

MONTHLY MONITOR

September 2021

Századvég Economic Research Institute



SZÁZADVÉG

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1. Summary

ECONOMIC GROWTH COULD EXCEED 7% THIS YEAR

We have revised up our expectations for this year's economic growth on the back of better-than-expected Q2 GDP data. We forecast the Hungarian economy to expand by 7.8% this year and 5.5% next year.

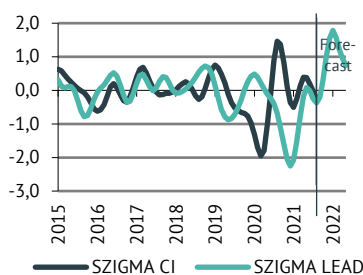
The Inflation has recently been higher than expected. For this year as a whole, we expect inflation to be 4.7%, which could moderate to 3.8% next year—still above the central bank's target, but back within the target range. With labour shortages re-emerging in a growing number of sectors, wages could resume dynamic increasing, averaging 10.6% in 2022, but this will be significantly affected by the decision on the minimum wage.

The main risks to economic growth include new waves or new mutations of the coronavirus and associated restrictions, shortages of chips and raw materials for the industry, and transport difficulties.

The Monetary Council of the Magyar Nemzeti Bank has tightened monetary conditions again. Although the interest rate was increased less than expected, by 15 base points, the decision was taken to phase out the swap facility for HUF liquidity and to further reduce the extent of the treasury security purchase programme.

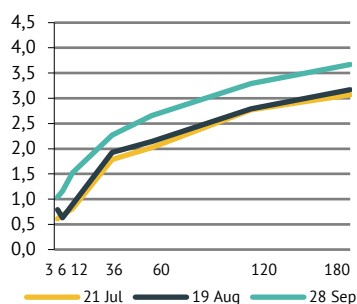
On 24 September, Moody's upgraded Hungary; the Hungarian sovereign debt rating is, therefore, at same level at all the three major credit rating agencies.

SZIGMA indicators



Source: Századvég

HUF yield curve (%)



Source: Refinitiv

Forecast (10 Sep 2021)	2021
GDP volume change (%)	7,8
Inflation (annual average, %)	4,7
Gross wages	8,4
Exchange rate (annual average)	353

2. Economic overview

2.1. External environment

The number of non-farm payrolls in the US rose by 235,000 in August compared with July, well below the 750,000 increase expected by analysts.

Employment in the US grew less than expected.

In August, the number of people employed in the US was 147.2 million, down 5.3 million from pre-crisis levels in February 2020. The number of unemployed people in the eighth month of the year was 8.4 million, while their rate was 5.2%—320,000 or 0.2 percentage points less than in the previous month. Even with employment expanding at a subdued rate, job vacancies rose to a new high of 10.1 million in June, as labour shortages in the world's largest economy continued to worsen. A large part of the labour shortage is attributable to the favourable unemployment benefits introduced as a result of the pandemic, which makes it unreasonable for some jobseekers to take low-paid jobs. Another consequence of the unfavourable labour market data is that the Fed may postpone its monetary policy tightening. Recently, with inflation rising above 5%, much attention has been focused on when the central bank will start to reduce asset purchases and when the first interest rate increase will take place. So far, the Fed has justified loose conditions on the grounds that employment is lagging behind previous levels, despite rising inflation, and the slowdown in employment growth reinforces the validity of this decision.

The European Central Bank left interest rates unchanged at its interest rate meeting in September, leaving the reference interest rate unchanged at 0%, the overnight lending rate at 0.25% and the overnight deposit rate at -0.4%. Compared to previous months, the only change in September was that the central bank decided to reduce the monthly pace of its asset purchase programme (PEPP), which was launched in response to the epidemic. This represents some monetary policy tightening, but given that the monthly pace of purchases will still be significant and the PEPP's planned spending until next March has not changed, it is a rather symbolic step. For the time being, the ECB is not under pressure to take action, as inflation has already

exceeded the central bank's target of 2% in July, but the central bank believes that this is only the result of temporary factors and that the inflation rate could return to below the target once these factors fade out. This is underpinned by the ECB's September forecast that the rate of price increases in the eurozone could reach 2.2% this year, slowing to 1.7% next year and 1.5% in 2023. Although this is 0.2-0.3 percentage points higher for each year than the June forecast, it still indicates that inflation developments in the eurozone are not converging towards the central bank's target over the medium term, which would induce a persistently loose monetary policy stance.

2.2. SZIGMA indicators

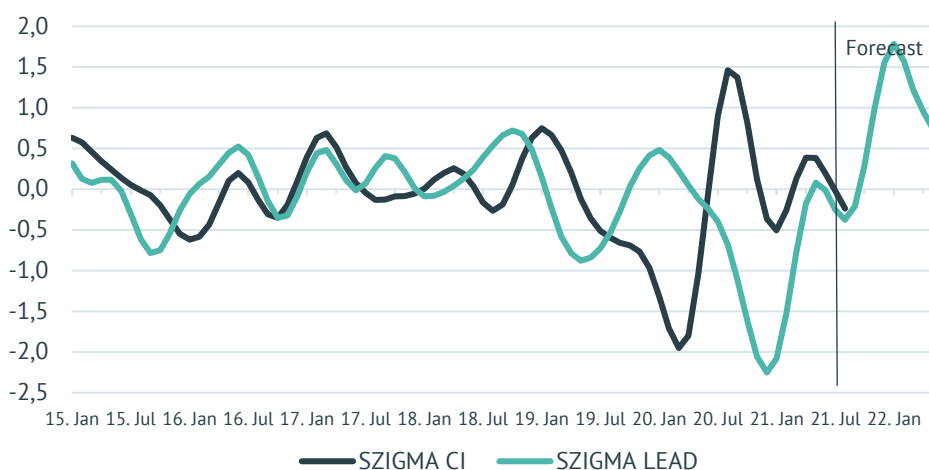
The SZIGMA CI indicator, which provides a snapshot of the current state of the Hungarian economy, turned slightly negative in the eighth month of the year, meaning that the Hungarian economy expanded slightly below trend. On an annual basis, domestic and export sales in the industry as a sector increased in July 2021 (by 13.0% and 9.6%, respectively); on a monthly basis, however, the former decreased (by 1.6%) and the latter increased (by 2.9%).

The Hungarian economy expanded slightly below trend in August.

New domestic orders increased on both an annual and monthly basis (by 13.1% and 0.5%, respectively), while the volume of new export orders increased on an annual basis (by 8.9%) and decreased on a monthly basis (by 12.4%). The industry's contribution to economic growth could have been positive in the Q3 and is expected to remain so for the year as a whole, but risks are posed by shortages of raw materials, including chips, and transport difficulties. In the seventh month of this year, the volume of construction contracts at the end of the month was up significantly, by 19.2%, on the same period last year, but down by 9.7% on a monthly basis. The number of new non-residential buildings to be built increased substantially on both a monthly and annual basis, with the number of new non-residential buildings 11.6% and 79.8% higher than the baseline, respectively.

The SZIGMA LEAD indicator, which expresses our expectations for the short-term performance of the Hungarian economy, indicates that growth will be slightly below the trend until September, while it will be above the trend until the end of the forecast period. The Ifo Business Climate index, which measures the change in business sentiment in the German economy, declined by 1.3 index points on a monthly basis in August, while it was 7.9 index points higher than in August 2020. The shortage of raw materials, the protracted recovery of the tourism and hospitality sector, and the evolution of the coronavirus epidemic pose significant risks from the external environment. Retail sales continued to expand in July 2021, suggesting that the sector's growth-supporting role could return, thanks to a rebound in the economy and rising employment and wages. On a monthly basis, Eurostat's consumer confidence index fell again in August (by 3.5 index points), but was 4.2 index points higher than a year earlier. The negative value of the index (-15.9 index points) suggests that improving confidence could further increase the segment's turnover. Overall, we expect the economy to expand by close to 8% this year.

FIGURE 1: SZIGMA SIMULTANEOUS (CI) AND LEADING (LEAD) INDICATORS



Source: Századvég

2.3. Real economy

**Hungarian GDP
increased by
17.9%.**

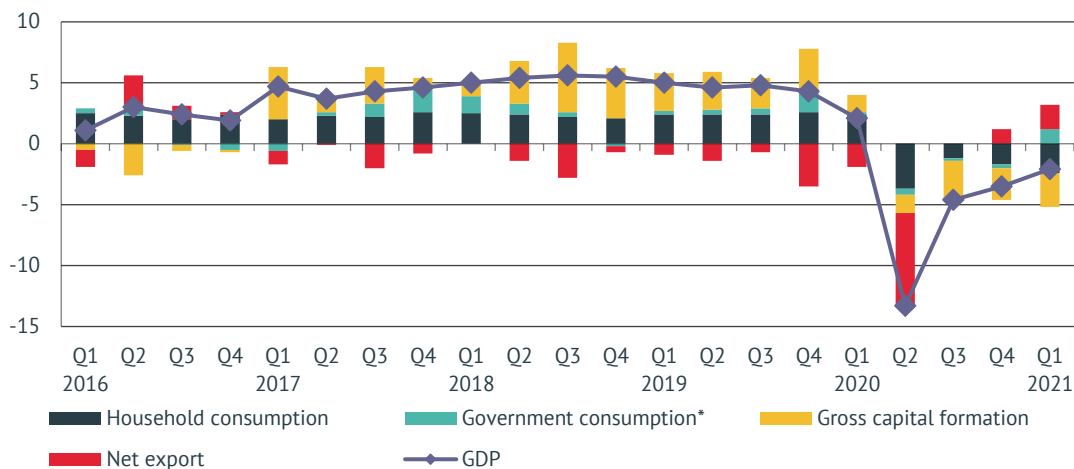
The Hungarian Central Statistical Office's second estimate for Q2 2021 showed a 17.9% year-on-year increase in gross domestic product, due to both the rebound in the economy and the base effect. On a seasonally and calendar-adjusted basis, GDP volume was 17.7% higher than in the same period of the previous year, while it was 2.7% higher than in the previous quarter.

On the production side, the added value generated by agriculture increased by 1.1% compared to the level a year earlier. The added value generated by the industry increased by 36.9% in the period under review, while that of manufacturing within the industry increased by 39.9% compared to Q2 2020. The added value generated by the construction industry in Q1 2020 was 18.4% higher, that of services was 12.4% higher than one year before. The construction industry contributed 0.9 percentage points, services 7.0 percentage points and industry 7.3 percentage points to GDP growth, while agriculture neither increased nor decreased GDP growth.

On the consumption side, household final consumption expenditure increased by 10.6% and the volume of collective consumption decreased by 0.5% compared to Q2 2020. Gross fixed capital formation increased by 8.3% compared to the same period of the previous year.

Q2 2021, the volume of exports was 33.0% higher than in the same period of the previous year, while the volume of imports was 23.4% higher. Hence, the foreign trade balance increased GDP growth by 6.5 percentage points. Within exports, exports of services increased by 20.3%, while exports of goods increased by 35.9% on an annual basis. As for imports, imports of services decreased by 3.4%, those of goods increased by 28.6%, relative to the same period of the previous year.

FIGURE 2: CONTRIBUTION TO Y-O-Y GDP-GROWTH (EXPENDITURE APPROACH; %)

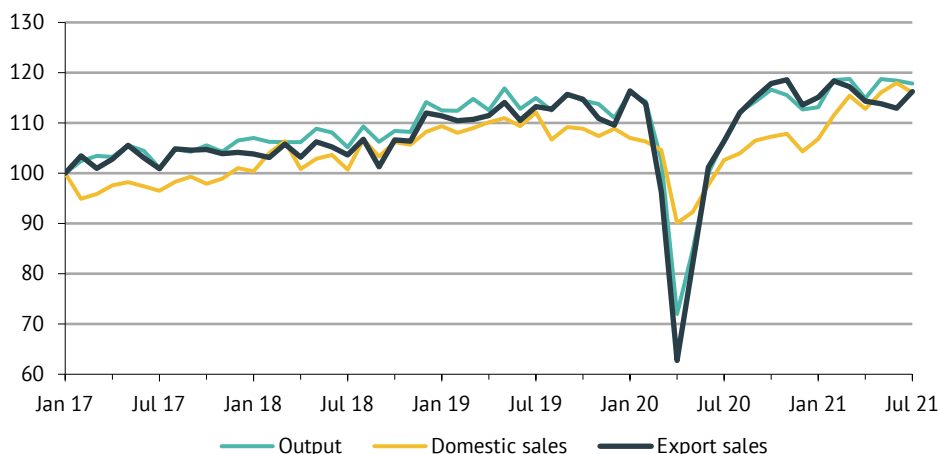


Source: HCSO. *: with any kind of social transfers

The output of the industry as a sector increased by 8.0%.

In July, the output of the industry as a sector was 8.0% higher than in the same period of the previous year, according to raw data, and 10.2% higher when adjusted for working-days. Compared to June, the sector’s output was 0.5% lower. The volume of sales in the industry as a sector increased by 8.9% on an annual basis, with domestic sales up by 11.7% and export sales up by 7.2%.

FIGURE 3: INDUSTRIAL OUTPUT AND SALES (JANUARY 2017 = 100%)



Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

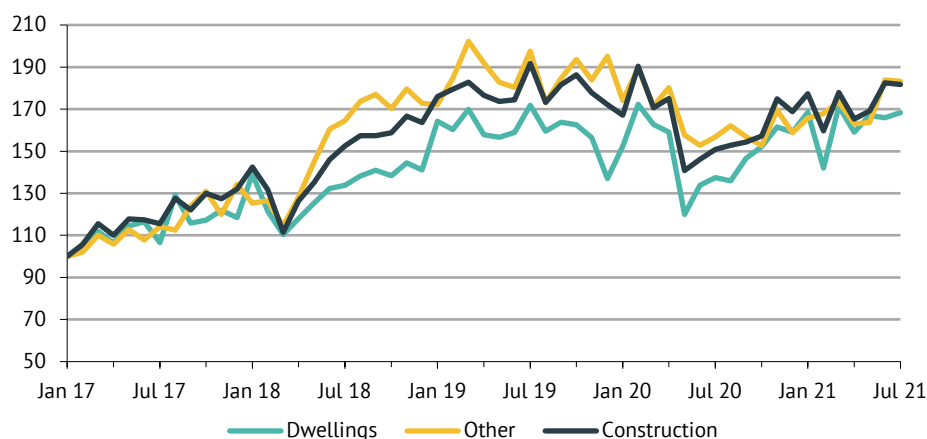
Among the various sub-sectors of industry, mining and quarrying output was 54.8% higher, manufacturing output was 20.5% higher and energy output was 3.4% higher than a year earlier. In manufacturing, the largest increase (150.5%) was in the electrical equipment sector, followed by rubbers, plastics and non-metallic minerals, which grew by 41.5%, and the computer manufacturing sector, which grew by 38.9%. The textile industry suffered the biggest decline of 14.3%, but output in the automotive sector, which has a considerable weight in the Hungarian economy, also fell by 1.2%. Order volume in the key manufacturing sectors were 11.9% higher at the end of July than a year earlier, with domestic new orders up 3.2% and export new orders up 12.6%. The volume of new sales orders was 9.6% higher than one year before. The volume of domestic new orders increased by 13.1% and that of export new orders by 9.0% over a year.

In July, construction output was 22.5% above the low of a year earlier, but down marginally by 0.4% from June. The latter could be seen as a

The output of the construction industry increased by 22.5%.

correction of the previous two months of growth, but it may also have been driven by a shortage of building materials. Compared to the same period of the previous year, the output in both building groups increased similarly: buildings by 21.1% and civil engineering works by 25.4%. If the right quantities of building materials and skilled labour are available, the sector's performance could continue to improve in the coming period. This is confirmed by the evolution of the contract portfolio. The total volume of contracts at the end of July was 19.1% higher than a year earlier, with contracts for the construction of buildings up by 32.6% and those for civil engineering works up by 10.4%. The volume of new contracts increased by 47.3%, with new contracts for buildings up by 38.3% and new contracts for civil engineering works up by 56.5% compared to a year earlier.

FIGURE 4: CONSTRUCTION SECTOR (JANUARY 2017 = 100%)



Remark: Seasonally and working-day adjusted data

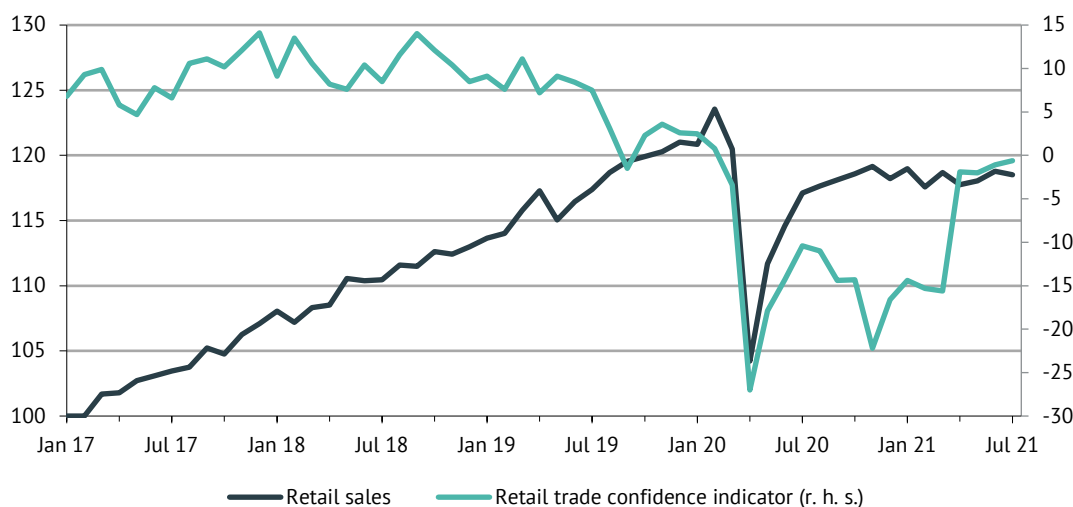
Source: HCSO, Századvég

The volume of retail sales increased by 3.0%.

In July 2021, retail sales volume increased by 2.5% based on raw data and by 3.0% based on calendar-adjusted data compared with the same period of the previous year. Adjusted data show a 0.3% decrease compared to the previous month. In July 2021, the calendar-adjusted volume of sales increased by 3.7% in specialised and non-specialised food shops, by 2.6% in non-food shops and by 1.9% in fuel retail, relative to July 2020.

The turnover of parcel companies and internet shops continued its years of dynamic growth in July, up 15.6% year-on-year on a calendar-adjusted basis. There was also a significant increase in the turnover of second-hand shops (7.1%). In addition, there was an increase in the turnover of shops selling a mixed range of manufactured goods (1.5%), textile products, clothing and footwear (3.3%), pharmaceuticals and medical products (2.8%), books, newspapers and stationery (1.0%) and computers and other manufactured products (0.4%). However, there was a decrease in the sales volumes of shops selling fragrances perfume (0.4%) and furniture and electric goods (7.6%) compared to July 2020. Calendar-adjusted data show that in July 2021, sales increased by 5.0% in non-specialised food shops and by 0.5% in shops selling food products, beverages, and tobacco products, relative to the same period of the previous year.

**FIGURE 5: RETAIL SALES VOLUME (JANUARY 2017 = 100%) AND
RETAIL TRADE CONFIDENCE INDICATO**



Remark: Seasonally and working-day adjusted data

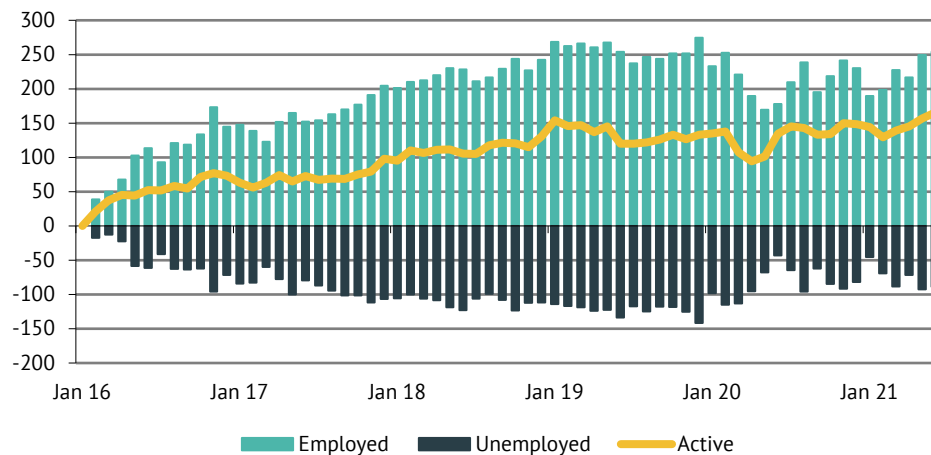
Source: HCSO, Eurostat, Századvég

**In July,
employment
exceeded its pre-
crisis peak.**

Based on seasonally adjusted data, the number of employed persons in July was 4,668,000. This represents an increase of 18,000 compared to the previous month and 76,000 compared to the same period last year. As a result, employment was already higher than in December 2019, at its pre-crisis peak. Together with employment, activity increased by 14,000 month-on-month and by 47,000 year-on-year to 4,857,000, bringing the activity rate in the 15-74 age group above 66% for the first time since the political changes in 1989-90. As a result of the two effects, the seasonally adjusted number of the unemployed decreased only slightly by 4,000 month-on-month, to 189,000, which means an unemployment rate of 3.9%. In one year, the number of the unemployed has fallen by nearly 29,000. In June, the number of employees also increased by nearly 14,000 on a monthly basis and by 319,000 on an annual basis, according to seasonally adjusted data. Thanks to uninterrupted growth since June last year, the number of employees reached its pre-crisis peak (December 2019) by June this year. As in previous months, in June the number of employees increased by 15,000, mainly in the competitive sector, among enterprises with more than 5 employees, while in the public sector the number of

employees decreased by 2,000. In June, 86,000 people were working under Start work programmes, the same as in May.

FIGURE 6: LABOUR MARKET TRENDS (JANUARY 2016 = 0, THOUSANDS OF PERSONS)



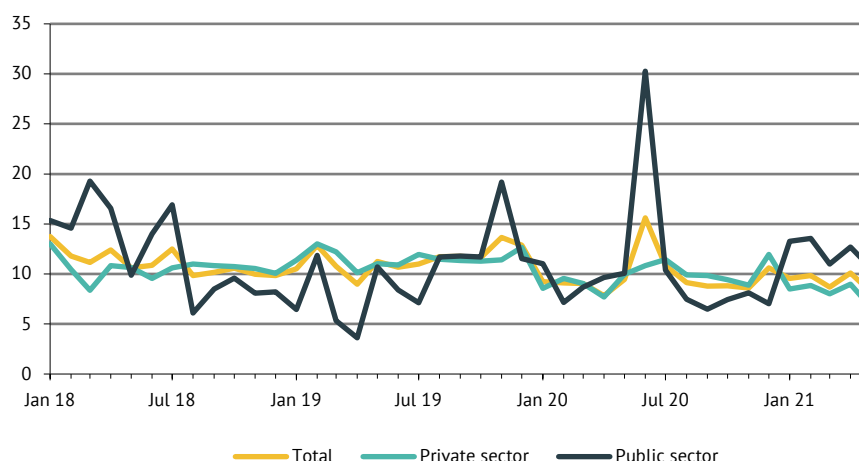
Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

In June, average gross earnings increased by a total of 3.5% to HUF 436,300 compared to the same period last year. However, the base effect also played a role, as the one-off, extraordinary allowance for health workers was paid in June 2020. As a result, average earnings in the public sector fell by 4%. However, earnings in the corporate sector also rose slowly, by 6.4% in a year. This may have been due to the base effect, with the resumption of tourism increasing the number of employees in the sector, but this is pulling back average earnings due to lower wage levels. Net earnings in June amounted to HUF 290,200, and HUF 299,100 if benefits are taken into account. In nominal terms, this represents an increase of 3.5%, which, taking into account the accelerating inflation rate of 5.3%, means that net real earnings fell by 1.7% in June.

In June, the base effect pulled back the growth rate of wages.

FIGURE 7: GROSS WAGES (ANNUAL CHANGE, %)



Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

2.4. External balance

In June, the EUR value of product exports increased by 22%, and the EUR value of product imports increased by 25% year-on-year. This means that the foreign trade balance was EUR 629 million, which is EUR 98 million less than last year.

In June 2021, the volume of food product imports increased by 9.7%, and food product exports increased by 1.4% year-on-year. As for energy carriers, import decreased by 18.4% and exports increased by 15.9%. As for processed products, imports increased by 13.1%, exports raised by 15.7% on a year-on-year basis. As for machinery and transport equipment, imports increased by 24.5%, and exports by 20.6%.

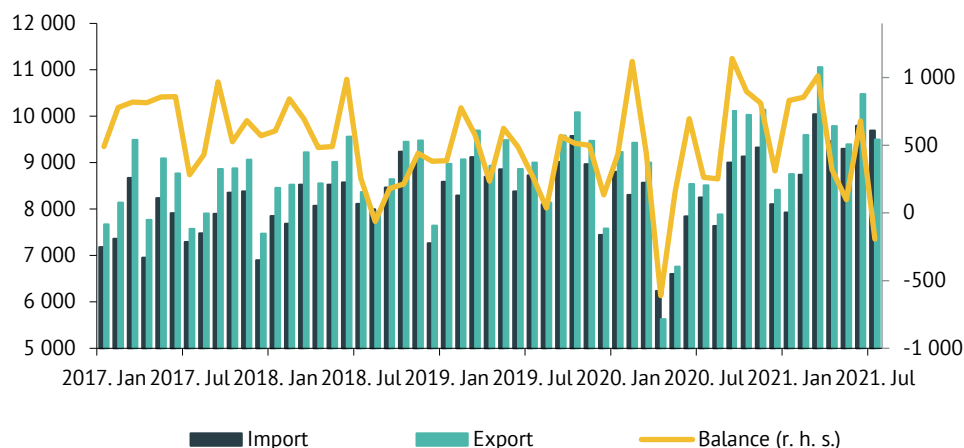
The current account balance was negative in the first 7 months.

In July 2021, the EUR value of exports was 10% higher, while the EUR value of imports was 15% higher than one year before. The foreign trade balance was therefore minus EUR 193 million, which is EUR 379 million more than one year before.

In July 2021, the current account balance was minus EUR 267.1 million. The balance of the first seven months of this year is minus EUR 112.5

million, better than the minus EUR 1274.1 million balance of January–July 2020.

FIGURE 8: BALANCE OF TRADE (IN MILLION EUR)



Remark: The data relating to July 2021 derive from the first estimates.

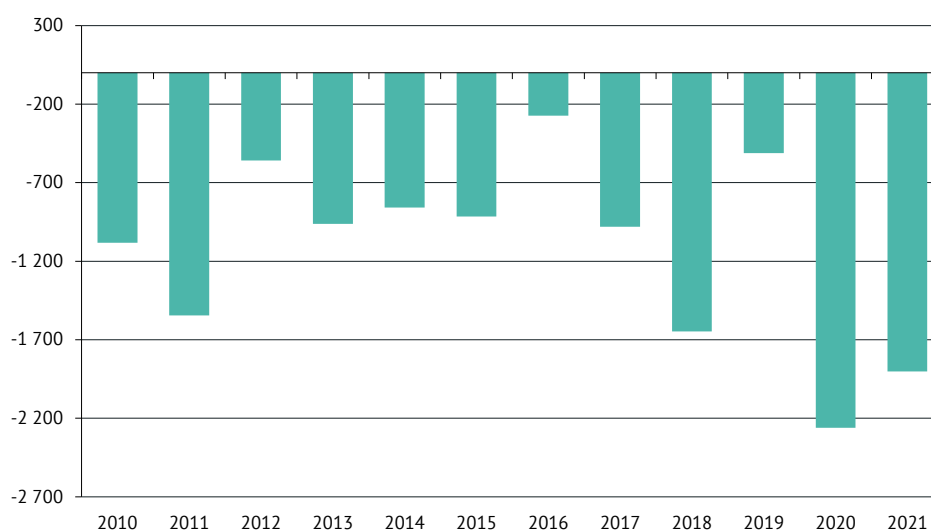
Source: HCSO

2.5. Fiscal outlook

The general government deficit is HUF 1,900.7 billion.

By the end of August 2021, the central budgetary subsystem had accumulated a deficit of HUF 1,900.7 billion, consisting of a deficit of HUF 1,717.1 billion in the central budget, a deficit of HUF 221.2 billion in the social security funds subsector and a surplus of HUF 37.6 billion in the extra-budgetary funds.

FIGURE 9: BUDGET DEFICIT IN JANUARY-AUGUST (BN HUF)



Source: PM

VAT revenues were 19.3% (HUF 543.2 billion) higher in the first eight months of the year than in the same period a year earlier, driven by higher VAT paid on domestic, import and tobacco products. Revenue growth was somewhat held back by an increase in refunds, thanks to the application of the shorter VAT refund deadline for SMEs. Revenues from excise duties exceeded their January–August 2020 level by 4.0% (HUF 30.3 billion). Growth was supported by higher fuel sales and a higher tax rate in Q1, but held back by a decline in tobacco sales. As the economy recovered, revenues from personal income tax, social contribution tax and social security contributions also increased, by 14.2% and 3.9%, respectively (by HUF 234.1 billion and HUF 142.2 billion).

Between January and August 2021, HUF 654.1 billion of revenue related to EU programmes was received by the treasury, while HUF 1,266.1 billion was advanced. Among the developments financed from Hungarian state funds, road developments (HUF 172.9 billion), transport sector programmes (HUF 134.7 billion) and competitiveness-enhancing subsidies (HUF 92.2 billion) should be highlighted.

2.6. Monetary developments

In August 2021, consumer prices increased by 4.9% on average relative to the same period of the previous year. Over the past year, the highest price increase was recorded for alcoholic beverages, tobacco products, and fuels. In comparison with the same period of the previous year, the price of alcoholic beverages and tobacco products increased by 10.5% on average, while that of food products increased by 3.7%. Taking a closer look at alcoholic beverages and tobacco products, one can see that the excise tax increase caused the price of tobacco products to increase by 17.0% as compared to the same period of 2020.

In August, prices increased by 4.9%, on average.

More significant drivers of the 3.7% average increase in food prices were the 8.9% increase in poultry prices, the 11.8% increase in the prices of

fresh vegetables, the 7.0% increase in the prices of restaurant meals, the 9.2% increase in pre-ordered menu meals at workplaces and the 30.6% increase in cooking oil prices. The latter was driven by the record high price of rapeseed, which is due to the fact that China has bought Ukrainian rapeseed and products made from it; not enough rapeseed enters, therefore, the Hungarian and European markets. However, average food inflation was held back by a fall in the prices of fresh Hungarian and southern fruits (3.2%), salami, dry sausages and ham (2.3%), and Extrawurst, cold cuts, sausages and pork (1.1% each).

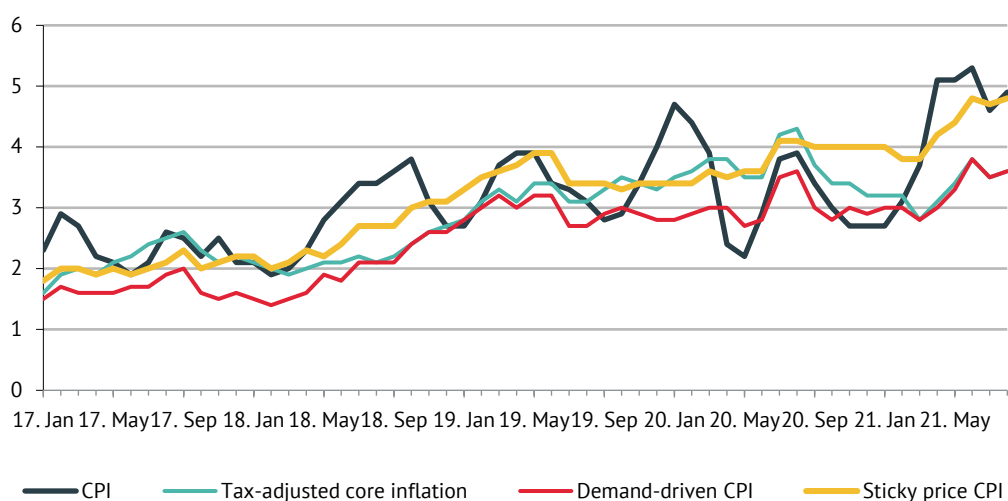
The prices of other products and fuels increased by 9.2% in August, year-on-year. Fuel prices increased by 21.7%, primarily because of the base effect. Coursebook prices decreased by 96.9%, which is attributable to the free school coursebooks from the 2020-2021 school year.

The average increase in household energy prices was 0.4% in August as compared to the same period of the previous year. Within household energy, fuelwood prices increased by 2.7%, coal prices increased by 5.3%, and bottled gas prices increased by 3.2% in a single year. The price of electricity, pipeline gas and district heating remained unchanged.

In August, prices of services increased by an average of 2.8%, driven by a 5.2% increase in tolls, vehicle rental and parking, a 5.4% increase in the prices of health services, a 12.1% increase in home repair and maintenance prices, an 8.1% increase in vehicle repair and maintenance prices, and a 6.7% increase in the prices of personal care services. The average price increase of services was moderated by the 2.0% increase in rents, the 0.2% increase in gambling prices, the 6.4% decrease in the prices of other long-distance travels, and the 0.4% decrease in telephony and internet prices.

Clothing prices increased by 0.5% and the prices of durable consumer goods increased by 4.4% on average in a single year. Taking a closer look at the latter, one can see that jewellery prices increased by 10.5%, home furniture prices increased by 10.8%, new car prices increased by 7.9%, but used car prices increased by 0.3%.

FIGURE 10: INFLATION (Y-O-Y, %)



Source: MNB

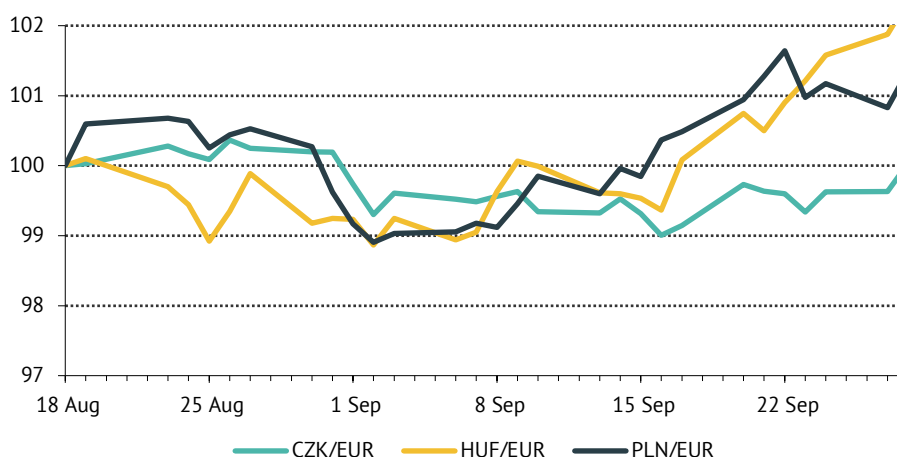
Based on the base inflation indicators disclosed by MNB, the seasonally adjusted core inflation rate was 3.3%, while both the core inflation rate excluding the effects of indirect taxes and the demand-sensitive inflation rate were 3.6% in August. The sticky price inflation rate was 4.8% in August.

Both the ECB Board of Governors and the Federal Open Market Committee met in the recent period. Eurozone interest rate conditions did not change, i.e. the reference interest rate is still 0.00%, the active and deposit rates of central bank availability are 0.25% and -0.50%, respectively. The Federal Open Market Committee did not change its base interest rate with a target range from 0% to 0.25%.

Czech and Polish 10-year yields increased.

Exchange rates in the region slightly weakened against the euro. The Czech koruna stagnated, and the Polish zloty has weakened by 1.4% against the euro over the period. The Czech 10-year treasury securities yields increased by 22 base points to 2.05%, the Polish 10-year yield increased by 31 base points, to 2.1%.

FIGURE 11: REGIONAL EXCHANGE RATES (START DATE = 100%)



Source: Refinitiv

The HUF weakened against the EUR.

Overall, indicators of the Hungarian financial and foreign currency markets have shown a mixed picture in the past period. The yield of 5-year treasury securities closed at 2.66%, rising 52 basis points. The HUF weakened by 2.4% against the euro, by 1.1% against the Swiss franc and by 2.7% against the US dollar. This means that on 28 September 2021, one euro was worth 359 forints, one US dollar was worth 308 Forints and one Swiss franc was worth 332 forints. Sovereign debt held by foreigners has recently increased by HUF 65 billion to HUF 4,759 billion.

The pace of interest rate rises has slowed.

At its interest rate meeting in September, the Monetary Council of MNB raised its base interest rate by 15 base points; the base interest rate is, therefore, 1.65%. The MNB Monetary Council also moved the edges of the interest rate corridor symmetrically upwards by 15 base points, increasing the overnight deposit interest rate to 0.7% and the credit rate to 2.6%. The central bank also raised the interest rate on the one-week deposit instrument by 15 base points to 1.65%.

The Monetary Council launched two programmes on 4 May 2020: a government bond purchase programme on the secondary market to ensure the stable liquidity of the government securities market and relaunched its mortgage bond purchase programme to increase the long-term supply of funds for the banking system. At its meeting in September 2021, the

Monetary Council of the Hungarian central bank decided to lower the weekly purchase limit from HUF 50 billion to HUF 40 billion, with the possibility to deviate from it flexibly, as the central bank's holdings of treasury securities had risen close to the HUF 3,000 billion ceiling. The next time it decides to change the target amount of weekly purchases for the next quarter is at the December rate-setting meeting. Furthermore, the central bank does not sell its treasury securities, but holds them until maturity. The Monetary Council also aims to keep short-term interest rates around the optimal level for the central bank in all segments. Taking this into account, the central bank is gradually phasing out its swap facility providing liquidity in forint.

Over the past month, yields on the secondary yield curve in the treasury securities market have risen by between 25 and 63 base points for shorter maturities. This means that the 3-month yield was 1.04%, the 6-month yield was 1.16% and the 1-year yield was 1.52% on 28 September. The 3-year yield increased by 34 base points to 2.27%. On a month-over-previous-month basis, 5-year yields increased by 52 base points, 10-year yields increased by 50 base points, and 15-year yields increased by 50 base points. These three yields changed, therefore, to 2.66%, 3.29%, and 3.67%, respectively.

Since 3 June 2019, retail investors can buy super government bonds (MÁP+) with a relatively high interest rate that gradually increases during its term, ensuring a total annual yield of 4.95%. On 15 September 2021, the total value of treasury securities held by retail investors was HUF 6,069.73 billion after a HUF 152.23 billion increase from the HUF 5,917.5 billion level in mid August 2021.

The share of foreign currency debt in the sovereign debt changed to 17.3% in August (corresponding to a decrease of 0.5 percentage points), which is near the upper edge of the range (10–20%) specified in the financing plan for 2021 of the Government Debt Management Agency Ltd. There were no maturing foreign currency bonds in August.

Issuance of foreign-currency treasury bonds (14-15 September 2021)

On 14 and 15 September 2021, the following international bond issue took place in Hungary, partly as a pre-financing of the expected RRF funds from the EU:

- On 14 September 2021, the ÁKK issued 10-year bonds worth USD 2.25 billion with a fixed interest rate of 2.125% and a yield of 2.279%,
- and a 30-year bond series worth USD 2 billion with a fixed interest rate of 3.125% per annum and a yield of 3.344%.

The yield on the former is 1 percentage point higher and that of the latter is 1.5 percentage points higher than that of the benchmark US treasury bond with similar maturity. According to the ÁKK, thanks to the nearly fourfold oversubscription, the bonds were sold at a yield 0.3 percentage points lower than originally planned for both maturities.

- On 15 September 2021, the ÁKK issued a 7-year bond series worth EUR 1 billion with a fixed interest rate of 0.125% and a yield of 0.326%.

The issuance of bonds denominated in foreign currency does not threaten an excessive increase in the share of sovereign debt in foreign currency, i.e. share of government securities in foreign currency will be only slightly higher than 20%, which is one of the strategic targets of ÁKK. The value of foreign currency bonds issued in USD and EUR amounts to HUF 1670.553 billion, calculated at the exchange rate of 29 September 2021. This issuance of foreign-currency treasury bonds increases the share of foreign currencies in the total sovereign debt to 20.8%, while slightly above the 20% upper limit (to 20.25%) if we take the foreign-currency treasury bonds maturing in 2021 into account. It is important to stress, however, that the exact determination of the share of sovereign debt in foreign currency is complicated by the issuance and

maturity treasury bonds in HUF, as well as by foreign currency purchases and exchange rate developments.

Some questions to consider arise in the case of foreign-currency treasury bonds. One is that a higher share of foreign currency treasury bonds implies a higher exchange rate risk, i.e. if the forint weakens, the HUF value of the repayable principal will increase. The principal is not due immediately, only at the end of the term, but a considerable currency weakening will increase the amount to be repaid. However, what has to be paid on an annual/semi-annual basis is the coupon on the bond, so the exchange rate loss is also proportionally higher, but this is a smaller amount.

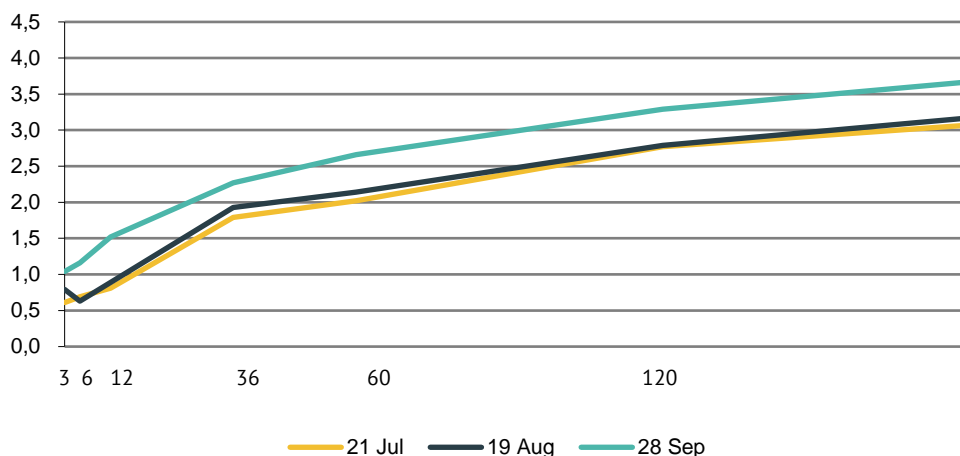
In addition to prefinancing RRF funds from the EU, the declared objective of ÁÁK is to replace previous higher-interest foreign-currency treasury bonds. In 2011, the interest rate on a 30-year loan in USD was 7.625%, while the interest rate on a 10-year loan in EUR was 1.75%.

In principle, of course, it is only worth taking on debt in foreign currency if you expect the exchange rate of the domestic currency to strengthen, i.e. the EUR or the USD to weaken against the HUF. This is because the principal to be repaid will then be subject to exchange rate gains and the actual cost will be lower than the bond yield. It is important to note that this was not the primary motive in this case, but the uncertain date of future RRF funding from the EU. And domestic businesses would be at a competitive disadvantage on the international stage if they do not have access to these resources in time. At the same time, available resources also provide opportunities to replace previously issued bonds with higher coupons and yields with cheaper sources.

Recently, one of the major international credit rating agencies had a scheduled date (Moody's, 24 September) for a change or confirmation of its risk rating. Moody's upgraded Hungary's sovereign debt risk rating. Hungary's sovereign debt rating is currently Baa2 with a stable outlook at Moody's, BBB with a stable outlook at S&P and BBB with a stable outlook at

Fitch. Thus, all three major international rating agencies have a risk rating for Hungarian treasury securities that is one category above the lowest grade that is still recommended for investment.

FIGURE 12: THE HUF YIELD CURVE (%)

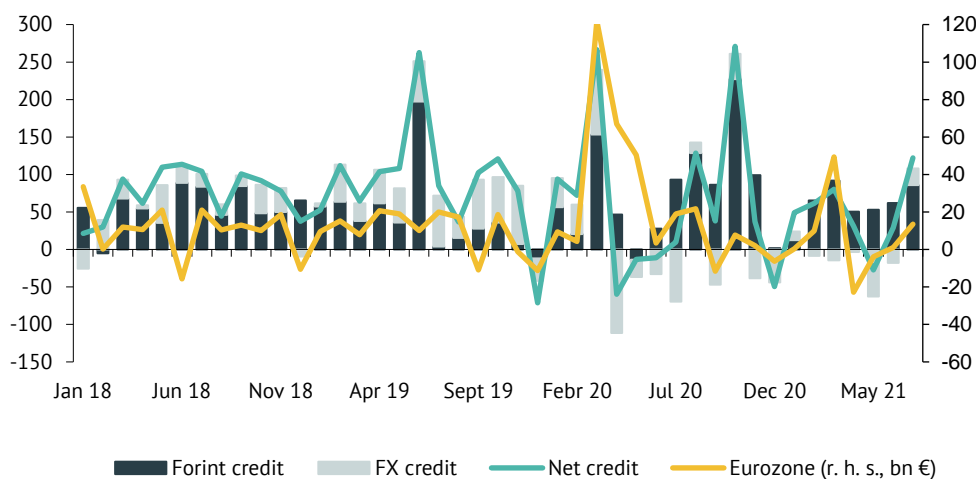


Source: ÁKK, Századvég

Corporate credits increased in July.

Seasonally adjusted data show that the net borrowing of HUF loans in the business sector was HUF 85.8 billion in July 2021. The net borrowing of foreign currency loans was HUF 22.4 billion in July; in other words, the aggregate value of the foreign currency loans held by the business sector increased. This means that, based on seasonally adjusted data, total net borrowing was HUF 122.3 billion in July. Corporate borrowing in the eurozone was EUR 13.463 billion in July 2021.

FIGURE 13: CORPORATE BORROWING (IN BILLION HUF)



Source: MNB, ECB

In July, the value of gross loan placement in HUF over and above bank overdrafts was HUF 117.6 billion, which is HUF 41.5 billion more than the amount of the previous month. The sum of newly granted euro-loans was HUF 26.4 billion, which is HUF 0.4 billion less than the figure for June.

3. Macroeconomic forecast of Századvég Economic Research

Growth this year is expected to exceed 7%.

Q2 was characterised by better-than-expected economic growth of 17.9% year-on-year and 2.7% quarter-on-quarter, with the Hungarian economy outperforming its pre-crisis level. This means that the economy as a whole has emerged from the crisis—although this is not true for every sector.

In our latest forecast, we have revised up our expectations for economic growth to 7.8% this year and 5.5% in 2022.

Household final consumption expenditure could rise by 5.2% this year and 5.3% next year. In both years, the lower base from the previous year's restrictions may play a role in the expansion, but the rebound in the economy is also improving household income, allowing consumption to expand further. As restrictions have been lifted, firms that had previously laid off workers have started to recruit again, with the unemployment rate expected to fall to 4.0% this year and 3.6% next year, and labour shortages are re-emerging in a growing number of sectors. The labour shortage could lead to a resumption of dynamic wage growth, averaging 10.6% next year, but this will be significantly affected by the decision on the minimum wage.

Investment is expected to grow by around 10% in 2021 and by 5.4% in 2022, boosted by the low base, preferential loan schemes and the EU's common borrowing resources.

After last year's downturn, foreign trade has returned to a growth trend, although international tourism is still significantly below its previous levels, which is also reflected in the foreign trade of services. Exports are expected to grow by 11.9% in 2021 and 6.6% in 2022, while import volume growth could reach 9.0% and 4.9%, respectively. In addition to the low baseline, the expansion in exports is also supported by high investment. We therefore forecast that the foreign trade balance could make a positive contribution to economic growth in both 2021 and 2022.

Inflation has recently been higher than expected, exceeding 5% between April and June. Inflation outside the central bank's target range was driven by rising fuel prices, rising excise duties on tobacco products, price increases in businesses forced to close during the virus outbreak, high demand and the weakening forint exchange rate. For this year as a whole, we expect inflation to be 4.7%, which could moderate to 3.8% next year, still above the central bank's target, but back within the target range. Tightening monetary policy and the end of the low base for tobacco excise duty increases and for fuel prices play a role in the decline in the inflation rate. At the same time, expansionary fiscal policy and dynamic increases in the minimum wage are upside risks.

To achieve the inflation target, the Magyar Nemzeti Bank has recently tightened monetary policy in several steps, raising the reference interest rate from 0.6% to 1.5%. At the same time, it has also started to phase out its unconventional instruments, such as its growth loan programme and its purchases of treasury securities on the secondary market. Further tightening is expected to achieve the inflation target, but at a slower pace than in recent months.

There are no signs of a tightening in fiscal policy so far, but the marked increase in nominal GDP is leading to a substantial reduction in the debt-to-GDP ratio. We forecast the budget deficit to be 7.2% of GDP this year and 5.4% of GDP next year, meaning that the 3% deficit target will not be met in the period under review. As a result of dynamic economic growth, however, the debt-to-GDP ratio will fall from 80.4% in 2020 to 77.2% in 2021 and 73.6% in 2022.

4. Századvég forecast ¹

TABLE 1: Q3 2021 PROJECTION

	2020	2021				2021	2022				2022
	annual	Q1	Q2	Q3	Q4	annual	Q1	Q2	Q3	Q4	annual
Gross domestic product (volume index, %)	-5,0	-2,1	17,9	7,7	7,5	7,8	6,8	5,3	5,0	4,9	5,5
Household consumption expenditure (volume index, %)	-2,5	-4,8	10,6	8,7	6,2	5,2	8,8	4,7	3,7	4,1	5,3
Gross fixed capital formation (volume index, %)	-7,3	-0,1	8,3	16,2	15,3	9,9	12,7	2,2	3,1	3,6	5,4
Export volume index (based on national accounts, %)	-6,8	3,3	33,0	5,6	5,5	11,9	5,2	7,9	7,2	5,9	6,6
Import volume index (based on national accounts, %)	-4,4	1,1	23,4	5,9	5,4	9,0	5,2	5,3	5,1	4,0	4,9
Foreign trade balance (bn EUR)	5,8	2,6	1,0	1,8	2,0	7,5	3,0	1,9	2,6	2,7	10,2
Consumer price index (%)	3,3	3,2	5,2	4,9	5,4	4,7	4,4	3,9	3,6	3,4	3,8
Central bank's base rate at the end of the period (%)	0,6	0,6	0,9	1,8	2,1	2,1	2,1	2,1	2,4	2,4	2,4
Unemployment rate (%)	4,2	4,5	4,1	3,8	3,7	4,0	3,8	3,7	3,5	3,5	3,6
Gross average earnings (year-on-year change, %)	9,7	9,3	7,2	8,8	8,1	8,4	9,6	10,9	10,7	11,3	10,6
Current account balance as a percentage of GDP	-0,1					1,0					2,1
External financing capacity as a percentage of GDP	1,9					2,7					3,9
General government ESA-balance as a percentage of GDP	-8,1					-7,2					-5,4
Government debt (% of GDP)	80,4					77,2					73,6
GDP based external demand (volume index, %)	-5,0	-2,1	17,9	7,7	7,5	7,8	6,8	5,3	5,0	4,9	5,5

Source: MNB, HCSO, Századvég-Calculation

TABLE 2: CHANGES COMPARED TO OUR PREVIOUS FORECAST

	2021			2022		
	Mar 2021	June 2021	Difference	Mar 2021	June 2021	Difference
Gross domestic product (volume index, %)	5,8	7,8	1,9	4,7	5,5	0,8
Household consumption expenditure (volume index, %)	3,7	5,2	1,5	5,3	5,3	0,1
Gross fixed capital formation (volume index, %)	7,2	9,9	2,8	8,3	5,4	-2,9
Export volume index (based on national accounts, %)	11,9	11,9	0,0	6,3	6,6	0,3
Import volume index (based on national accounts, %)	9,7	9,0	-0,8	5,7	4,9	-0,8
Foreign trade balance (bn EUR)	7,9	7,5	-0,4	9,2	10,2	1,0
Consumer price index (%)	3,9	4,7	0,8	3,5	3,8	0,3
Central bank's base rate at the end of the period (%)	1,20	2,10	0,9	1,5	2,40	0,9
Unemployment rate (%)	4,0	4,0	0,0	3,6	3,6	0,1
Gross average earnings (year-on-year change, %)	9,4	8,4	-1,1	10,3	10,6	0,4
Current account balance as a percentage of GDP	0,6	1,0	0,4	0,8	2,1	1,3
External financing capacity as a percentage of GDP	2,5	2,7	0,2	2,9	3,9	1,0
General government ESA-balance as a percentage of GDP	-7,9	-7,2	0,7	-6,1	-5,4	0,7
Government debt (% of GDP)	80,1	77,2	-2,9	79,6	73,6	-6,0
GDP based external demand (volume index, %)	4,2	5,1	0,9	4,4	4,6	0,2

Source: Századvég-calculati

¹ The forecast is valid as of 10 September 2021

