the central bank's tolerance band. The sharp deceleration in inflation over the past 13 months results from a combination of disciplined monetary policy, pro-competitive government measures, subdued demand, base effects and a much lower external cost environment than in the past. Both core inflation and core inflation net of indirect taxes eased to 5.1 percent in February, and disinflation was observed generally within core inflation. The rate of price change versus the previous month for both inflation and core inflation is in line with the historical average for this period of the year.

Chart 3-26: Development of world market prices of food



Source: FAO

Chart 3-27: Development of agricultural prices



Note: Based on seasonally adjusted data.
Source: HCSO

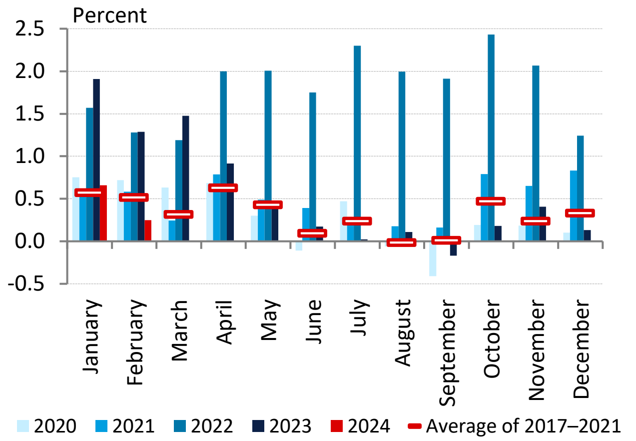
3.5.1 Producer prices

In February, world food prices continued on the downward trend that has been seen since March 2022. The month-on-month decline in food prices is explained by developments in cereal and oilseed prices, which were only partly offset by increases in sugar, meat and dairy product prices. According to FAO data, cereal prices in February fell by 22.4 percent on an annual basis and by 5 percent on a monthly basis, as harvests in southern regions began and prices in Ukraine were favourable. Meat prices were 0.8 percent lower than in February last year, but rose by 1.8 percent compared to January, breaking the downtrend observed since June. Oilseed prices fell by 11 percent year-on-year and 1.3 percent on a monthly basis. Prices for dairy products were 13.4 percent lower on an annual basis, but up 1.1 percent on January. World sugar prices rose by 12.5 percent year-on-year and 3.2 percent on a monthly basis, driven by below-average supply in Brazil and unfavourable production prospects in India and Thailand (Chart 3-26).

The rate of decline in domestic agricultural producer prices began to slow down in December, but year-on-year prices still fell by 26.1 percent in January. Among the sub-categories, only the producer price index for seasonal products rose in year-on-year terms, advancing by 8.3 percent. The decline in the price level of products of animal origin continued, with the price index for these products falling by 14.0 percent on an annual basis. Compared to the same period of the previous year, producer prices for cereals fell significantly, showing a decline of 48.2 percent (Chart 3-27).

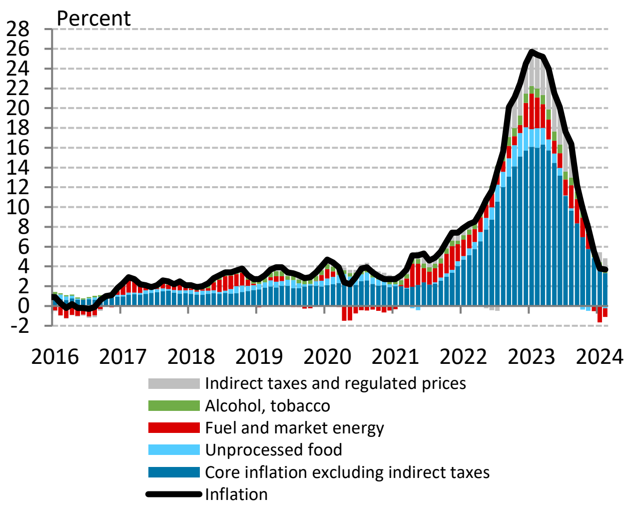
Producer prices for manufactured goods for domestic sale fell by 3.8 percent on an annual basis in January 2024. Domestic sales prices for industry overall decreased by 7.6 percent compared to January of the previous year. Producer prices were 16.6 percent lower in the energy sector and 6.2 percent lower in the food sector compared to the same period last year.

Chart 3-28: Monthly price changes of consumer prices excluding fuel and regulated prices



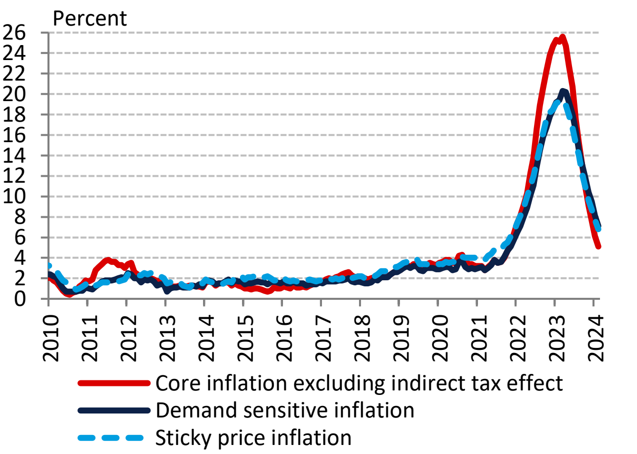
Note: Tax-adjusted, seasonally unadjusted monthly change.
Source: MNB calculation based on HCSO data

Chart 3-29: Decomposition of inflation



Source: MNB calculation

Chart 3-30: Underlying inflation indicators



Source: MNB calculation based on HCSO data

3.5.2 Consumer prices

On a year-on-year basis, consumer prices rose by 3.7 percent in February, bringing the price index back into the central bank's tolerance band again after January (Chart 3-29). The consumer price index fell by 0.1 percentage point compared to the previous month, with the contribution of industrial goods (–0.4 percentage point) and food (–0.3 percentage point) to disinflation offset by the upward impact of fuels (+0.6 percentage point). The sharp deceleration in inflation over the past 13 months results from a combination of disciplined monetary policy, pro-competitive government measures, subdued demand, base effects and a much lower external cost environment than in the past. The price of the basket excluding fuel and regulated prices rose by 0.2 percent relative to the previous month (Chart 3-25). Month-on-month core inflation excluding processed food, which better reflects underlying trends, rose by 0.3 percent.

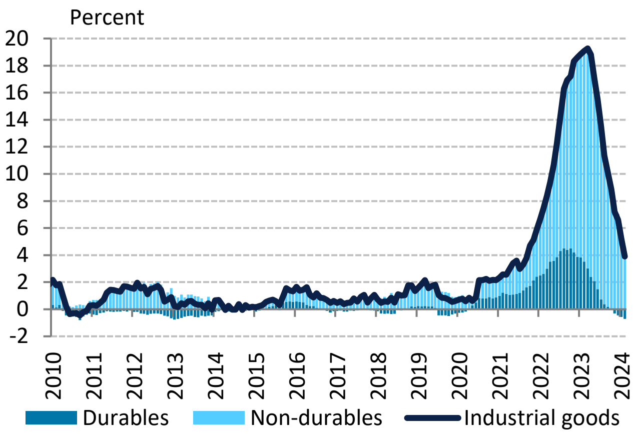
Both core inflation and core inflation excluding indirect tax effects eased to 5.1 percent. Core inflation fell by 1.0 percentage point on an annual basis, with disinflation being widespread. Indicators capturing more persistent inflation trends also moderated (Chart 3-30). The deceleration in underlying inflation processes is indicated by the fact that both core inflation and inflation were below 3 percent in the annualised shorter base (annualised 3month/3month change) comparison. The rate of price increase compared to the previous month was in line with the historical average for this time of year for both the overall consumer basket and core inflation.

The annual inflation of industrial goods dropped to 3.9 percent in February. The price dynamics of non-durable goods decreased to 6.7 percent, while prices of durable goods fell by 2.0 percent compared to the same period of the previous year (Chart 3-31). On a monthly basis, prices of industrial goods decreased by 0.1 percent. Within the product group, the monthly price increase in non-durable industrial goods was offset by a decrease in the prices of durable industrial goods (Chart 3-32).

The year-on-year price index for market services fell to 10.7 percent, continuing the moderation in annual price dynamics that started in June of last year. Month-on-month prices increased by 0.6 percent (Chart 3-33).

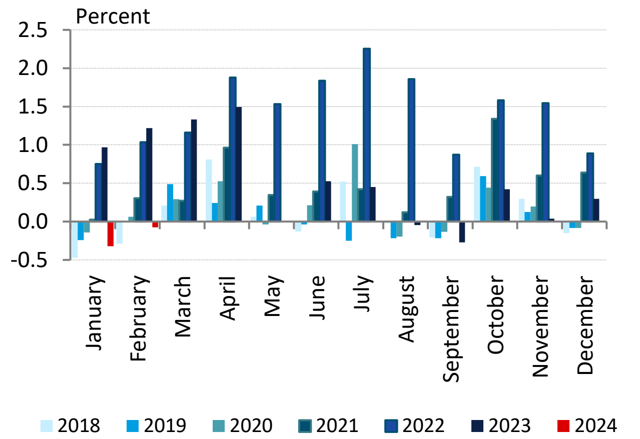
The price index for alcohol and tobacco products dropped into the single-digit range at the start of the year, with inflation for this product group easing to 5.3 percent in February. Compared to January, the price of this product group rose by 1.0 percent.

Chart 3-31: Inflation of industrial goods



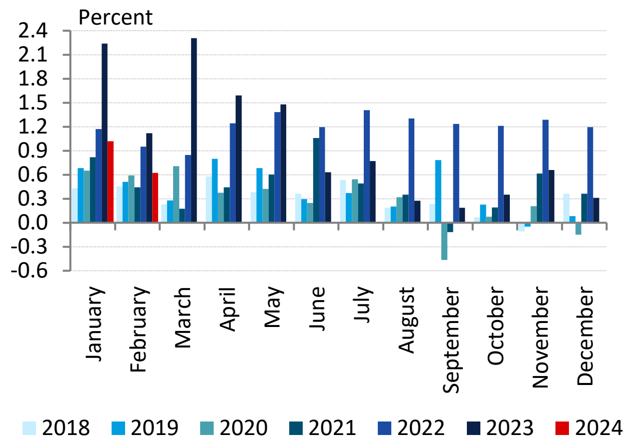
Note: Year-on-year change, excluding the effect of indirect taxes.
Source: MNB calculation based on HCSO data

Chart 3-32: Monthly price changes of traded goods



Note: Seasonally non-adjusted, tax adjusted monthly change.
Source: MNB calculation based on HCSO data

Chart 3-33: Monthly price change of market services



Note: Tax-adjusted, seasonally unadjusted monthly change.
Source: HCSO, MNB

Annual food inflation eased to 2.2 percent in February, according to HCSO data. Within the product group, unprocessed and processed food inflation both declined, with the latter showing negative year-on-year price changes, similar to January. Compared to January, unprocessed food prices were flat, while processed food prices fell by 0.1 percent.

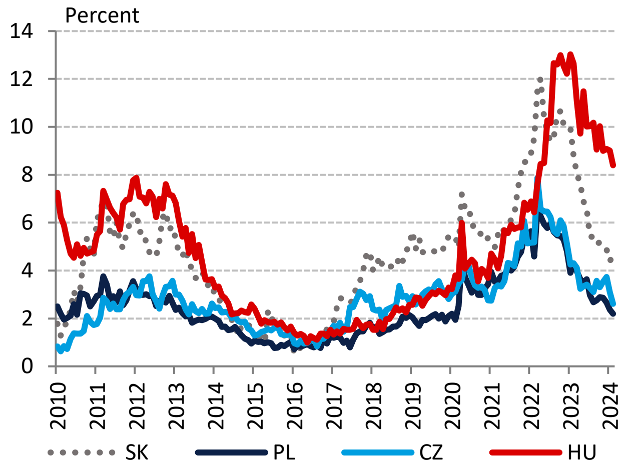
Fuel prices rose by 6.7 percent month-on-month. The increase in excise duty, which came into force on 1 January, has contributed significantly to the rise in prices and has gradually fed through to the consumer price of fuel. The average price of the product group decreased by 2.4 percent on an annual basis.

In February, both inflation and core inflation were below the median forecast in the December Inflation Report, with the difference explained mainly by better-than-expected price developments for food in the case of inflation and for processed food in the case of core inflation.

3.5.3 Inflation expectations

In Hungary, households' inflation expectations moderated somewhat in February. Compared to 2023 Q4, inflation expectations in the countries of the region also fell slightly in February (Chart 3-34).

Chart 3-34: Inflation expectations in the region



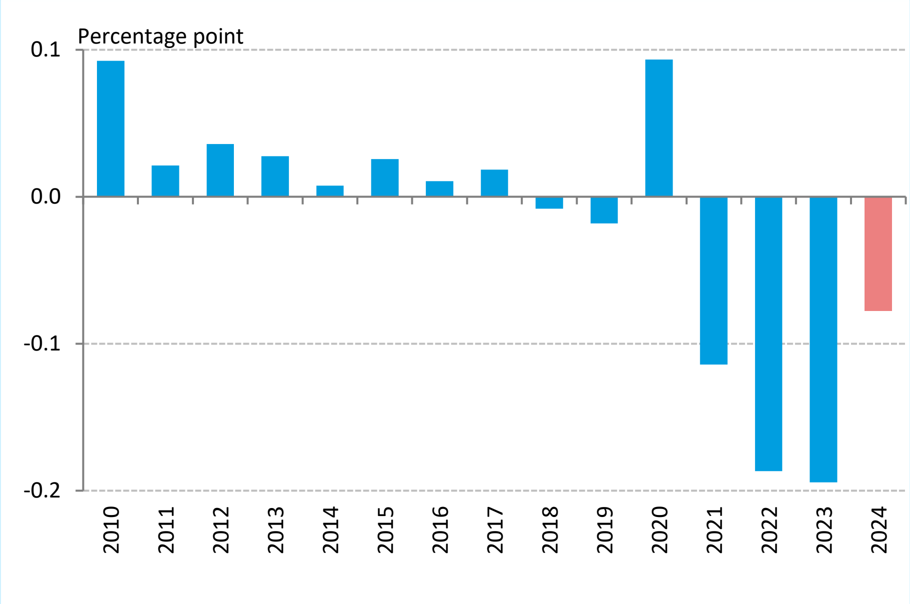
Source: MNB calculations based on European Commission data

Box 3-3: Impact of the change in the weights of the consumer basket on inflation

In line with international practice, the HCSO annually reviews the weight of each item in the consumer basket to better reflect current consumption patterns. Changes in weights may affect the inflation rate if price dynamics differ significantly across product and service groups. In this box we examine the impact on inflation of changes in the weights of the consumer basket between 2023 and 2024.

Changes in weights generally had a minimal impact on inflation until 2020. The structure of household consumption rarely changes much from one year to the next, and accordingly the distribution of items within the consumer basket has typically changed little and their impact on inflation has generally been modest. This effect never exceeded 0.1 percentage point in absolute terms between 2010 and 2020 (Chart 3-35). **The successive waves of inflation in the 2020s have accelerated the pace of change in consumer habits and, as a result, the change in weights has had a greater impact on the CPI.** The change in weights increased inflation in 2020, while decreasing it by 0.1 percentage point in 2021 and by almost 0.2 percentage point in 2022 and 2023. The larger-than-usual inflationary impact in all three years was caused by large weight shifts in different product groups. The disinflationary effect is mainly related to changes in the share of fuel in 2021, food and regulated prices in 2022 and alcohol and tobacco in 2023.

Chart 3-35: Inflationary impact of changes in inflation weights in the past

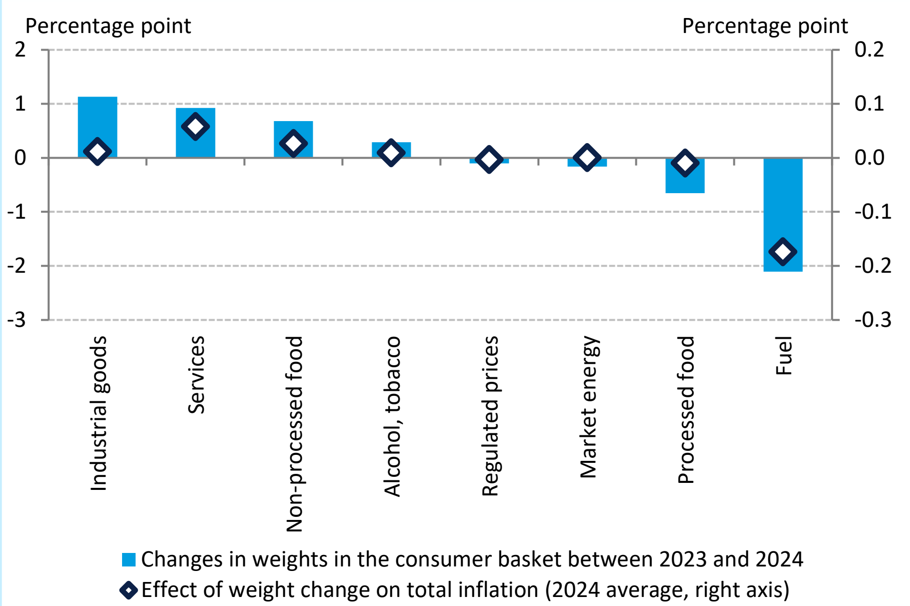


Note: Estimate of 2024 value based on the midpoint of our forecast range for 2024.
Source: HCSO, MNB calculation

Based on consumption data for 2023, the main change this year is a decrease in the weight of fuels and a corresponding increase in the share of industrial goods and services in the consumer basket. From 2023 to 2024, the weight of fuels decreased from 8.1 percent to 6.0 percent, while the weight of industrial goods and market services both increased by 1 percentage point. Among food products, the decline in the share of processed food was offset by an increase in the share of unprocessed food. The weights of the other items changed to a negligible extent. As a result of the above effects, the weight of core inflation within the total consumer basket rose to 65.1 percent. This represents an increase of 1.4 percentage points in one year, which is historically high, with a larger change over one year only seen once since 2010, namely in 2021. The volatility of the weight change is also significant for fuels: the weight of this product group increased by 1.7 percentage points last year and decreased by 2.1 percentage points this year, while between 2010 and 2020, changes of 0.5 percentage point per year were typically observed.

Despite the continued high volatility of weights, the overall impact on inflation is moderate, with the change in weights reducing inflation this year by almost 0.1 percentage point. The fall in the weight of fuels reduces inflation by almost 0.2 percentage point, but this is partly offset by the upward impact of the weight changes in market services and processed food (Chart 3-36).

Chart 3-36: Changes in inflation weights in 2024 and their impact on inflation this year



Note: Based on the midpoint of our forecast range for 2024.

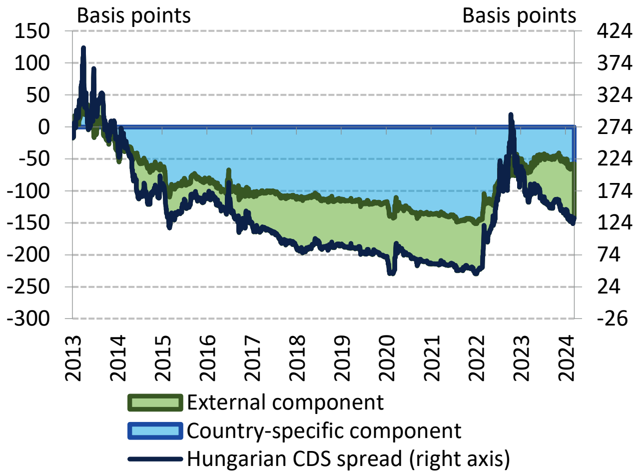
Source: HCSO, MNB calculation

4 Financial markets and interest rates

4.1 Domestic financial market developments

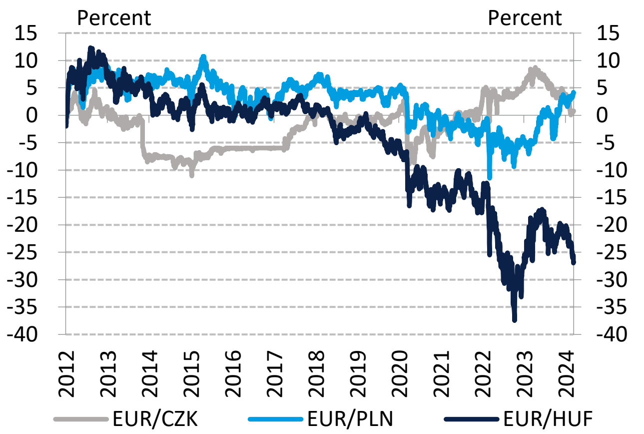
Overall, money and capital market sentiment deteriorated somewhat in the past quarter. The risks from the geopolitical conflict in the Middle East remain significant. Expectations about the interest rate policies of the advanced market central banks and the communication of central bank decision-makers played a key role in asset price developments. Moreover, investors' risk appetite has been dampened by concerns about the Chinese economy. Domestic long-term government bond yields rose on the back of weakening global investor sentiment. At the same time, domestic disinflation and continued monetary policy easing have led to a decline in domestic interbank yields and a reduction in the country's risk premium. The forint weakened against the euro and the US dollar over the period, with the rate of depreciation against both of these currencies amounting to nearly 5 percent.

Chart 4-1: Components of the 5-year Hungarian CDS spread



Note: The decomposition method used can be found in the MNB Bulletin: Variance decomposition of sovereign CDS spreads, Kocsis–Nagy (2011).
Source: Bloomberg, MNB

Chart 4-2: Exchange rates in the region



Note: Changes compared to beginning of 2012. Positive values mean appreciation of the currency.
Source: Bloomberg

4.1.1 Risk assessment of Hungary

Hungary's credit risk premium continued to decline over the period. A larger decrease was observed in the middle of the period, with an overall reduction of the premium by 13 basis points to 132 basis points (Chart 4-1), with country-specific factors contributing more significantly to this.

4.1.2 Foreign exchange market trends

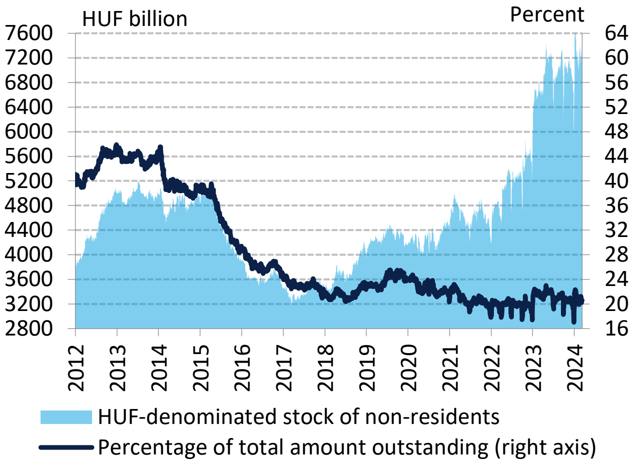
The forint weakened by nearly 5 percent against the euro over the period as a whole, showing a larger depreciation in the second half of the period. Within the region, the Czech koruna also weakened by 3.2 percent, while the Polish zloty appreciated by 1 percent, and the Romanian leu remained broadly unchanged over the period (Chart 4-2). Risk appetite, the monetary policy decisions of developed and regional central banks and incoming macroeconomic data over the period were behind the developments in regional currencies. The forint and the Czech koruna weakened by around 3–3.5 percent versus the US dollar, while the Polish zloty strengthened by more than 1 percent over the period.

4.1.3 Government securities market and changes in yields

Over the past quarter, the stock of non-residents' government securities continued to rise (Chart 4-3). Non-residents' holdings of HUF government securities expanded by HUF 464 billion during the period to reach HUF 7,297 billion. The share of forint government bonds moderately rose in the last quarter to around 20.6 percent.

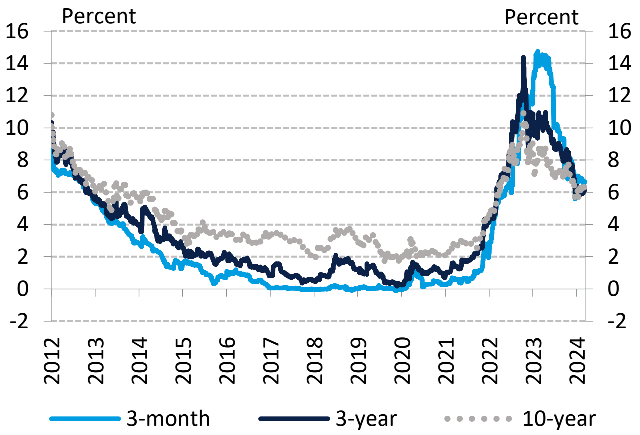
During the period, the Government Debt Management Agency accepted somewhat higher-than-announced volumes of bids at government bond auctions, as demand was more subdued than in the previous quarter, but still almost double the volume offered at auctions. Over the past quarter, average yields on short-term and long-term bonds rose, while average yields on medium-term bonds

Chart 4-3: HUF-denominated government securities held by non-residents



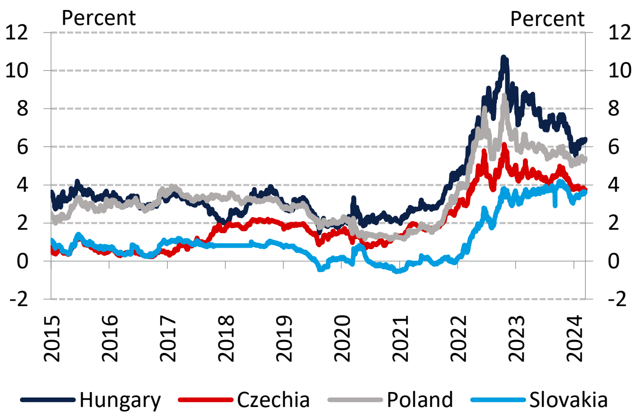
Note: The chart shows the stock of T-bills and T-bonds.
Source: MNB

Chart 4-4: Yields of benchmark government securities



Source: Government Debt Management Agency (ÁKK)

Chart 4-5: 10-year government benchmark yields in CEE countries



Source: Bloomberg

fell. Average yields rose by 10 basis points at the 3-month discount treasury bill auction and by 46 basis points at the 10-year auction.

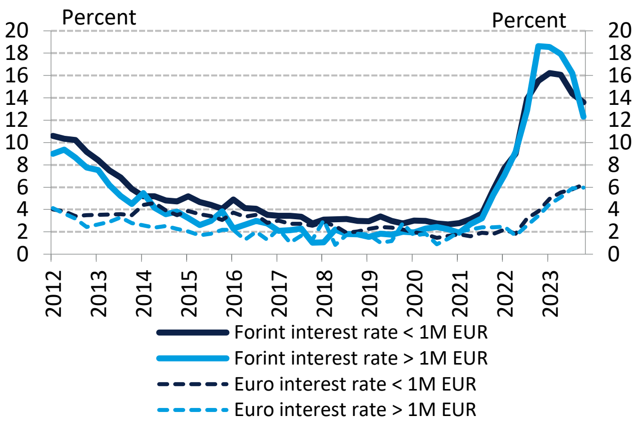
Yields on government bond markets rose on the short and long sections of the yield curve, while yields fell somewhat on the middle section, with the largest change for the period observed for long maturities (Chart 4-4). Overall, the 5-year yield rose by 27 basis points and the 10-year yield by 46 basis points during the past quarter. Looking at interbank yields, the 3-month BUBOR fell by 217 basis points to 8.08 percent.

With the exception of Czechia, long benchmark yields in the region rose during the past quarter (Chart 4-5). The 10-year Polish yield rose by 36 basis points and the 10-year Slovak yield by 44 basis points, while the Czech 10-year yield fell by 17 basis points.

4.2 Credit conditions of the financial intermediary system

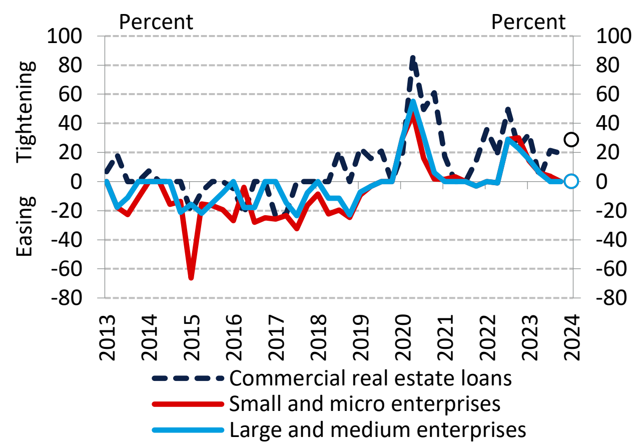
In 2023 Q4, corporate credit conditions did not change in any company size category, while a net 19 percent of banks tightened their credit standards for commercial real estate loans. In the fourth quarter, a narrow range of banks, almost net 6 percent, reported a decline in demand for corporate loans, but looking ahead to the next six months, 23 percent of respondents expect overall demand for loans to pick up again. Banks' lending capacity remains high. Overall, banks left housing loan conditions broadly unchanged, while 15 percent of banks eased standards on consumer loans, but looking ahead to the next six months, no significant changes in lending standards are expected for any of the products. Banks reported a pick-up in demand for both housing and consumer loans in 2023 Q4, with further strengthening expected in 2024 H1. The average financing cost of newly contracted corporate HUF loans and the average cost of newly contracted fixed-rate long-term housing loans both declined during the period under review, due to the fall in borrowing costs and partly due to regulatory action.

Chart 4-6: Interest rates on new corporate loans



Note: Loans with variable interest rate or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million.
Source: MNB

Chart 4-7: Changes in credit conditions in corporate sub-segments



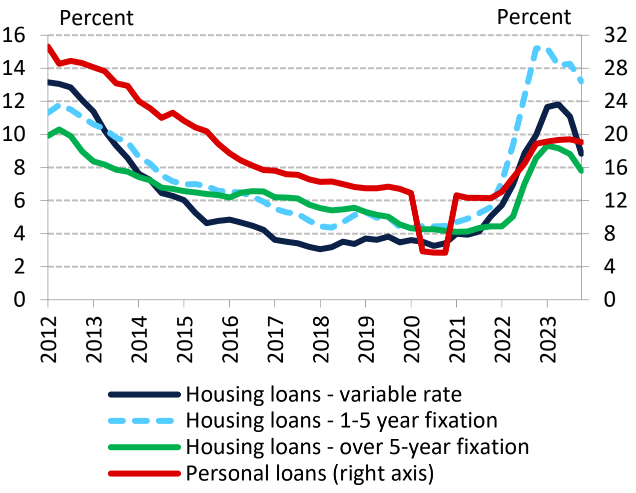
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Forecast for 2024 H1.
Source: MNB, based on banks' responses

4.2.1 Corporate credit conditions

In 2023 Q4, HUF lending rates fell in conjunction with the decline in borrowing costs. Net of money market transactions, the average interest rate on newly contracted corporate HUF loans with variable interest rates within a 12-month period, which are largely market-based, decreased by 0.8 percentage point from the previous quarter for small loans and by 3.9 percentage points for larger loans. As a result, the average interest rate on forint loans amounted to 12.4 percent at end-December (Chart 4-6). The interest rate on small, EUR-denominated loans increased by 43 basis points, while the interest rate on large EUR loans rose by 6 basis points in the fourth quarter, bringing the average cost of funds of EUR loans to 6.0 percent at end-December. The increase in corporate euro interest rates was due to the rise in interbank interest rates in the euro area.

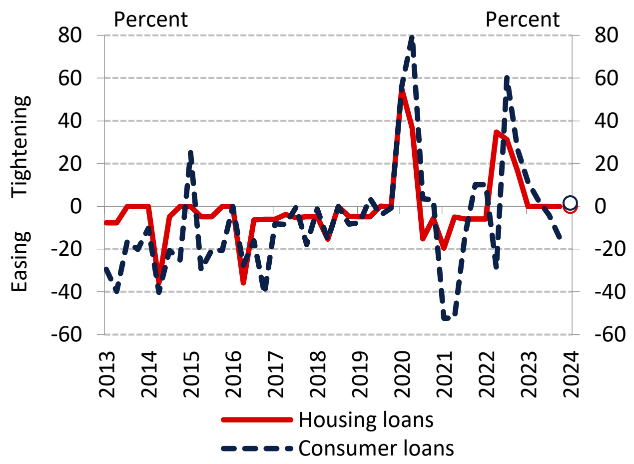
In 2023 Q4, banks left overall corporate credit conditions unchanged, and they do not intend to change these conditions in 2024 H1. In the fourth quarter, the banks participating in the Lending Survey did not change their standards for small and micro enterprises and large and medium-sized enterprises. A net 19 percent of banks reported tightening credit standards for commercial real estate loans. Among the individual factors, industry-specific problems in the corporate sector and changes in banks' risk tolerance had the greatest impact on tightening. Banks' lending capacity remains high. Banks do not plan to make significant changes to corporate lending standards in any corporate size category in the next six months, but 29 percent of banks in net terms are considering further tightening in commercial real estate lending (Chart 4-7). In terms of loan demand, a narrow range of banks, at almost net 6 percent, reported a decline in demand for corporate loans in the fourth quarter, while looking ahead to the next six months 23 percent of respondents expect overall demand for corporate loans to pick up again.

Chart 4-8: Annual percentage rate of charge on new household loans



Note: Quarterly average of lending rates on newly disbursed loans. In the case of loans with 1-5 year fixation, the most recent data cover loans subsidised by the state, in which case the interest rate shown in the figure also includes the subsidy paid by the state.
Source: MNB

Chart 4-9: Changes in credit conditions in the household sector



Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Forecast for 2024 H1.
Source: MNB, based on banks' responses

4.2.2 Household credit conditions

The average interest rate on long-term fixed-rate mortgages continued to fall during the quarter. The average APR of housing loan contracts signed in 2023 Q4 for loans with fixed interest rates for 1–5 years (a significant share of which are subsidised loans linked to the Home Purchase Subsidy Scheme for Families) was 13.2 percent, down 1.1 percentage points from the previous quarter, while the average cost of credit for loans with fixed interest rates for a term of more than five years reached 7.8 percent in December 2023, down from 8.8 percent in September 2023 (Chart 4-8). The application of the voluntary APR cap by the majority of banks from 9 October may have contributed to the reduction. In 2023 Q4, the volume of certified consumer-friendly housing loans with an interest period of at least five years accounted for 39 percent of new housing loan disbursements in the quarter, while the share of loans with a fixed term of at least ten years reached 78 percent. The average smoothed APR for personal loans decreased by 33 basis points to 19.1 percent at the end of the period under review.

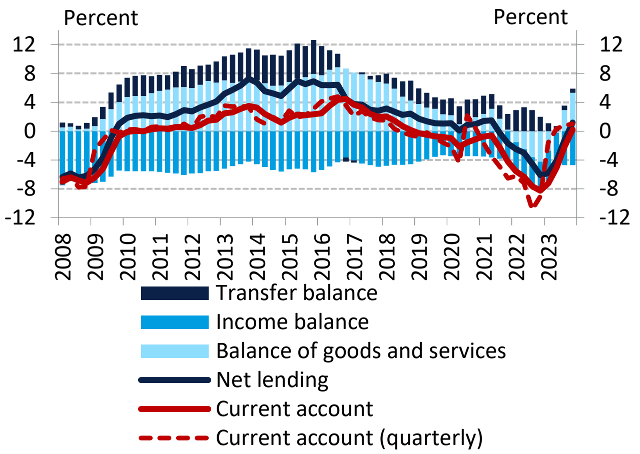
Overall, the standards for housing loans have not changed, and no substantial changes are expected going forward. Based on the responses to the Lending Survey, overall, banks did not change the standards for housing loans in 2023 Q4, while 15 percent of banks eased the standards on consumer loans (Chart 4-9). Looking ahead to 2024 H1, responding banks did not indicate any significant changes in the expected evolution of credit conditions for either housing or consumer loans. During 2023 Q4, responding institutions saw a pick-up in demand for both housing loans and consumer loans, which they expect to strengthen further in 2024 H1.

5 Balance position of the economy

5.1 External balance and financing

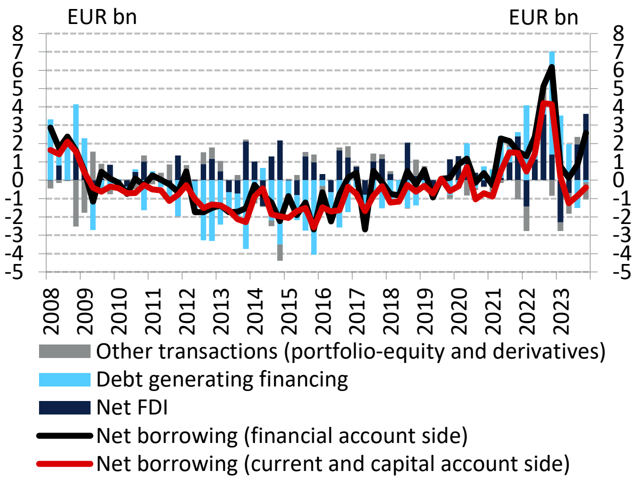
According to preliminary data, the current account balance turned into a surplus of 0.2 percent of GDP in 2023, after a deficit of 8.2 percent in 2022, while the net lending of the real economy amounted to around 1.2 percent of GDP. The improvement in the external balance continues to be linked to the trade balance, mainly driven by lower energy prices and a general contraction in domestic demand. On the financing side, net FDI inflows were significant at the end of the year, while debt-generating funds declined somewhat. In 2023 Q3, the country's external debt-to-GDP ratios declined more sharply, with gross external debt at 64.4 percent of GDP and net external debt at 11.9 percent of GDP.

Chart 5-1: Changes in net lending and its components



Note: Cumulated four-quarter values, as a percentage of GDP.
Source: MNB

Chart 5-2: Structure of net lending



Note: Net lending from the financial account side corresponds to the sum of current account, capital account and the BOP balance of statistical errors and omissions. From an economic point of view, fundamental developments in the dynamics of debt ratios are not affected by the switch between gold bullion and unallocated gold accounts so this technical effect is excluded from time series.
Source: MNB

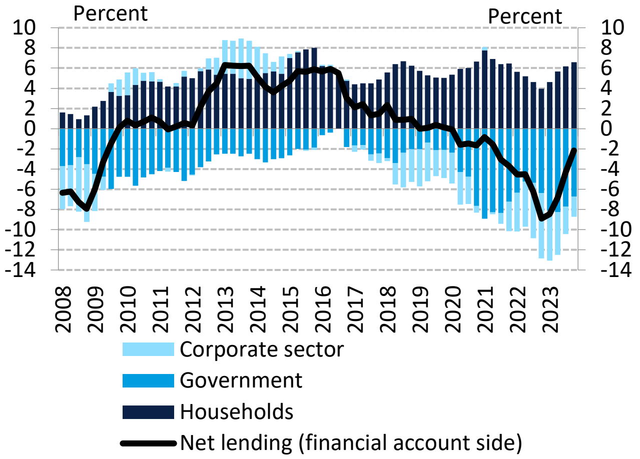
According to preliminary data, Hungary's current account balance and net lending both turned positive in 2023 (Chart 5-1). Based on preliminary monthly data, the country's current account balance turned into surplus in 2023, mainly due to an improvement in the foreign trade balance, including the balance of goods. For the year as a whole, the increase in the balance of goods was also driven by a decline in the energy import bill and falling imports, reflecting contracting consumption and investment. The other component of the foreign trade balance, the surplus of the balance of services over GDP, remained broadly stable. The improvement in the indicators was held back somewhat by the fact that interest expenditure and rising profits of foreign companies increased the deficit on the income balance. The surplus on the transfer balance has been restrained at below 1 percent of GDP, despite EU transfers arriving in 2023 Q4.

5.1.1 Developments in financing

In 2023 Q4, FDI stock continued to grow dynamically, while debt-generating funds showed a moderate outflow (Chart 5-2). In the last quarter of 2023, net foreign direct investments increased again significantly, mainly due to the reinvestment of foreign investment income in Hungary. The stock of debt-type funds continued to decline moderately in the fourth quarter, as indicated by transaction data: the inflow of general government was more than offset by a substantial reduction in foreign debt by banks and corporates.

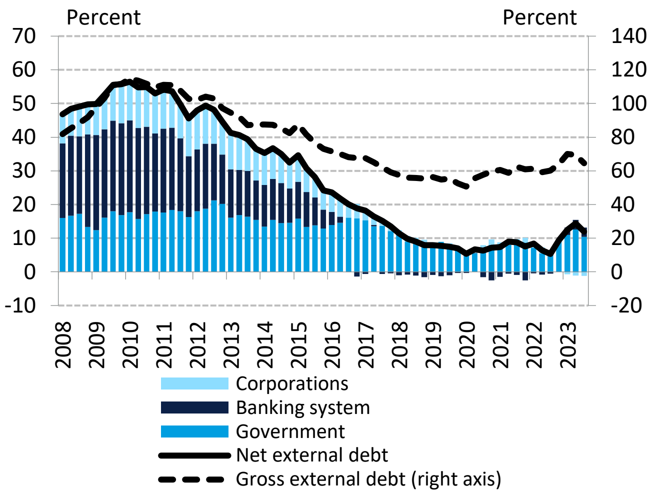
In 2023 Q4, all three domestic sectors contributed to the decline in net borrowing (Chart 5-3). The net borrowing of the general government declined mainly as a result of nominal GDP growth and the reduction in public energy expenditure in line with world prices. Net financial savings in the private sector also improved, mainly related to subdued consumption and investment. Household net savings rose further to 6.6 percent of GDP, returning to levels close to those at the end of 2021. At the same time, the economy's financing needs have also been dampened

Chart 5-3: Decomposition of net lending by sectors



Note: Four-quarter cumulation, as a percentage of GDP.
Source: MNB

Chart 5-4: Development of net external debt by sectors



Note: From an economic point of view, fundamental developments in the dynamics of debt ratios are not affected by the switch between gold bullion and unallocated gold accounts so this technical effect, as well as intercompany loans are excluded from time series. As a percentage of GDP.
Source: MNB

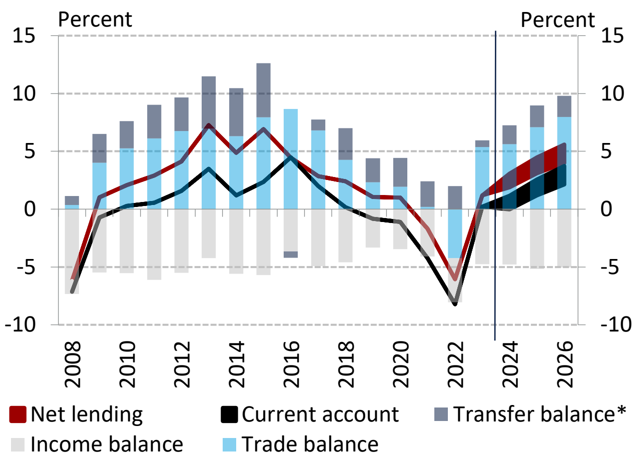
by the fact that companies have cut back their investment activity as a result of falling domestic demand.

By the end of September 2023, the economy's net external debt fell to 11.9 percent of GDP (Chart 5-4). In addition to transactions, revaluation and nominal GDP growth also contributed to the decline in the indicator. The reduction in net external debt was mainly linked to a decline in the general government's indicator, but the debt ratios of the banking sector and non-financial corporations also improved somewhat. Hungary's gross external debt, linked to the consolidated general government, declined substantially, reaching 64.4 percent of GDP at end-September 2023.

5.2 Forecast for Hungary's net lending position

The current account balance continues to rise over the forecast horizon, mainly driven by the improving external trade balance. This is initially supported by an improvement in the terms of trade thanks to the low energy prices, followed by the entry into production of newly constructed export capacities over the next few years and improving export dynamics as the global economic environment normalises. However, the impact of these favourable developments is partly offset by the import-increasing effect of the expansion in investment and household consumption. Financing trends in individual sectors suggest that the net position of the private sector will continue to improve in the coming years, while the general government deficit will also gradually narrow.

Chart 5-5: Evolution of net lending



Note: As a percentage of GDP* The sum of the balance of the current transfers and the capital account balance.
Source: MNB

Table 5-1: Development of trade balance as a percentage of GDP

	2023	2024	2025	2026
Balance of goods	0.3	0.4	1.7	2.6
Balance of energy	-4.4	-3.4	-3.0	-2.7
Balance of other goods	4.7	3.8	4.7	5.3
Balance of services	5.1	5.2	5.4	5.4
Trade balance	**5.4**	**5.6**	**7.1**	**8.0**

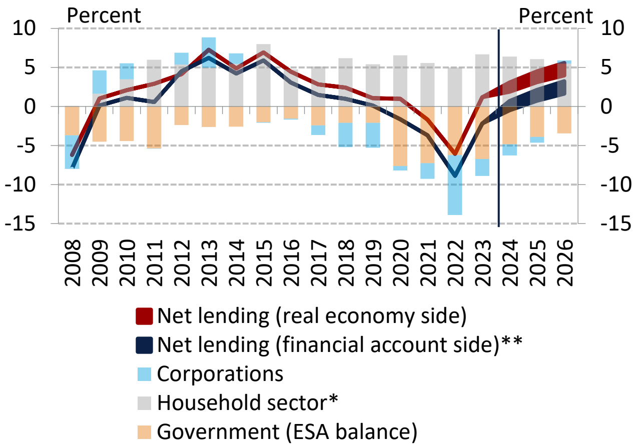
Source: HCSO, MNB

The improving trade balance leads to a further increase in the external balance indicators over the forecast horizon (Chart 5-5). In 2023, the current account balance as a share of GDP exhibited a moderate surplus, after an improvement of more than 8 percentage points. The effect of the improving terms of trade, also due to low energy prices, will be largely offset this year by the balance-deteriorating effect of imports, which are increasing in line with the rebound in consumption and investments. However, from 2025, the entry into production of new export capacities built and a normalising global economic environment will boost exports, which will accelerate export growth by increasing export market share. The income balance deficit increases somewhat in the context of rising interest expenditure due to higher interest rates. Overall, the current account surplus will continue to rise, which, together with the expected increase in EU transfers, implies increasingly significant net lending.

The reduction in the energy deficit will make a significant contribution to the improvement in the external balance this year, and a smaller contribution from 2025 onwards. Energy prices are expected to be lower in 2024 compared to the average in 2023, which, together with subdued energy demand, is expected to further reduce the energy deficit as a share of GDP. The surplus on the other goods balance will decline temporarily in 2024, in line with consumption and investment growth, before rising over the longer term, with accelerating export dynamics driven by strengthening external demand and new investment in production. The surplus on the services balance may gradually increase somewhat further in the coming years (Table 5-1).

Financing trends in individual sectors suggest that the net position of the private sector will continue to improve in the coming years, while the general government deficit will also gradually narrow (Chart 5-6). The decline in the budget deficit in 2024 is mainly related to lower energy prices, as well as lower interest expenditure from 2025 onwards. As consumption and household investment recover, the net financial savings of households will start to

Chart 5-6: Changes in the savings of sectors



Note: As a percentage of GDP. * Net financial saving of households does not contain the pension savings of those who return to the public pension system. The net savings in the financial accounts differ from the data in the chart. ** We expect that 'Net errors and omissions' (NEO) will return to the historical average.
Source: MNB

drop slowly over the forecast horizon, but will remain above 5 percent of GDP. In addition to rising profits and higher EU transfers received, the improvement in companies' net position is mainly driven by lower energy prices, supported in later years by the balance-improving effect of the recovering external environment.

5.3 Fiscal developments

According to preliminary data for the financial accounts, the accrual-based deficit of the general government amounted to 6.7 percent of GDP in 2023, exceeding the government target of 5.2 percent. We forecast the budget deficit to be between 4.5–5.0 percent of GDP in 2024. Depending on macroeconomic developments and the degree of fiscal discipline, the deficit-to-GDP ratio may be between 3.5–4.5 percent in 2025 and 2.8–3.8 percent in 2026. The reduction in the deficit in 2024 will be substantially facilitated by the decline in energy prices, while VAT revenues may fall significantly short of the appropriation in the Budget Act, as occurred in 2023. The high inflationary environment over the past two years has led to a significant increase in government interest expenditure, which will continue to be a heavy burden on the budget this year as well. Based on preliminary data, gross government debt fell to 73.4 percent of GDP by the end of 2023, followed by a moderate reduction this year. For the reduction of the debt ratio to continue in 2024 and the improvement of country risk assessment, it is also necessary to achieve the set deficit targets in a credible manner.

5.3.1 Main balance indicators

According to the preliminary data for the financial accounts, the budget deficit amounted to 6.7 percent of GDP in 2023. Based on the preliminary data, the accrual-based deficit exceeded the increased budget deficit target of 5.2 percent by 1.5 percentage points in 2023 and exceeded the 2022 deficit by 0.5 percentage point, mainly due to lower consumption tax revenues and rising interest expenditure as a result of higher inflation. The Budget Act for 2024 provides for a deficit of 2.9 percent for the current year, while based on government announcements the deficit may amount to 4.5 percent in 2024, 3.7 percent in 2025 and 2.9 percent in 2026.

The budget deficit is projected to be between 4.5-5.0 percent of GDP in 2024, depending on macroeconomic developments and the degree of fiscal discipline (Table 5-2). The budget deficit is expected to narrow compared to the previous year, supported mainly by lower energy prices, the stabilising macroeconomic environment and a reduction in public investment expenditure. High inflation over the last two years led to a significant increase in government interest expenditure, which will continue to be a heavy burden on the budget in the following years as well.

The accrual-based deficit-to-GDP ratio may come in between 3.5–4.5 percent in 2025 and 2.8–3.8 percent in 2026. In the absence of adopted budgets and based on the current macroeconomic and fiscal base, we forecast the deficit-to-GDP ratio to be in the 3.5–4.5 percent range in 2025, while in 2026 it might reduce to close to 3 percent, in line with the government target (Chart 5-7).

5.3.2 Budget balance in 2023

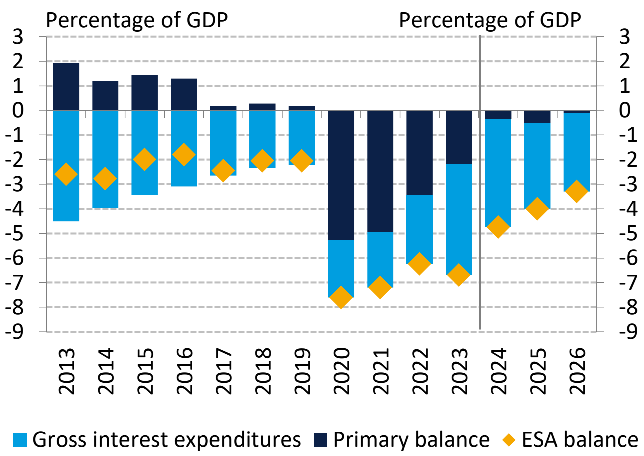
The accrual-based deficit of the general government amounted to 6.7 percent of GDP, according to the preliminary data for the financial accounts. The 2023 Budget Act was adopted with a deficit target of 3.5 percent

Table 5-2: General government balance indicators

	2023	2024	2025	2026
ESA balance	-6.7	(-5.0) - (-4.5)	(-4.5) - (-3.5)	(-3.8) - (-2.8)
Primary ESA balance (point estimate)	-2.2	-0.4	-0.5	-0.1
Gross interest expenditures	-4.5	-4.4	-3.5	-3.2

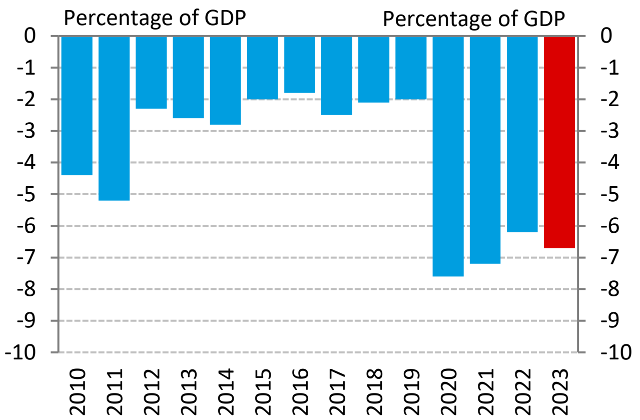
Note: The time series of the primary ESA balance (point estimate) are consistent with the midpoint of the ESA balance forecast bands. Source: MNB

Chart 5-7: Changes in the fiscal balance and government interest expenditures



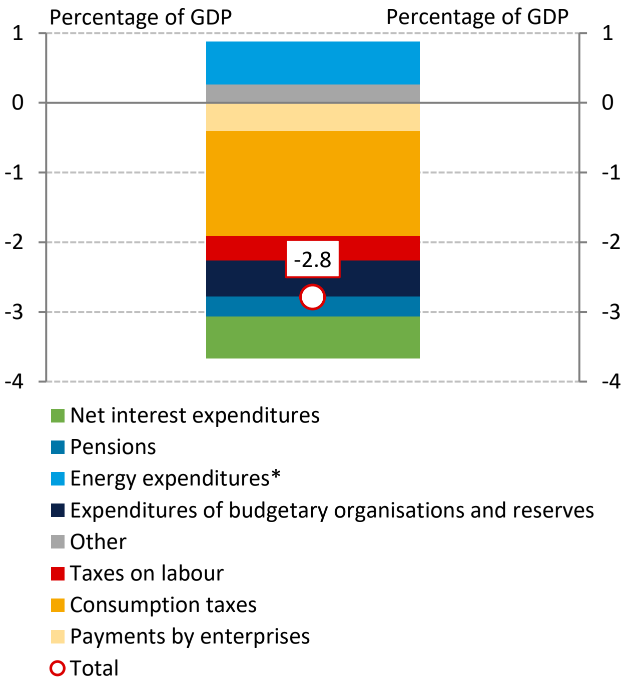
Note: The time series of the ESA balance and the primary ESA balance after 2023 are point estimates, which are consistent with the midpoint of the ESA balance forecast bands.
Source: HCSO, MNB

Chart 5-8: Accrual balance of the general government sector



Note: The 2023 data shows the net lending capacity of general government as reported in the preliminary financial accounts published by the MNB.
Source: HCSO, MNB

Chart 5-9: Development of the 2023 accrual balance of the budget compared to the appropriation



Note: * Expenditures of the Utility Protection Fund related to utility support of households and government institutions.
Source: Budget Act of 2023, MNB

of GDP in July 2022, which was initially raised to 3.9 percent at the end of 2022 with the amendment adopted in March 2023, and then to 5.2 percent at the same time as the publication of the October EDP report. According to the preliminary financial accounts data published by the MNB, the net financing need of the general government was 6.7 percent of GDP in 2023, which reflects a deficit that is 0.5 percentage point higher compared to 2022 (Chart 5-8). The deviation from the amended Budget Act was mainly due to the shortfall in revenues from VAT and excise duties, energy sector contributions and mining fees, as well as a significant increase in interest expenditure.

The main reason for the high budget deficit is that instead of the more than 16-percent increase in net VAT revenue projected in the budget due to inflation, the actual increase was less than 2 percent in 2023. As a result, last year's VAT revenues were more than HUF 1,000 billion below the planned amount. As a further negative fiscal effect of the high inflationary environment, government interest expenditure as a share of GDP increased from 2.8 percent in 2022 by nearly HUF 1,500 billion to around 4.5 percent in 2023 (Chart 5-9).

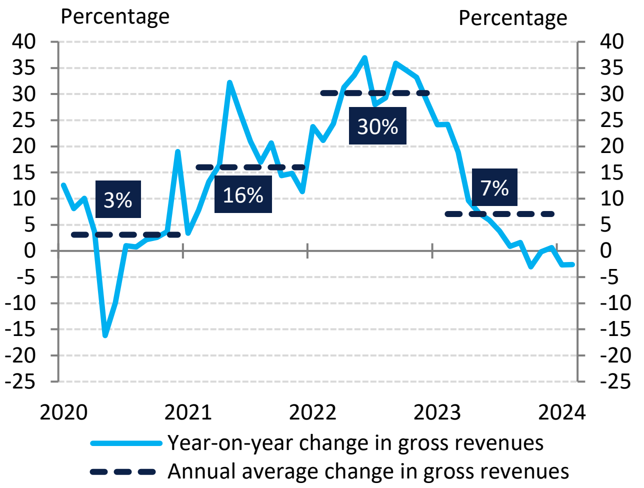
5.3.3 Budget balance in 2024

Based on our forecast, the budget deficit will amount to 4.5–5.0 percent of GDP in 2024. The reduction in the deficit compared to 2023 is mainly supported by the stabilisation of energy prices in Europe at lower levels. In the high inflationary environment, interest rates on inflation-linked retail government securities have risen sharply and a substantial stock has built up, with yields being determined by inflation of the previous year (in the case of accrual-based interest expenditure), thus continuing to raise interest expenditure significantly. Achieving the 4.5-percent deficit announced by the government is therefore only possible with a balanced primary balance, which can be achieved through tight expenditure discipline. In order to compensate for inflation and rising real wages, the government has decided on wage increases for a wide range of employees in the public sector and government institutions, which will raise the expenditure of budgetary organisations by a total of 1.3 percent gross of GDP, and thus also increase the disposable income of families.

5.3.4 Balances in 2025–2026

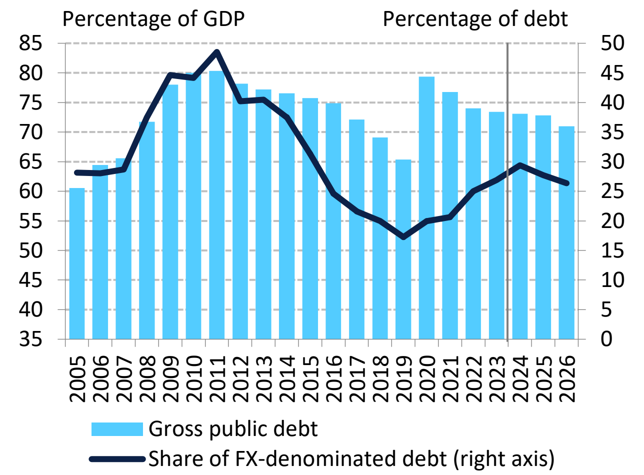
We forecast an accrual-based deficit to GDP ratio of 3.5-4.5 percent in 2025 and 2.8–3.8 percent in 2026. In the absence of budgetary appropriations, we prepare a technical forecast based on the current macroeconomic and fiscal base for 2025 and 2026, on the basis of which the

Chart 5-10: Change in gross VAT revenues versus same prior-year period



Source: Hungarian State Treasury, MNB

Chart 5-11: Gross public debt forecast



Note: The time series of the gross public debt and the share of FX-denominated debt after 2023 are point estimates, which are consistent with the midpoint of the ESA balance forecast bands.
Source: MNB, ÁKK

declining deficit path is still sustainable. A government target below the Maastricht deficit criterion of 3 percent can be achieved with substantial discipline and balance in budgetary developments at the end of the outlook horizon.

5.3.5 Risks surrounding the baseline scenario

The macroeconomic environment has a significant impact on the evolution of tax revenues. In terms of tax revenues, there is a risk that economic growth, and in particular household consumption, will recover at a different pace than currently expected. The year-on-year dynamics of gross VAT revenues, in line with consumption demand, were in the negative range in the first two months of 2024 (Chart 5-10). A prolonged period of adverse developments poses a negative risk to the budget balance, while a recovery in consumption improves the balance.

Adoption of the judicial reform and recovery plan mitigated the uncertainty surrounding EU funds. The European Commission accepted that the horizontal eligibility criteria for judicial reform and two sectoral eligibility criteria have been met, giving Hungary access to a total of EUR 12.2 billion from the 2021–2027 cohesion funds. Prior to this, after the European Commission and ECOFIN both approved the REPowerEU chapter of the Hungarian Recovery and Resilience Plan, Hungary received RRF pre-financing of EUR 920 million in total in recent months. The majority of the still unavailable recovery and cohesion funds (nearly EUR 20 billion) can be released by fulfilling the 27 super milestones selected by the Commission. The advance payments and the absorption of funds affects the level of government debt, while the timing of their implementation affects the accrual balance and real economic developments.

5.3.6 Expected developments in public debt

According to preliminary data, the government debt-to-GDP ratio declined to 73.4 percent at the end of 2023, reflecting a 0.6-percentage point decrease from 74 percent at the end of 2022. The decline in the government debt ratio was mainly driven by a high GDP deflator, while the high budget deficit, the increase in the debt of Eximbank classified as public debt, and the declining real economy offset this effect. The foreign currency ratio of central government debt rose to 26.9 percent by the end of 2023 from 25 percent at the end of last year, due to the significant foreign currency bond issuance.

We forecast the government debt ratio to fall to nearly 73 percent in 2024. For the reduction of the debt ratio to continue in 2024 and the improvement of country risk assessment, it is also necessary to achieve the set deficit targets in a credible manner. In 2025, there may also be a moderate decline in debt, and subsequently the debt ratio may decrease to 71 percent by the end of 2026 (Chart 5-11). Based on our forecast, the planned foreign currency issuance may raise the foreign currency ratio of central debt above 29 percent this year. A HUF 10 change in the EUR/HUF exchange rate alters the public debt-to-GDP ratio by over 0.6 percentage point.

6 Special topics

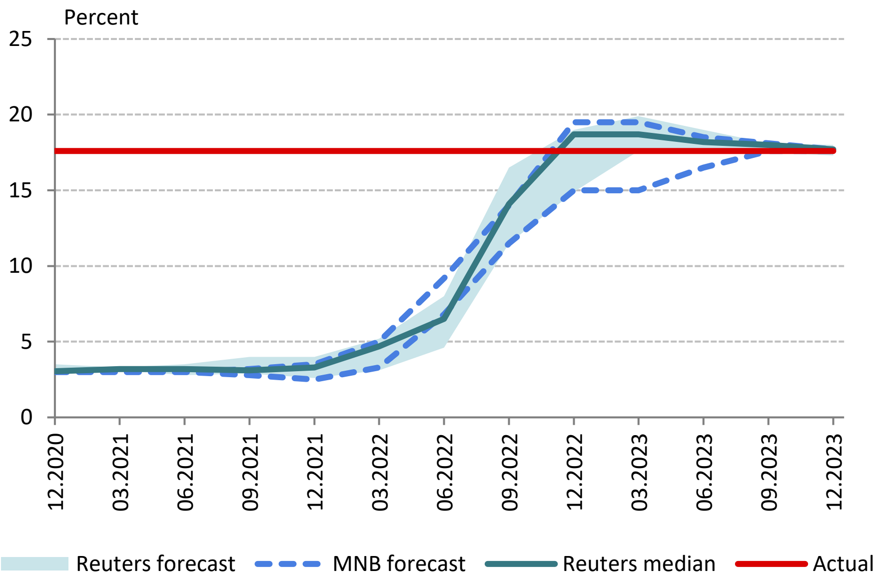
6.1 Evaluation of central bank forecasts for 2023

The aim of this section is to show how accurate our forecasts for the main macroeconomic indicators for 2023 turned out to be over the past three years. In addition, we also look at how the forecasting performance of the central bank compares with market analysts. For 2023, the first forecast for the variables under review was made in December 2020. Overall, actual inflation in 2023 was in line with our projections from last year, with economic growth having been somewhat lower, and private sector headcount and wage dynamics somewhat higher than our projections last year.

6.1.1 Inflation

In 2023, inflation was 17.6 percent on an annual average. The supply and demand frictions that emerged in 2021 in parallel with recovery from the COVID-19 epidemic did not materially affect the forecasts for 2023, which fell within the central bank's tolerance band based on our projections during 2021 and in 2022 Q1. Our expectations for inflation in 2023 were significantly altered by the impact of the Russian-Ukrainian conflict that broke out in February 2022. Conflict-related disruptions to supply chains further intensified and energy, food and commodity prices, which were already on the rise due to the return of demand postponed due to closures related to the pandemic, increased further. Geopolitical factors affecting commodity prices added to the uncertainty in inflation forecasts, as illustrated by the widening spread in analysts' expectations. During 2022, both market and central bank forecasts for 2023 increased gradually and significantly. The drought in Europe, changes in the utility cost reduction programme, strong profit inflation and the abolition of the fuel cap in December 2022 also played a role in the rise in the forecast. **The mid-range of our forecasts for 2023 was closer to the actual data over the past year than the median of market analysts' expectations** (Chart 6-1).

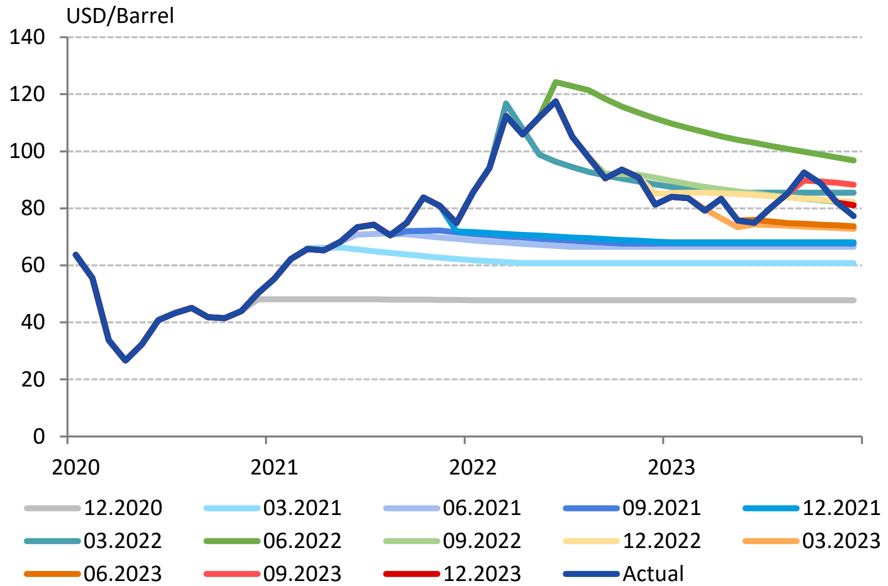
Chart 6-1: MNB and market forecasts for inflation in 2023



Note: In view of the uncertain global economic situation, starting from September 2021 the MNB published a forecast range for inflation in 2023.
Source: HCSO, MNB, Reuters

The change in our projections for 2023 was largely linked to energy price developments (Chart 6-2). After a significant decline in early 2020 (to USD 27 per barrel in April 2020), the global market price of Brent oil in US dollars, the key determinant of domestic fuel prices, started to rise significantly in 2021, due to surplus demand in global markets, peaking at USD 117.5 per barrel in mid-2022. The weakening of global economic activity then reduced demand for energy and contributed to a gradual decline in demand for commodities, reinforcing the disinflationary process that started in early 2023.

Chart 6-2: Assumptions on oil prices

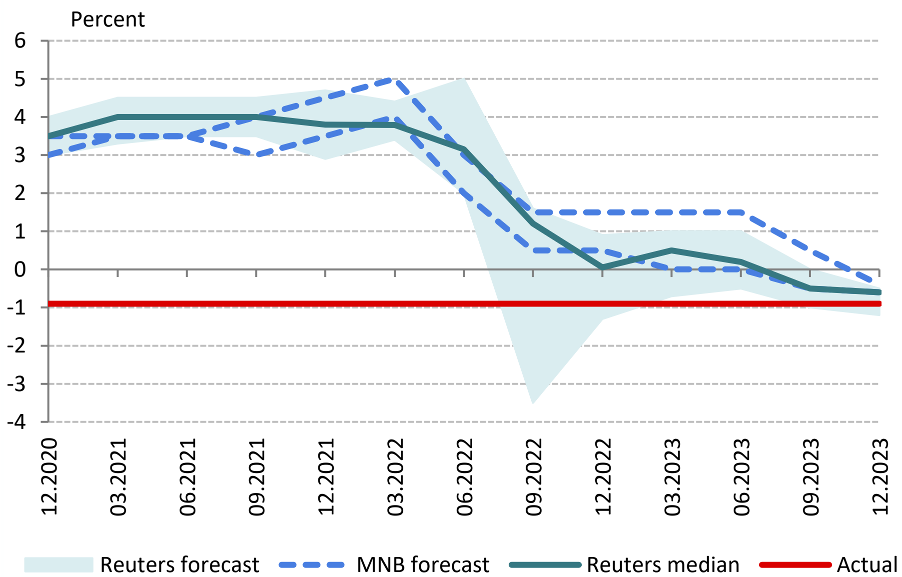


Source: Bloomberg

6.1.2 Economic growth

In 2023, domestic GDP fell by 0.9 percent year-over-year. Starting from 2022 Q2, we gradually lowered our forecast for 2023. The conflict between Russia and Ukraine and the disruption of international production chains had a negative impact on the global economic activity. Rising inflation due to increasing commodity, food and energy prices reduced real incomes and household consumption. The fall in public investment and the decline in corporate and household investment due to rising corporate costs also reduced domestic GDP. The fall in domestic demand could not be offset by a positive contribution from net exports. **In 2023 H2, our forecasts were close to the actual data.** The average error of our forecast and the median of the market analysts' forecasts over the time period considered was broadly the same (Chart 6-3).

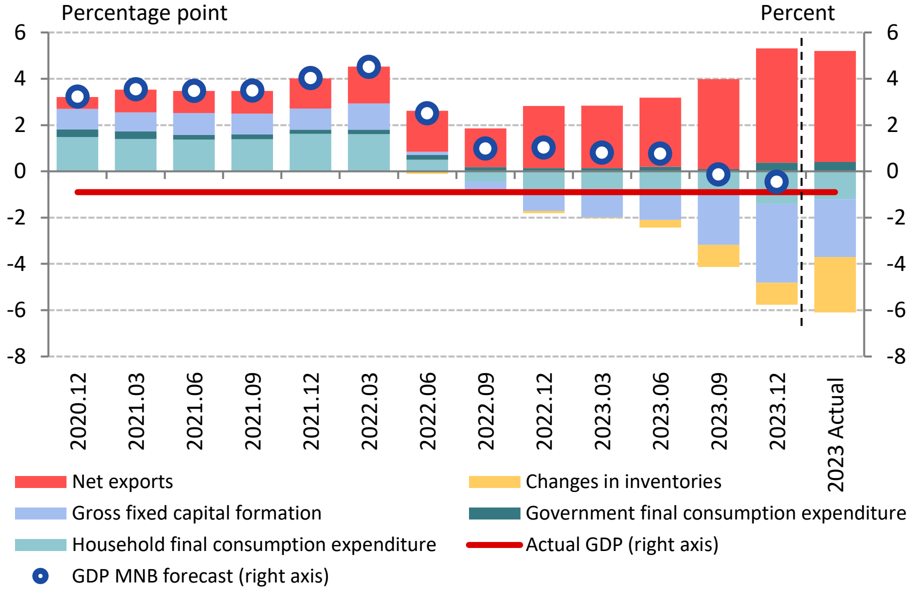
Chart 6-3: MNB and market forecasts for GDP growth in 2023



Note: Due to the uncertainty in the global economy, starting from December 2020, the MNB published a forecast range for GDP in 2023, aside from the March and June 2021 Inflation Reports, where a point estimate was given.
Source: HCSO, MNB, Reuters

In 2023, household consumption (–2.5 percent) and gross fixed capital formation (–8.7 percent) fell, while government final consumption expenditure (+1.6 percent) rose and the contribution of net exports (+4.8 percent) was also positive. In our forecast, we expected net exports to make a positive contribution to domestic growth, despite the deteriorating external economic activity, which was also explained by falling import demand. Our expectations for gross fixed capital formation were gradually revised downwards, after we projected a slowdown in corporate and household investment activity due to weak demand, in addition to a slowdown in public sector investment. With real wages declining until August 2023 and consumer confidence recovering slowly, we gradually lowered our forecast for household consumption. Overall, our projections were above the actual dynamics (Chart 6-4).

Chart 6-4: MNB forecasts for the expenditure-side decomposition of GDP in 2023

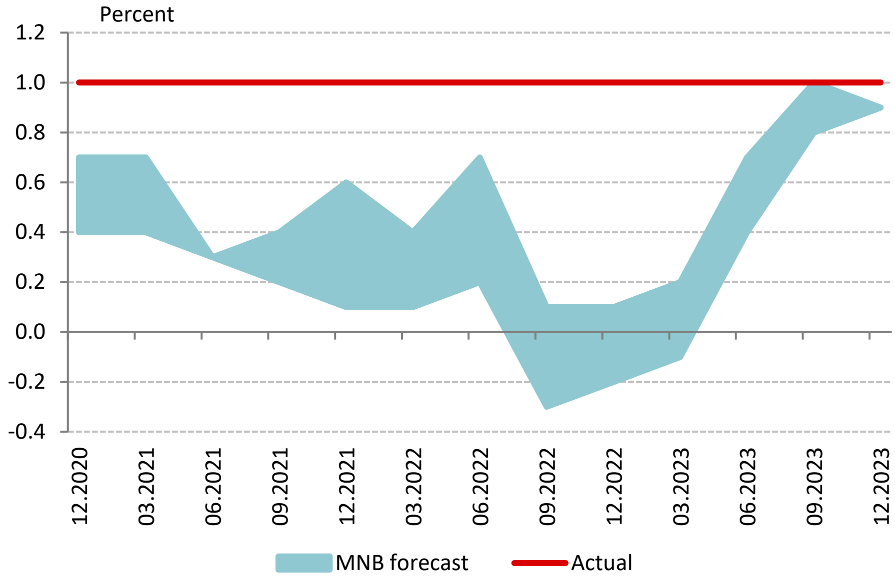


Note: Due to the uncertain situation in the world economy, starting from December 2020, a forecast range was published by the MNB for GDP, aside from the March and June 2021 Inflation Reports, where a point estimate was given. The data for GDP represent the point estimate, while the GDP components show the contribution to GDP growth. Government final consumption expenditure includes final consumption expenditure of general government and nonprofit institutions.
Source: HCSO, MNB

6.1.3 Labour market

In 2023, employment in the private sector increased by 1.0 percent. Our projections in 2021 assumed a moderate growth in employment. We expected that the demographic limitations would become effective after the post-pandemic readjustment. Due to the Russia-Ukraine conflict we revised our forecast downwards, forecasting a fall in labour demand in view of rising corporate costs due to commodity and energy prices, rising inflation, supply chain frictions and declining investment activity. Given the lagged labour market response to the slowdown in economic performance, and labour market proving very resilient we gradually increased our forecast over 2023, **bringing our projections in the second half of last year close to the actual dynamics** (Chart 6-5).

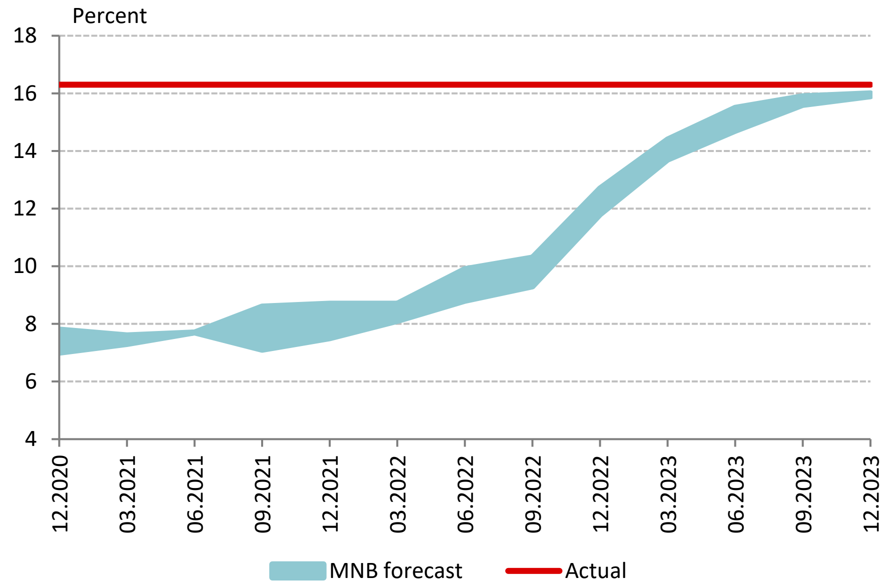
Chart 6-5: MNB projections for 2023 private sector employment growth



Note: Due to the uncertain situation in the world economy, since December 2020, a forecast range had been published by the MNB for private employment growth in 2023, excluding the June 2021 Inflation Report, which was a point estimate.
Source: HCSO, MNB

In 2023, wages in the private sector rose by 16.3 percent. Our initial projections for 2023 wage growth were influenced by the rapid recovery and gradual tightening of the labour market after the pandemic. Average wage growth was also supported by the significant increases in the minimum wage and the guaranteed minimum wage at the beginning of the year, amounting to 16 and 14 percent respectively, and by household inflation expectations. **Overall, our projections made last year for 2023 wage dynamics in the private sector were below the actual wage growth and close to it in the second half of the year** (Chart 6-6).

Chart 6-6: MNB forecasts for the 2023 wage growth in the private sector



Note: Due to the uncertain situation in the world economy, from December 2020, a forecast range was published by the MNB for 2023 wage growth in the private sector, aside from the June 2021 Inflation Report, which provided a point estimate.
Source: HCSO, MNB

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Mátyás Hunyadi

(23 February 1443 – 6 April 1490)

He ruled from 1458 to 1490 as King of Hungary, and had been Czech king from 1469 and Prince of Austria from 1486. Hungarian tradition regards him as one of the greatest Hungarian kings whose memory is preserved in many folk tales and legends. He is also known as Matthias Corvinus, King Matthias the Just or officially as Matthias I, but commonly he is simply denoted as King Matthias.

His father, János Hunyadi, the regent of Hungary, was one of the most outstanding military leaders and strategists in the country's medieval history who triumphed at the Battle of Nándorfehérvár in 1456. Matthias' mother was Erzsébet Szilágyi, and he had an elder brother, László Hunyadi. The future king was brought up by his mother and nurse until the age of six, and was subsequently placed under the supervision of his tutors. János Hunyadi did not have a chivalrous education in mind for his son: first, it was a Polish humanist, Gergely Szánoki who introduced him to the realm of knowledge, then this task was assigned to János Vitéz. Mátyás was brought up and educated in a humanistic spirit to become a versatile and curious-minded person who had been taught canon and constitutional law, arts and Latin. In addition to Hungarian, he also spoke German and Czech.

After the death of László V, his uncle, Mihály Szilágyi, and the armed forces supporting Hunyadi exercised pressure to have Matthias crowned as King of Hungary on 24 January 1458. Even in the early years of his reign Matthias had troubles both with the magnates of the country and Emperor Frederick III of the Holy Roman Empire. As the king was still a minor, parliament appointed Mihály Szilágyi to act as regent on his behalf. However, Matthias did not tolerate any guardianship and pushed his uncle to the background who devised a plot against the king in response. Returning from battle with the Turks, the king had the rebels captured and he imprisoned his uncle in the castle of Világos.

Upon his ascension to the throne the annual income of the treasury hardly exceeded 110 to 120 thousand forints. During his rule spanning thirty-two years the king managed to multiple revenues from taxes. Considering the average of the taxes levied, less the revenues from the Czech and Austrian provinces, this yearly amount approximated 628,000 forints and may as well reached 900,000 gold forints in the most prosperous years. This was still much less than the annual revenue of the western powers of the age. In order to raise the low income of the treasury, reform-like and comprehensive financial actions were needed. Matthias recognised that a centralised, nationwide financial system was the only solution to the problem, and that the royal revenues had to be directed to a single person, the treasurer. The reforms of Matthias were adopted by parliament and his decrees were promulgated on 25 March 1467.

We can get a glimpse of the cultural life in the royal court, which represented the elite of European civilisation at the time, at the partly reconstructed Royal Palace in Visegrád. The most distinguished pieces of the cultural legacy of Matthias are the Corvinian books, richly illustrated volumes of the former royal library.

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