MINISTRY
FOR NATIONAL ECONOMY

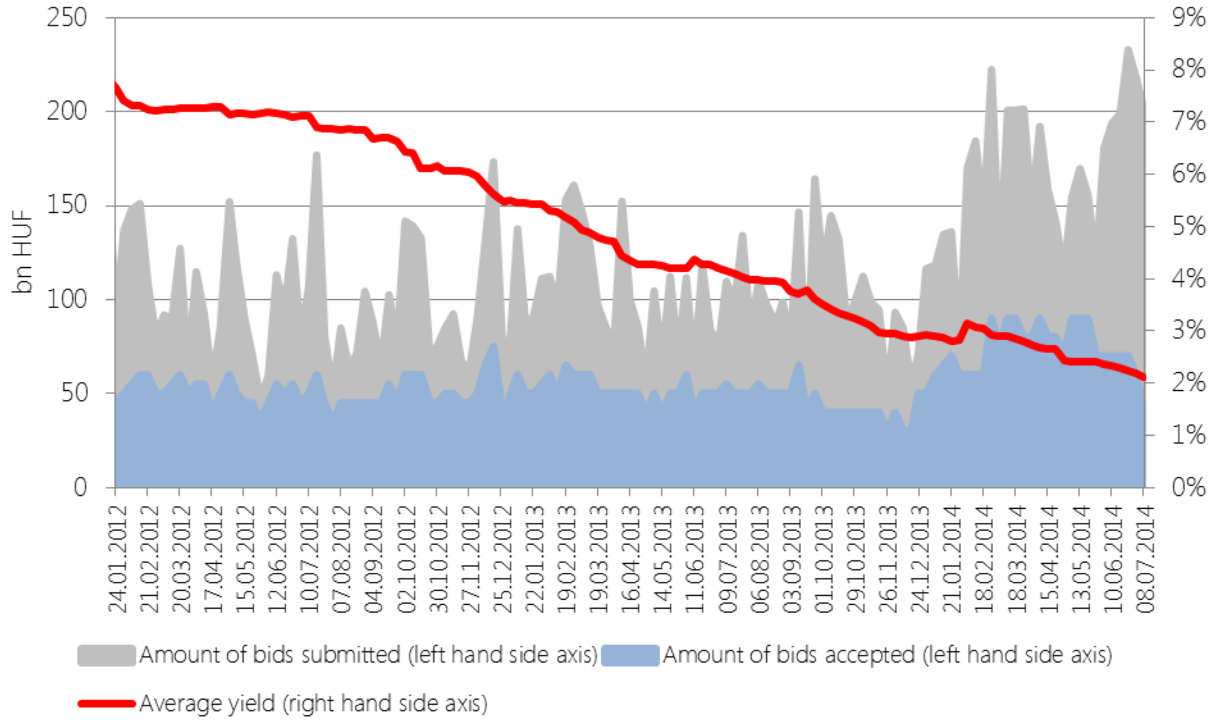
Hungarian sovereign bond yields down to a record low

Over the past two years, changes in several economic indicators have signalled that Hungarian economic prospects became brighter and the Government's economic policy, which is aiming to turn Hungary into one of the most competitive countries in the regional and a growth hub, is bearing fruits.

Tendencies observed on the Hungarian government bond market also show that Hungary's competitiveness has improved and these trends are bolstering debt financing: while the low central bank base rate is creating a favourable investment environment, average yields at auctions have reached a record low level. Auction yield curves have recently turned sharply lower; however, this downward trend is rather expected to be reversed soon, especially in case of yields on longer-dated securities.

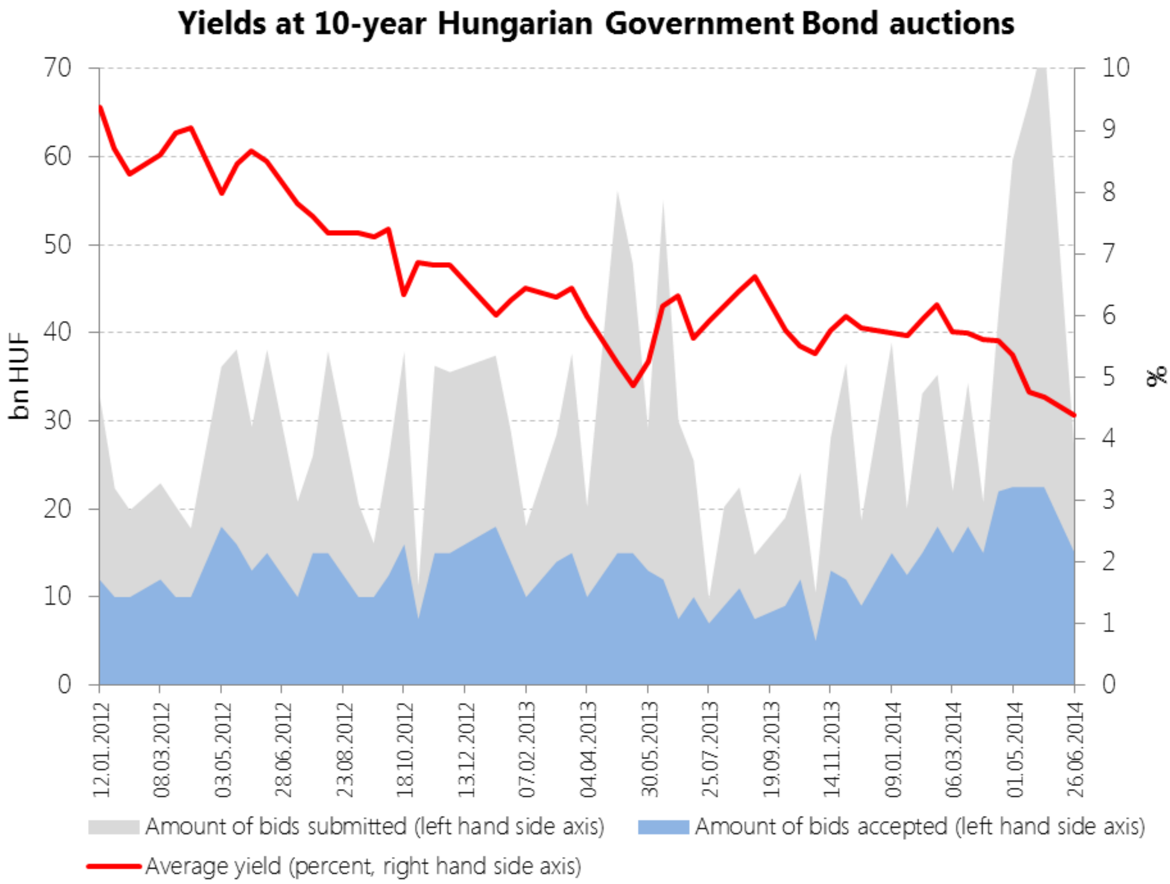
Over the past months, average yields at auctions hit historic lows. Despite low yields, however, there is still very heavy demand at auctions. At the auction of three-month Discount Treasury Bills (DTB) on 8 July 2014, primary dealers bid more than HUF 200bn for the offered amount of HUF 40bn and the average yield dropped to 2.11 percent. In the month of July 2014, the yield on the 3-month DTB was down by 4 percent compared to the average in the corresponding period of 2012. It is obvious that the Hungarian Debt Management Agency (ÁKK) has reduced the amount offered at the DTB auction in order to cap the increase of state debt, whereas – thanks to steady, strong demand – yields have plummeted further.

Yields at 3-month Discount Treasury Bill auctions



Source: AKK (Hungarian Debt Management Agency), NGM (Ministry for National Economy)

On the other hand, the yields of not only short-dated state bonds fell to record low levels. **While the average yield of 10-year Government Bonds was 9.38 percent at auctions in January 2012, the same indicator was 4.38 percent at the end of June this year.** According to the forward guidance of the National Bank of Hungary, the rate cutting cycle is nearing an end, and this fact – especially in light of the extreme low yields on longer-dated securities -- increases the risk that yields will rise again.



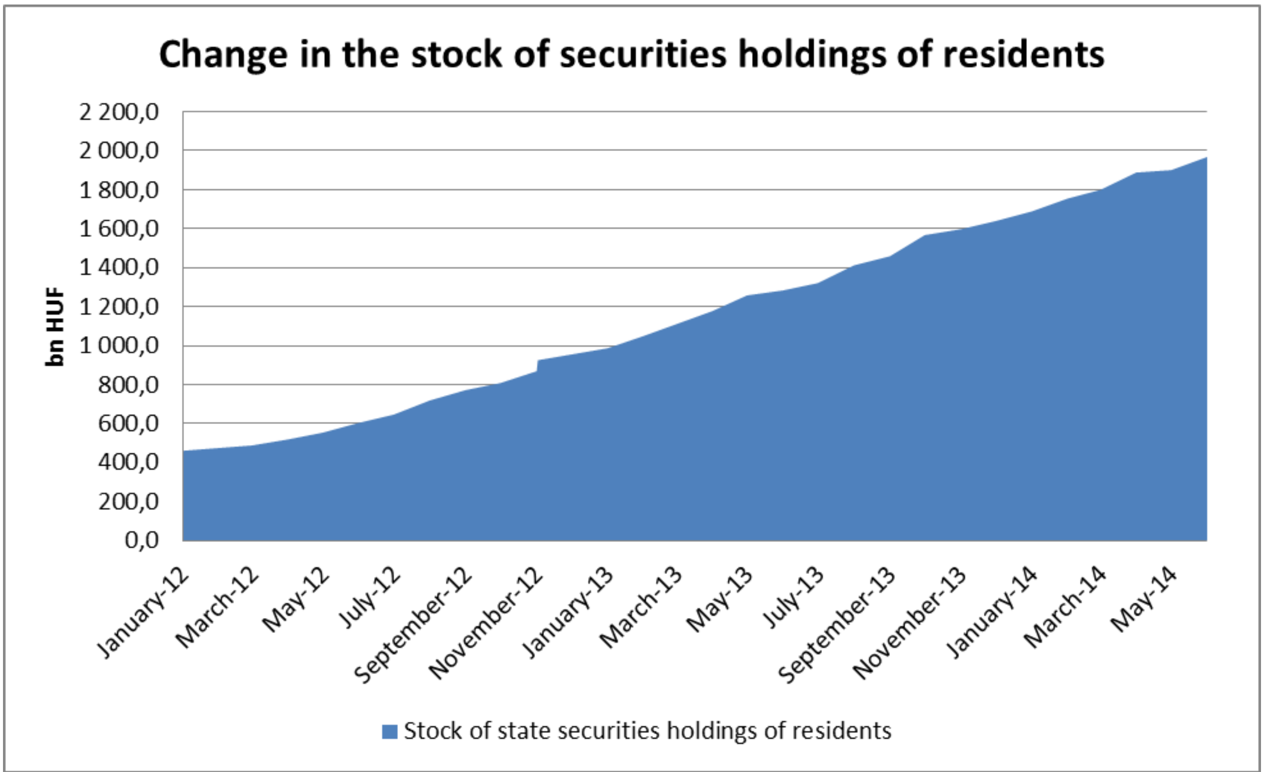
Source: AKK (Hungarian Debt Management Agency), NGM (Ministry for National Economy)

In the month of May, the Monetary Council announced that they will make a decision on whether to continue with the rate cutting cycle following a thorough assessment of macroeconomic outlook and risk perceptions and after taking into account the outlook and risk scenario overview of the inflation report in June. Parallel to the publication of the latest inflation report for June, the Monetary Council reduced the benchmark central bank base rate by another 10 basis points, to 2.3 percent, another historic low. The latest MNB guidance emphasised again that "the central bank base rate had significantly approached a level which ensured the medium-term achievement of price stability and a corresponding degree of support for the economy".

The securities holdings of residents

The fact that the amount of securities sold for residents doubled already in 2012 and this dynamic increase continued in 2013 and 2014 shows the success of the retail bond programme launched in 2012. **On the basis of the latest data, the stock of securities held by residents exceeded HUF 1967bn in May this year**, and thus the amount increased some 4.3 times since January

2012. Within the above amount, the stock of Interest Bearing Treasury Bills and 6-month Treasury Bills increased to HUF 1 181.6bn and HUF 26.8bn, respectively, the aggregate amount of 1-year and 2-year Government Bonds and Treasury Bill Plus totalled HUF 346.5bn, holdings of Premium and Bonus Hungarian Government Bonds reached HUF 407.8bn and the stock of so-called Baby Bonds jumped to HUF 5.2bn.



Source: ÁKK (Hungarian Debt Management Agency), NGM (Ministry for National Economy)

In the initial five months of the year, the total increase of state securities held by residents was HUF 279.4bn, of which HUF 193.4bn was invested in Interest Bearing Treasury Bills, HUF 5.5bn in 6-month DTBs, HUF 64.9bn in the inflation-linked Premium Hungarian Government Bonds and the floating-rate Bonus Hungarian Government Bonds introduced in March, and HUF 11.8bn in the one-year and two-year Treasury Bills and the Treasury Bill Plus. The stock of Baby Bonds totalled HUF 3.7bn in the initial four months of the year. **The growth in the state securities holdings of residents is a favourable development from the aspect of debt**

financing and, at the same time, it is indicating that trust in the state has been improving steadily.