

MONTHLY MONITOR

June 2022

Századvég Economic Research Institute



SZÁZADVÉG

Table of Contents

1. Summary	2
2. Economic overview	3
2.1. External environment	3
2.2. SZIGMA indicators.....	4
2.3. Real economy	5
2.4. External balance.....	12
2.5. Fiscal outlook	13
2.6. Monetary developments	16
3. Századvég forecast	22

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1. Summary

ECONOMIC GROWTH COULD BE ABOVE 5% THIS YEAR

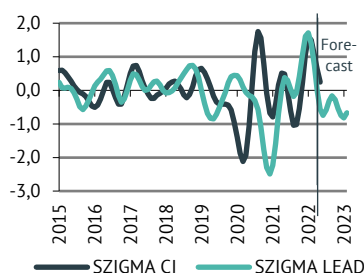
Given the much better-than-expected Q1 data, we have revised up our growth forecast for this year. In 2023, economic output could expand by 4.5%.

Consumption growth will be a major growth driver in both years, helped this year by above-inflation wage growth and government transfers. A prolonged Russo-Ukrainian war and the possible further extension of sanctions associated with it, however, pose a significant risk to growth next year in particular. The persistence or possible worsening of energy market anomalies, a weak forint exchange rate (HUF/EUR) and high inflation also pose risks.

Inflation could reach 10.3% in 2022 and fall to 7.1% in 2023, still above the central bank's target. The slowdown in inflation is conditional on the end of the war and the strengthening of the forint and the normalisation of energy prices. Wages could rise by an average of 16.5% this year and 10.1% next year, i.e. above inflation in both years.

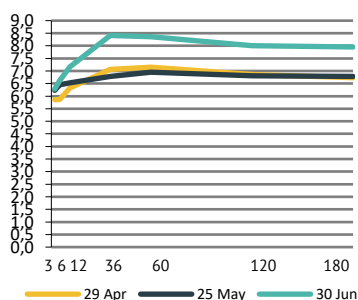
Among balance indicators, fiscal balance is expected to improve over the forecast horizon, with the deficit at 4.4% of GDP in 2022 and 3.5% in 2023, above the 3.0% threshold. The current account deficit, however, looks significant, at 7.3% of GDP this year and 5.5% of GDP next year. In addition to the increase in domestic demand, the deteriorating balance is also significantly influenced by the rise in global energy prices.

SZIGMA indicators



Source: Századvég

HUF yield curve (%)



Source: Refinitiv

Forecast (21 June 2022)	2022
GDP volume change (%)	5,4
Inflation (annual average, %)	10,3
Gross wages	16,5
Exchange rate (annual average)	389

2. Economic overview

2.1. External environment

The European Central Bank might tighten its monetary conditions in July.

Although the European Central Bank did not change its reference rates at its June meeting, it did announce a 25-basis-point increase for the July meeting. This could bring the base rate to 0.25%, the overnight deposit interest rate to -0.25% and the overnight lending rate to 0.5%. The central bank also announced that it will end its asset purchase programme (APP) on 1 July but will continue to renew maturing bonds for a long period. The central bank plans to raise interest rates further in September, but the pace will be influenced by the inflation outlook. In parallel with the interest rate decision, the ECB published its latest forecast. Compared with the March forecast, the central bank expects growth in the euro area to slow by 0.9 percentage points to 2.8% this year, and to 2.1% next year, 0.7 percentage points lower than previously forecast. The ECB also revised its inflation forecast upwards, by 1.7 percentage points to 6.8% this year and 1.4 percentage points to 3.5% next year. The expectation for 2024 is 2.1%, which means that the central bank is forecasting that price development in the euro area will remain above target on a sustained basis.

The interest rate decision was, however, followed by a sudden sharp rise in yields in euro area countries. The closing level on 9 June for 10-year government bonds had risen by nearly 60 basis points in Italy and Greece, by more than 50 basis points in Spain and by nearly 45 basis points in Portugal by 14 June. Further acceleration in US inflation and expectations of a Fed rate hike also contributed to the rise in yields. This forced the ECB to take action to ensure the sustainability of the sovereign debt of the euro area's most vulnerable member states, and the central bank called an extraordinary meeting for 15 June. Here it was decided that the assets maturing under the Pandemic Emergency Purchase Programme (PEPP) will be renewed by the central bank in a flexible way to ensure a transmission mechanism in the euro area. In practice, this means, for example, that

maturing German bonds are not renewed by the ECB by buying new German bonds, but by buying, say, Italian bonds. In other words, the ECB is engaging in qualitative easing, with no change in the size of the bond holdings for the euro area as a whole, only in their structural composition. At the same time, this also leads to a split in the euro area, with the central bank tightening the money supply in some markets and increasing it in others.

2.2. SZIGMA indicators

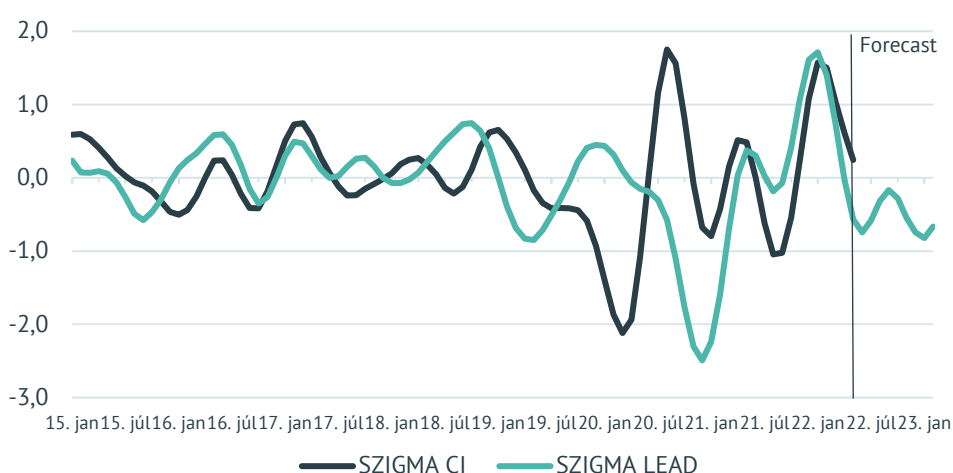
In May 2022, the SZIGMA CI indicator, which provides a snapshot of the current state of the Hungarian economy, was in positive territory, meaning that the economy expanded above trend. In April 2022, the volume of domestic industrial sales increased by only 0.5% on a monthly basis, but by 14.5% on an annual basis, while export sales decreased on a monthly basis (by 1.7%) and increased slightly on an annual basis (by 0.4%). The volume of domestic and export sales orders decreased on a monthly basis, by 16.7% and 7.1%, respectively, but exceeded the level of the same period of the previous year by 7.6% and 10.4%, respectively. The contribution of industry to growth could be positive overall, but the Russo-Ukrainian war, raw material and chip shortages, and rising energy prices remain major risks. The month-end volume of contracts in construction continued to decline on a monthly basis (1.3%), while it increased by 8.0% on an annual basis. The number of new non-residential building projects decreased on both a monthly and annual basis, by 10.9% and 15.0%, respectively.

The SIGMA LEAD indicator, which reflects our expectations for the short-term performance of the Hungarian economy, points to below-trend growth until the end of the forecast horizon. In May 2022, the Ifo Business Climate index, which provides a picture of the changes of the business climate of the German economy, improved on a month-on-previous-month basis (by 1.1 index points) but was still below last year's level (by 5.8 index points). Retail sales showed double-digit growth in April 2022, driven by government transfers and petrol tourism. The sector's

Consumer confidence in the European Union has deteriorated.

contribution to growth could be positive this year. The Eurostat consumer confidence index fell on both a monthly and annual basis, by 4.3 and 10.4 index points respectively, to stand at -27.4 index points. The negative value of the index suggests that the segment's turnover can be further expanded by improving confidence. In 2022, the economy is expected to grow by more than 5%.

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



Source: Századvég

2.3. Real economy

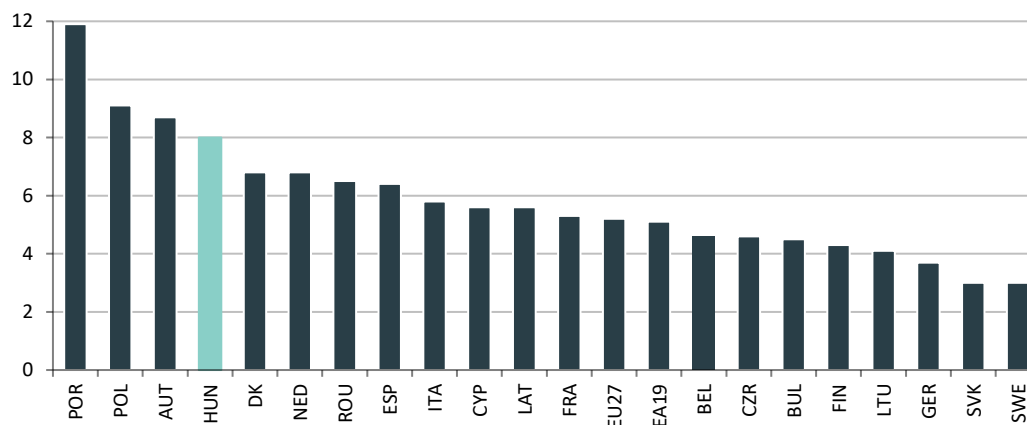
Hungarian GDP increased by 8.2%.

The Hungarian Central Statistical Office's second estimate for Q1 2022 showed a 8.2% increase in gross domestic product compared with a year earlier. On a seasonally and calendar-adjusted basis, GDP volume was 8.0% higher than in the same period of the previous year, while it increased by 2.1% compared with the previous quarter.

On the production side, the added value generated by agriculture was 3.9% lower than one year before. The added value generated by the industry increased by 4.9% in the period under review, while that of manufacturing within the industry increased by 4.6% compared to Q1 2021. The added value generated by the construction industry in the quarter in question was 18.3% higher, that of services was 9.9% higher than one year before. Agriculture moderated GDP growth

by 0.1 percentage points, while construction contributed 0.6 percentage points, services 5.3 percentage points and industry 1.2 percentage points.

FIGURE 2: GDP-GROWTH ACROSS THE EU (Q12022; Y-O-Y; %)



Remark: Seasonally and working-day adjusted data from the first estimates.

Source: Eurostat

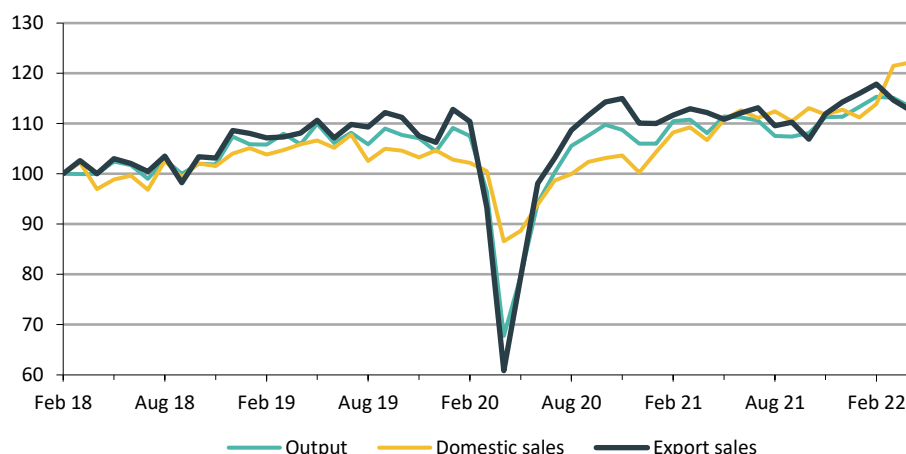
On the consumption side, household final consumption expenditure decreased by 14.1% and the volume of community consumption increased by 6.4% compared to Q1 2021. Gross fixed capital formation increased by 13.2% compared to the same period of the previous year.

In Q1 2022, the volume of exports was 5.2% higher and the volume of imports 8.3% higher than in the same period of the previous year. As a result, the trade balance reduced GDP growth by 2.6 percentage points. Within exports, exports of services rose by 23.1% and exports of goods by 2.0% on an annual basis. Imports of services increased by 15.5% and imports of goods by 7.1% compared to the same period last year.

The volume of industrial production in April was 3.1% higher than a year earlier, according to raw data, while the expansion rate was 4.7% according to working-day adjusted data. On a monthly basis, however, output has already fallen by 1.6%, which means that the impact of the Russo-Ukrainian war has already been reflected in industrial production data. In the aftermath of the conflict, supply chains were further disrupted, with shortages of some raw materials and parts. Sales volumes in the sector were 2.7% higher in April than a year earlier, with domestic sales up 13.3% and export sales down 3.8%.

The effects of the Russo-Ukrainian war are already being felt in industrial

FIGURE 3: INDUSTRIAL OUTPUT AND SALES (JANUARY 2018 = 100%)



Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

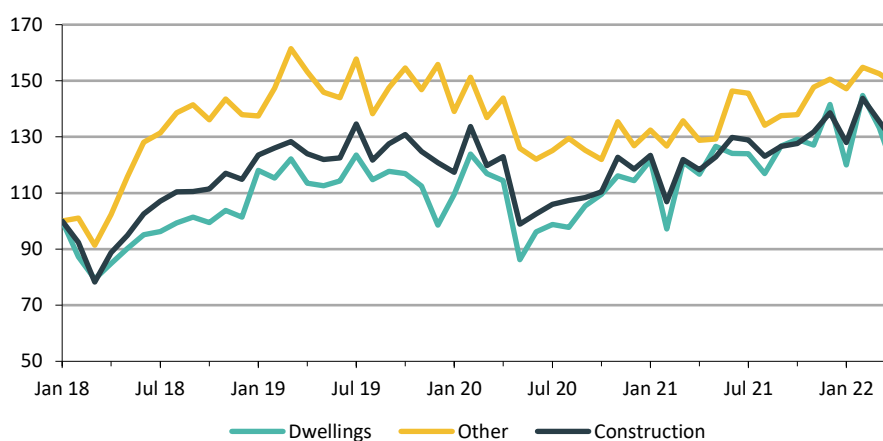
Among the individual sub-sectors of industry, output fell by 3.9% in mining, while manufacturing grew by 2.8% and energy by 6.3%. Within manufacturing, the largest increase in output (23.0%) was in the electrical equipment manufacturing sector, followed by coke and refined petroleum products (18.6%) and food products (11.9%). In April, the performance of the automotive industry, which is a major contributor, was 7.1% down on a year earlier, while that of the pharmaceutical industry was 8.5% down. The evolution of sales orders in the industrial sector shows that demand for the sector's products is high, but is difficult to meet due to a shortage of raw materials: the total order volume at the end of April was 28.3% higher than a year earlier, driven by a 30.8% increase in export sales orders, while domestic sales orders fell by 6.2%. Meanwhile, the volume of new sales orders was 9.9% higher than a year earlier, with new domestic sales up by 7.6% and new export sales orders up by 10.4%.

The volume of construction output expanded slightly.

Compared with the previous months, the output of the construction industry was down in April, with year-on-year volume growth slowing to 3.2% and a 5.9% month-on-month decline, also due to the war-related product shortages. Production in the two main building groups diverged in April, with buildings falling by 1.2% and civil engineering works

up by 11.4%. Sales orders in the sector remained high, up 8.0% on a year earlier. Within this, the volume of contracts for buildings decreased by 8.8%, while the volume of contracts for civil engineering works increased by 20.6%. The volume of new contracts increased significantly, by 33.9%. Within this, both main groups achieved substantial increases: buildings by 43.4% and civil engineering works by 25.2%.

FIGURE 4: CONSTRUCTION SECTOR (JANUARY 2018 = 100%)



Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

The volume of retail sales increased by 15.8%.

In April 2022, the volume of retail sales increased by 15.7% on a raw basis and by 15.8% on a calendar-adjusted basis compared with the same period of the previous year. Adjusted data show a 2.4% decrease compared to the previous month. The significant expansion was helped by the emergence of additional demand following the payment of household transfers at the beginning of the year, but the monthly moderation suggests that its impact is becoming less pronounced. The base effect also played a significant role in the year-on-year increase, as in the same period of 2021 the population postponed its purchases due to the restrictions imposed by the coronavirus epidemic. In April 2022, the calendar-adjusted volume of sales increased by 7.1% in specialised and non-specialised food shops, by 15.4% in non-food shops and by 37.3% in fuel retail, relative to April 2021.

On a calendar-adjusted basis, sales of books, newspapers and stationery (49.7%), second-hand goods (50.8%) and textile products, clothing and footwear (66.8%) showed outstandingly high increases, which is indeed driven by the base effect. In addition, a significant increase in sales was also recorded in perfumes (21.8%), and computers and other manufactured goods (29.6%). Compared to April 2021, retail sales volumes of mixed range of manufactured goods (11.0%), pharmaceuticals and medicinal products (12.6%) and furniture and technical goods (13.6%) increased by less than retail sales volumes. The turnover of parcel companies and online stores, however, showed a decline (-4.2%), which can be explained by the high base. Calendar-adjusted data show that in April 2022, sales increased by 6.8% in non-specialised food shops and by 8.0% in shops selling food products, beverages, and tobacco products, relative to the same period of the previous year.

FIGURE 5: RETAIL SALES VOLUME (JANUARY 2018 = 100%) AND RETAIL TRADE CONFIDENCE INDICATOR



Remark: Seasonally and working-day adjusted data

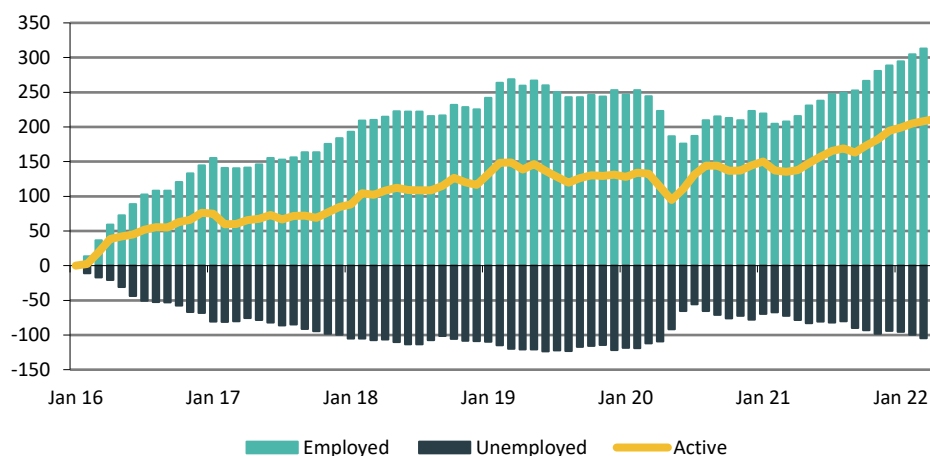
Source: HCSO, Eurostat, Századvég

The unemployment rate has fallen to levels seen before the coronavirus

In February–April 2022, the seasonally adjusted number of employees was close to 4,712,000, an increase of 29,000 compared to the previous 3-month period and 108,000 compared to the same period of the previous year. Over the period, the employment rate for the 15-74 age group rose to

64.2%. Activity has also increased, with the seasonally adjusted number of the active population rising by 12,000 in three months and by nearly 74,000 in a year. As a result, the number of the unemployed fell by nearly 17,000 on a quarterly basis and by 34,000 on an annual basis to 167,000 in the February-April period. This represents an unemployment rate of 3.4%, last seen before the outbreak of the coronavirus epidemic. Based on seasonally adjusted data, the number of employees rose by 6,000 on a monthly basis and by 73,000 on an annual basis in March. Within this, enterprises having at least 5 employees recorded an increase of 8,000 and 84,000 respectively over these two time periods. By contrast, the number of employees in the public sector fell by 2,000 on a monthly basis, while the number of employees in non-profit companies stagnated. The decline in the number of public sector employees was partly attributable to the fact that the number of people in public employment fell below 75,000 in March, 4,000 below the February level and 6,000 below the level of March last year.

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



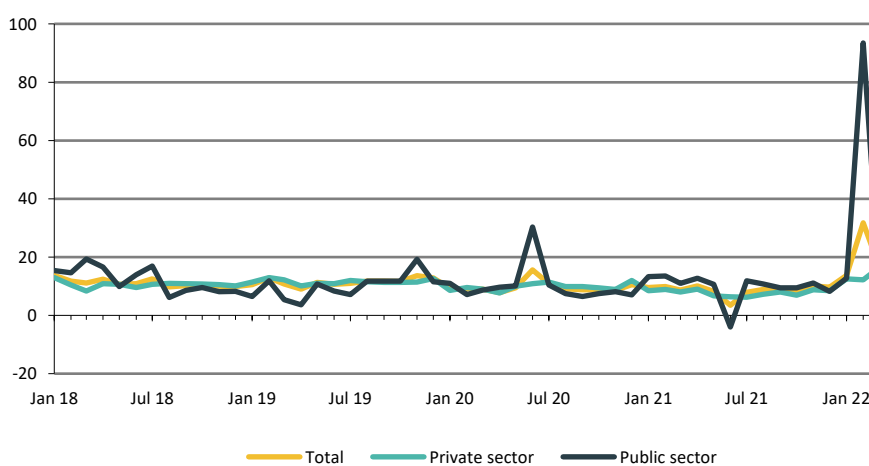
Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

The average net monthly wage has risen to over HUF 350,000 as a result of tax allowance.

In March, the average gross monthly wage increased by 17.5% to HUF 511,400. The average regular monthly wage (i.e. net of premiums, bonuses, one-month extra benefits) increased by 15.5%. The average monthly wage of full-time employees in the competitive sector, among enterprises having at least 5 employees, increased by 16.2%, while by 17.3% in the public sector. In the competitive sector, the 20% increase in the minimum wage and the guaranteed minimum wage at the beginning of the year, as well as the growing labour shortage, played a role in the dynamic wage growth. In the public sector, in addition to the increase in the statutory minimum wage, pre-scheduled wage increases have played a prominent role, but earnings dynamics in this sector have been affected since August last year by the reallocation of employees of structure-changing higher education institutions to the non-profit sector. The average net monthly wage also increased by 17.5% to HUF 340,100, while taking into account various benefits (family tax allowance, personal income tax exemption for under-25s, etc.), it increased by 18.1% to HUF 352,200. Net real wages rose by 8.3% in March.

FIGURE 7: GROSS WAGES (ANNUAL CHANGE, %)



Remark: Seasonally and working-day adjusted data

Source: HCSO, Századvég

2.4. External balance

The trade balance deteriorated.

In March, the EUR value of product exports increased by 8.8%, and the EUR value of product imports increased by 25.0% year-on-year. The foreign trade deficit was, therefore, EUR 708 million, by EUR 1.6 billion less than in the previous year.

In March, the volume of food product imports increased by 5.0%, and food product exports decreased by 8.3% on a year-on-year basis. As for energy carriers, imports increased by 6.2% and exports by 21.0%. As for processed products, imports increased by 9.0%, and exports increased by 2.2% on a year-on-year basis. As for machinery and transport equipment, imports increased by 3.3%, and exports by 8.4%.

In April 2022, the EUR value of exports was 13.0% higher and the EUR value of imports was 22.0% higher than a year earlier. The trade deficit in goods amounted to EUR 503 million, which is EUR 1,354 million less than a year earlier.

The current account balance stood at EUR -779.8 million in April 2022, so the balance in the first four months of this year (EUR -3,125.0 million) was lower than in January-April 2021, a year earlier.

FIGURE 8: BALANCE OF TRADE (IN MILLION EUR)



Remark: The data relating to April 2022 derive from the first estimates.

Source: HCSO

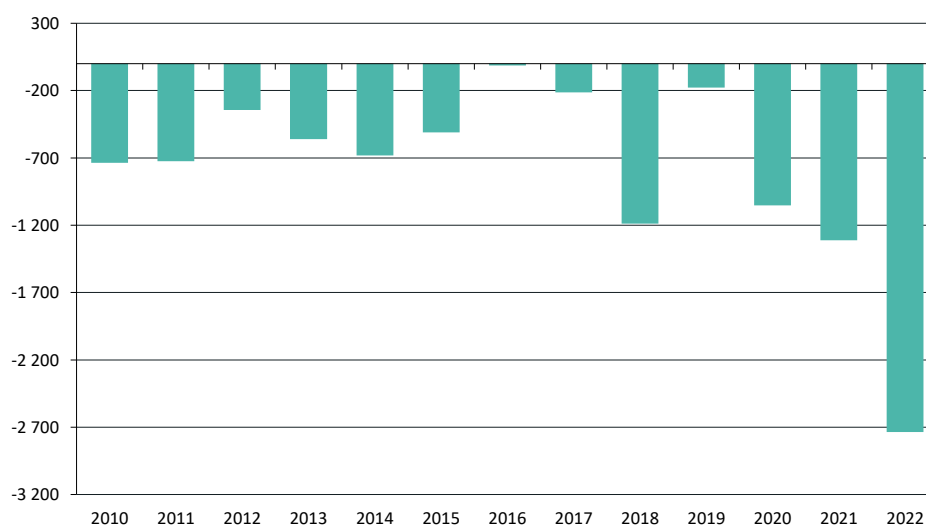
2.5. Fiscal outlook

In May 2022, the cumulative deficit of the central budgetary subsystem amounted to HUF 2,737.0 billion. This deficit consisted of the HUF 2,879.0

**In the year to May,
VAT receipts
increased by almost**

billion deficit of the central budget, the HUF 8.6 billion deficit of the social security funds subsector and the HUF 150.6 billion surplus of the extra-budgetary funds.

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



Source: PM

VAT receipts were HUF 586.6 billion (29.3%) higher than the cumulative total a year earlier, driven by an increase in VAT receipts on domestic, import and tobacco products. Excise duty receipts were HUF 12.7 billion (2.7%) higher than in January-May 2021. This was due to the combined effect of higher fuel prices and a higher tax rate in Q1 2021. Personal income tax receipts were HUF 405.4 billion (34.8%) lower in the first five months of the year than in the base period, due to the tax refund for families with children. Revenues from social contribution tax and social security contributions increased by HUF 315.5 billion (13.9%) over a year, due to the increase in average wages. By contrast, the reduction in the

social contribution tax rate and the abolition of the vocational training contribution have moderated revenue growth.

Receipts from EU programmes amounted to HUF 356.8 billion and expenditure to HUF 1,700.3 billion. Among domestic expenditures, pension benefits and preventive medical care stand out, which closed at HUF 2,021.5 billion and HUF 892.0 billion, respectively.

The budget for the protection of low household utility bills and defence has been presented

On 7 June 2022, Minister of Finance Mihály Varga submitted the 2023 budget to Parliament, which became the budget for the protection of low household utility bills and defence. The general debate will take place on 21 June and the final vote is expected to take place between 15 and 18 July.

The budget bill foresees a GDP growth of 4.1%, a budget deficit of 3.5% of GDP and a government debt-to-GDP ratio of 73.8% for next year, while inflation is forecast to be 5.2%. Important elements of next year's budget are the Fund to Protect Low Household Bills and the Defence Fund, with planned revenues of HUF 670 billion and HUF 842 billion, respectively. Revenues for the Fund to Protect Low Household Bills will come from payments from the energy sector, mining levies, airline contributions and telecoms tax, while the Defence Fund will receive revenues from the special tax on financial institutions, transaction tax and insurance tax. The declared aim of the Fund to Protect Low Household Utility Bills is to cushion the effects of the drastic rise in energy prices, to preserve the reduction in energy bills and thereby protect families. The Defence Fund is intended to respond to the challenges of the war in the region: to mitigate security risks, to provide a basis for further defence development and to strengthen Hungary's physical security.

The government will continue to pay special attention to family policy, with related measures totalling HUF 3,225 billion in the budget, which is nearly HUF 450 billion more than in 2022. The items include the previously

launched programmes (Family Housing Allowance, Loans for Expecting Families, personal income tax exemption for mothers of four and under-25s), so it is expected that programmes that expire this year will be extended next year.

In addition to protecting and supporting families, the 2023 budget also aims to protect pensioners. In order to preserve the purchasing power of pensions, benefits will be increased by 5.2% next year, the full amount of the 13th month pension will be paid, and pensioners will also receive a pension premium as a result of the expected economic growth. The budget for the latter amounts to HUF 371.8 billion and HUF 24.9 billion, respectively. In addition, the Women40 programme will continue, for which the government has earmarked HUF 372.4 billion. The budget also covers the career paths and wage measures introduced, including pay rises for the National Tax and Customs Administration, public education, cultural and social sectors, the judiciary, police and defence, and increases in wages due to the minimum wage and guaranteed minimum wage increases. In addition, the necessary resources are available for further wage increases, should a decision be taken. Wage increases will also continue in the health sector: the third phase of the wage improvement programme for doctors in primary and specialised care is due next year, but there will also be further pay increases for health professionals and for doctors working in public health and epidemiology.

The treasury will continue to support model-changing and church-maintained universities, with funding for infrastructure, innovation and ecosystem development in addition to operational costs. Finally, the implementation of investments of economic and social importance through the Investment Fund and the Investment Agency should also be highlighted. The former provides funding for improvements in education, transport, culture, leisure, heritage protection, the environment and urban development, while the latter provides funding for the modernisation of sport, education and culture infrastructure.

For the 2021-2027 EU budget cycle, expenditure in 2023 will amount to HUF 3,408 billion, compared to HUF 2,057 billion in revenue. For rural

development programmes, the government will apply the maximum co-financing rate of 80%.

2.6. Monetary developments

In May 2022, consumer prices increased by 10.7% on average, compared to the same period of the previous year. Over the past year, the prices of food and consumer durables have risen the most (18.6% and 11.4%, respectively). Consumer prices rose by 1.7% on average over a month.

Inflation accelerated to over 10%.

More significant contributors to the 18.6% average increase in food prices were the 34.3% increase in poultry prices, the 35.4% increase in cheese prices, the 30.3% increase in the prices of dairy products (excluding cheese), the 37.5% increase in bread prices and the 27.3% increase in pastry prices. The average food inflation rate was, however, held back by the 11.4% increase in fresh domestic and tropical fruit prices, the 12.9% increase in pork prices, the 10.0% increase in the prices of non-alcoholic beverages, and the 3.9% increase in the prices of sugar, chocolate and cocoa.

The prices of other products and fuels increased by 10.5% in May, year-on-year. Within this, prices of home repair and maintenance increased by 28.3% and vehicle fuel by 10.8%, the latter explained by long-standing imbalances in supply and demand. Higher price increases were held back by the government's fuel price cap.

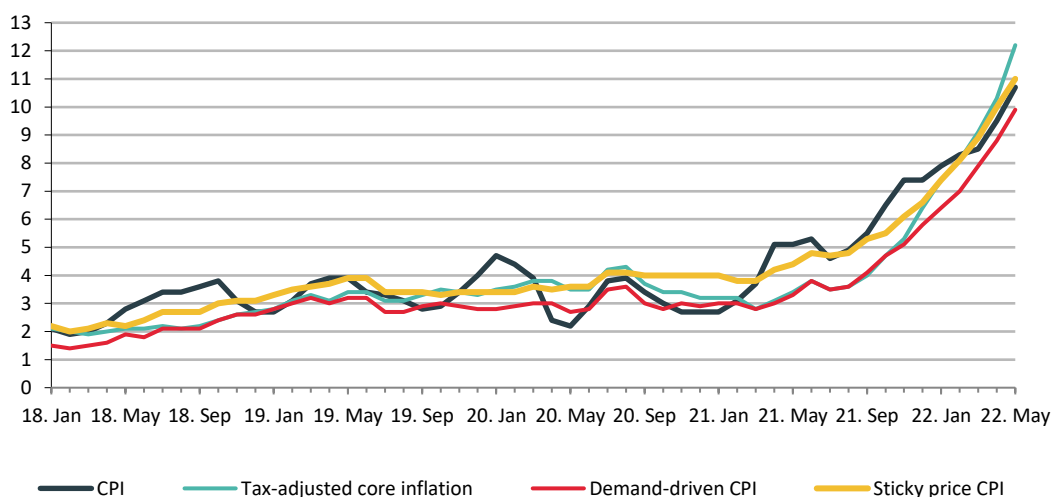
The average increase in household energy prices was 1.6% in May as compared to the same period of the previous year. Within household energy, fuelwood prices increased by 10.5%, coal prices increased by 15.4%, and bottled gas prices increased by 11.6% in a single year. The price of electricity, pipeline gas and district heating remained unchanged.

In May, prices of services increased by an average of 6.8%, mostly driven by a 42.5% increase in motorway tolls, vehicle rental and parking, a 7.7% increase in the prices of health services, a 20.1% increase in home repair and maintenance prices, an 14.4% increase in vehicle repair and

maintenance prices, and an 10.7% increase in the prices of personal care services. The average increase in the price of services was moderated by the 0.4% increase in gambling prices, a 5.0% increase in condominium common charges, a 3.8% decrease in the price of local public transport and a 0.3% decrease in the price of telephone and internet.

Clothing prices increased by 4.0% and the prices of durable consumer goods increased by 11.4% on average in a single year. Taking a closer look at the latter, one can see that jewellery prices increased by 16.2%, home furniture prices increased by 18.3%, new car prices increased by 10.6% and used car prices increased by 15.4%. On average, the prices of spirits and tobacco increased by 6.4%, including beer by 8.6% and tobacco by 5.3%, compared to the same period in 2021.

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



Source: MNB

Among the core inflation indicators published by the MNB, in May, the seasonally adjusted core inflation rate was 12.1%, the core inflation rate net of indirect taxes was 12.2%, and the sticky price inflation rate was 11.0%. Core inflation excluding processed food was 9.9% in May 2022.

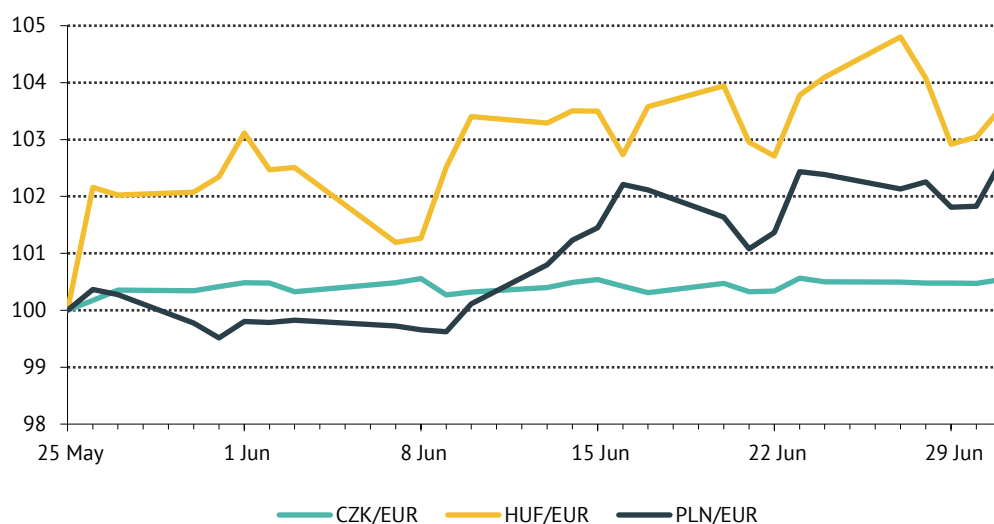
Both the ECB Board of Governors and the Federal Open Market Committee met in the recent period. Euro area interest rate conditions did not change, i.e. the reference interest rate is still 0.00%, the active and deposit rates of central bank availability are 0.25% and -0.50%, respectively. The Fed's

Federal Open Market Committee (FOMC), which decides on interest rates, raised its base interest rate by 75 basis points to a target range of 1.5-1.75%.

Both the Czech koruna and the Polish zloty weakened.

Exchange rates in the region showed a negative picture in relation to the euro. In the past period, the Czech koruna weakened by 0.5%, the Polish zloty weakened by 2.6% against the Euro. Government bond yields rose slightly because of higher risks and central bank rate hikes (increases by 125 basis points in the Czech Republic and by 75 basis points in Poland), with the Czech 10-year government bond yield 35 basis points higher at 5.00% and the Polish 10-year yield up 29 basis points to 6.94%.

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



Source: Refinitiv

The forint weakened again.

Overall, Hungarian money and foreign exchange market indicators have shown a more negative picture in the past period. The yield of 5-year treasury securities closed at 8.36%, rising 141 basis points. The HUF weakened by 3.56% against the euro, by 6.17% against the Swiss franc and by 5.65% against the US dollar. This means that on 30 June 2022, one Euro was worth 399 Forints, one US Dollar was worth 381 Forints and 1 Swiss Franc was worth 398 Forints. Over the past period, the government debt held by foreigners has fallen by HUF 650 billion to HUF 4,644 billion.

In June, the base rate increased by 185 basis points..

At its June interest rate meeting, the Monetary Council raised its reference interest rate by more than expected, by 185 basis points, to 7.75%. The Monetary Council raised the overnight deposit interest rate to 7.25% and the lending rate to 10.25%. The central bank increased the interest rate of the one-week deposit facility to 7.75%. The central bank had previously declared that it would gradually converge the base rate and the one-week deposit rate, which are now equal. The MNB has increased the effective interest rate by 700 basis points since the start of the rate hike cycle. The asymmetric interest rate corridor defines the overnight interbank market interest rate and the central bank's one-week deposit rate.

MNB will continue to focus on keeping short interest rates in line with what it considers to be the optimal short interest rate. Therefore, the MNB has been actively using its foreign exchange liquidity swap facility again since the beginning of March (HUF 3,392.87 billion since the beginning of March).

The Bond Funding for Growth Scheme has been closed as the budget (HUF 1,550 billion) has been exhausted

In a statement issued about its May meeting, the Monetary Council declared the objective that all monetary policy instruments of MNB should support the achievement of price stability as quickly as possible. This is why MNB stopped buying government bonds in December. Maintaining the stability of the government securities market continues, however, to remain important to the Monetary Council, which is, therefore, ready to intervene with temporary purchases of government bonds if necessary, which does not imply a change in its fundamental monetary policy stance.

Over the past month in the government bond market, yields for shorter maturities increased by between 5 basis points and 63 basis points on the secondary yield curve. This means that the 3-month yield was 6.28%, the 6-month yield was 6.62% and the 1-year yield was 7.16% on 30 June. The 3-year yield increased by 163 basis points to 8.41%. Yields are up 141 basis points over the 5-year horizon, 120 basis points over the 10-year horizon and 117 basis points over the 15-year horizon compared to the previous

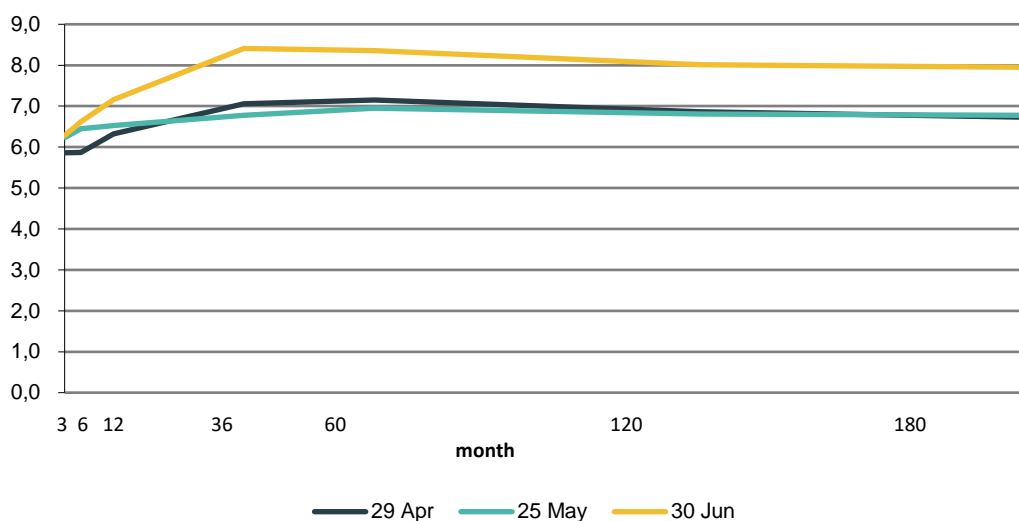
month. These three yields changed, therefore, to 8.36%, 8.01%, and 7.95%, respectively.

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%. As of 16 June 2022, retail investors held HUF 4,982.86 billion worth of these government securities, down HUF 148.63 billion from HUF 5,131.49 billion in mid-May. Given the high inflationary environment, the public prefers to hold government bonds with a fixed real interest rate, which are inflation-tracking, to the tune of HUF 3,265.66 billion (PMÁP as of 16 May: HUF 3,056.03 billion). The GDMA currently maintains the interest rate premium on the 5-year government bond at 1.5 percentage points, while the interest rate premium on the 3-year government bond at 0.75 percentage points.

The share of foreign currency debt in the sovereign debt changed to 21.3% in May (corresponding to an increase of 0.6 percentage points), which is in the range (10–25%) specified in the financing plan for 2022 of the Government Debt Management Agency Ltd.

Recently, none of the major international credit rating agencies has announced a date for a change or confirmation of the risk rating of Hungarian sovereign debt. The rating of Hungary's sovereign debt is currently unchanged at Baa2 with stable outlook with Moody's, BBB with S&P and BBB with Fitch. Thus, all three major international credit 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 (%)

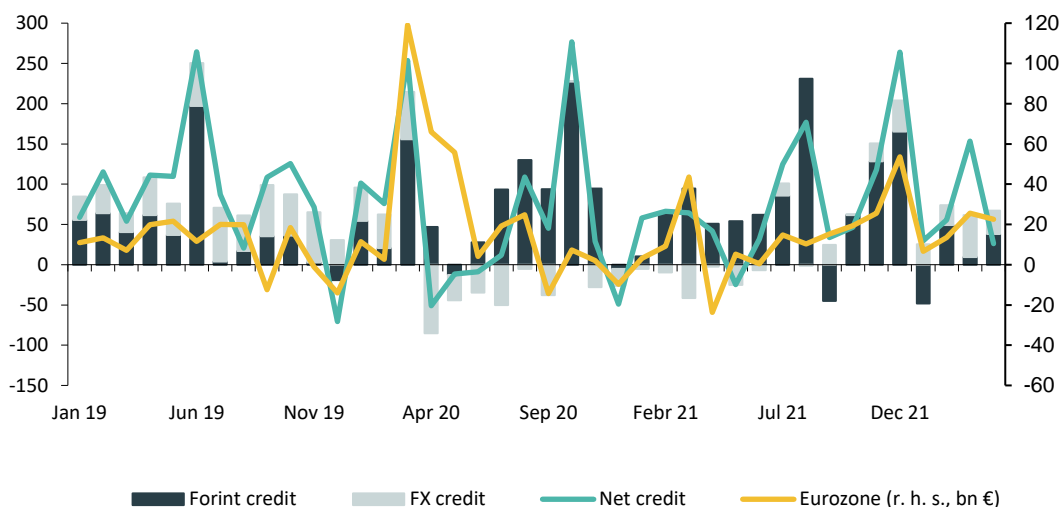


Source: ÁKK, Századvég

Corporate holdings of foreign currency loans have increased substantially.

Seasonally adjusted data show that the net borrowing of HUF loans in the business sector was HUF 38.1 billion in April 2022. The net borrowing of foreign currency loans was HUF 29.2 billion in April; in other words, the aggregate value of foreign currency loans held by the business sector, i.e. exchange rate risk exposure, increased. This means that, based on seasonally adjusted data, total net borrowing was HUF 26.3 billion in April. Corporate borrowing in the euro area was EUR 22.509 billion in April 2022.

FIGURE 13: CORPORATE BORROWING (IN BILLION HUF)



Source: MNB, ECB

3. Századvég forecast ¹

Even with the Russo-Ukrainian war, growth is expected to be above 5%.

Our latest June forecast takes into account the impact of the Russo-Ukrainian war on the Hungarian economy. At the same time, it is important to underline the uncertainty: it is currently impossible to predict when the conflict in the neighbouring country will end, or what the economic damage will be from the sanctions that have been or are planned to be imposed.

Even so, we still expect our country's economic output to expand by 5.4% this year, and to slow to 4.5% next year. Compared with our previous forecast in March, we have revised up the growth forecast substantially, reflecting the strong first-quarter expansion, whose carry-over effect could support GDP for the rest of the year. The growth engine this year will be consumption, while next year it could be investment.

The growth path of the Hungarian economy continues to be materially affected by the Russo-Ukrainian war and the sanctions policy, and the high degree of uncertainty surrounding the economic outlook should be underlined. The better-than-expected Q1 economic growth, however, combined with high employment and investment rates through carry-over effects, provides a positive base for the rest of the year. The disruption of supply chains and the rise in energy and food prices, however, are a major risk factor.

We have revised up our forecast for the consumer price index in response to rising external inflationary pressures. The rate of price increases is expected to be 10.3% this year and to slow to 7.1% next year.

Despite high price rises, consumption could be the main driver of growth this year: household final consumption expenditure could increase by 8.5% in 2022, driven by government transfers (13th month pension, personal income tax refunds) and wage dynamics, including a 20% increase in the minimum wage and the guaranteed minimum wage. The growth rate of consumption could slow to 3.5% next year, in which, in addition to the base

¹ The forecast is valid as of 21 June 2022

effect, the slower-than-expected real wage growth of 2.8% for this year (5.6%) should be highlighted.

Investment volumes are expected to grow by 5.2% this year, meaning that despite economic uncertainty, business investment should remain high, while the postponement of some public developments will have little macroeconomic impact. We do not expect the momentum to change materially next year, to 5.4%, so the investment rate is likely to remain at a sustained high level.

We expect net exports to be a drag on economic growth this year and a slight support next year. Exports are expected to grow by 8.0% this year and 7.8% next year, while imports are expected to expand by 9.5% and 6.5% respectively. The higher import growth this year is driven by a pick-up in consumption. It is important to stress, however, that the Hungarian economy relies heavily on imports of energy commodities, so the price increase will have a significant negative impact on the trade balance.

The labour market situation remains stable, with data from recent months suggesting that employment is resilient to the war. We expect the number of employees to remain high this year and next, with unemployment rates of 3.7% and 3.6% respectively, meaning labour shortages are still more likely to be the problem. Employment levels are supported by high investment rates, while the placement of refugees remaining in the country should help to alleviate labour shortages somewhat.

In recent months, the Magyar Nemzeti Bank has responded to rising inflation by raising the base rate and the one-week deposit rate, in line with its mandate. In our view, the series of interest rate hikes is not over yet: the central bank should continue until inflationary developments turn more favourable and the price increase starts to slow down and approach the central bank's 3% target. We expect the base rate to rise to 8.0% by the end of this year, but the first interest rate cut could take place as early as next year, in the second half of the year. The one-week deposit rate, on the other hand, can remain above the base rate throughout and only converge to it during the rate cut cycle.

The fiscal position is positively affected by economic growth and wage dynamics, while transfers at the beginning of the year, the controversy over EU funds and the offsetting economic impact of the war are negative. At the same time, the extra profit taxes are necessary to achieve the government's goals of maintaining low household utility bills, increasing defence spending and meeting the deficit target at the same time. As a result of favourable economic growth and expenditure cuts, the ESA deficit-to-GDP ratio of the budget could turn out better than the government forecast, reaching 4.4% this year and falling to 3.5% next year. The declining budget deficit, together with economic growth, will lead to a further improvement in the government debt-to-GDP ratio, which could fall to 74.5% of GDP by the end of this year and 72.2% next year.

4. Századvég forecast

TABLE 1: Q2 2022 PROJECTION

	2021	2022				2022	2023				2023
	annual	Q1	Q2	Q3	Q4	annual	Q1	Q2	Q3	Q4	annual
Gross domestic product (volume index, %)	7,1	8,2	5,5	4,7	3,0	5,4	2,1	3,9	5,4	6,4	4,5
Household consumption expenditure (volume index, %)	4,6	14,1	8,9	6,0	5,1	8,5	2,2	2,0	4,9	4,8	3,5
Gross fixed capital formation (volume index, %)	5,9	13,2	3,0	1,5	2,9	5,2	5,1	6,8	4,9	4,7	5,4
Export volume index (based on national accounts, %)	10,3	5,2	8,7	10,1	7,9	8,0	6,5	7,4	7,9	9,2	7,8
Import volume index (based on national accounts, %)	8,7	8,3	9,5	9,6	10,7	9,5	6,7	6,6	6,3	6,4	6,5
Foreign trade balance (bn EUR)	1,9	-1,1	-0,4	-1,8	-4,3	-7,7	-0,6	0,3	-1,3	-4,0	-5,6
Consumer price index (%)	5,1	8,2	10,5	11,6	11,0	10,3	9,8	7,1	5,9	5,6	7,1
Central bank's base rate at the end of the period (%)	2,4	4,4	6,4	7,4	8,0	8,0	8,0	7,70	7,40	7,10	7,10
Unemployment rate (%)	4,1	3,7	3,7	3,7	3,7	3,7	3,7	3,6	3,6	3,5	3,6
Gross average earnings (year-on-year change, %)	8,7	20,7	16,5	15,4	13,5	16,5	4,2	9,8	12,0	14,2	10,1
Current account balance as a percentage of GDP	-3,1					-7,3					-5,5
External financing capacity as a percentage of GDP	-0,5					-4,5					-3,4
General government ESA-balance as a percentage of GDP	-6,8					-4,4					-3,5
Government debt (% of GDP)	76,6					74,5					72,2
GDP based external demand (volume index, %)	5,6	5,6	3,2	1,8	1,4	3,0	2,0	2,4	2,7	2,9	2,5

Source: MNB, HCSO, Századvég-Calculation

TABLE 2: CHANGES COMPARED TO OUR PREVIOUS FORECAST

	2022			2023		
	March 2022	June 2022	Difference	March 2022	June 2022	változás
Gross domestic product (volume index, %)	3,9	5,4	1,4	4,7	4,5	-0,3
Household consumption expenditure (volume index, %)	3,9	8,5	4,7	3,8	3,5	-0,3
Gross fixed capital formation (volume index, %)	6,0	5,2	-0,9	5,7	5,4	-0,3
Export volume index (based on national accounts, %)	4,6	8,0	3,4	5,9	7,8	1,9
Import volume index (based on national accounts, %)	5,1	9,5	4,4	4,7	6,5	1,8
Foreign trade balance (bn EUR)	-1,5	-7,7	-6,2	-0,3	-5,6	-5,3
Consumer price index (%)	9,3	10,3	1,0	6,4	7,1	0,7
Central bank's base rate at the end of the period (%)	6,80	8,00	1,2	5,00	7,10	2,1
Unemployment rate (%)	3,8	3,7	-0,1	3,7	3,6	-0,1
Gross average earnings (year-on-year change, %)	13,8	16,5	2,8	11,2	10,1	-1,1
Current account balance as a percentage of GDP	-4,8	-7,3	-2,5	-3,2	-5,5	-2,3
External financing capacity as a percentage of GDP	-2,5	-4,5	-2,0	-1,0	-3,4	-2,4
General government ESA-balance as a percentage of GDP	-4,2	-4,4	-0,2	-3,2	-3,5	-0,3
Government debt as a percentage of GDP	72,5	74,5	2,0	67,7	72,2	4,5
GDP based external demand (volume index, %)	3,3	3,0	-0,3	2,4	2,5	0,1

