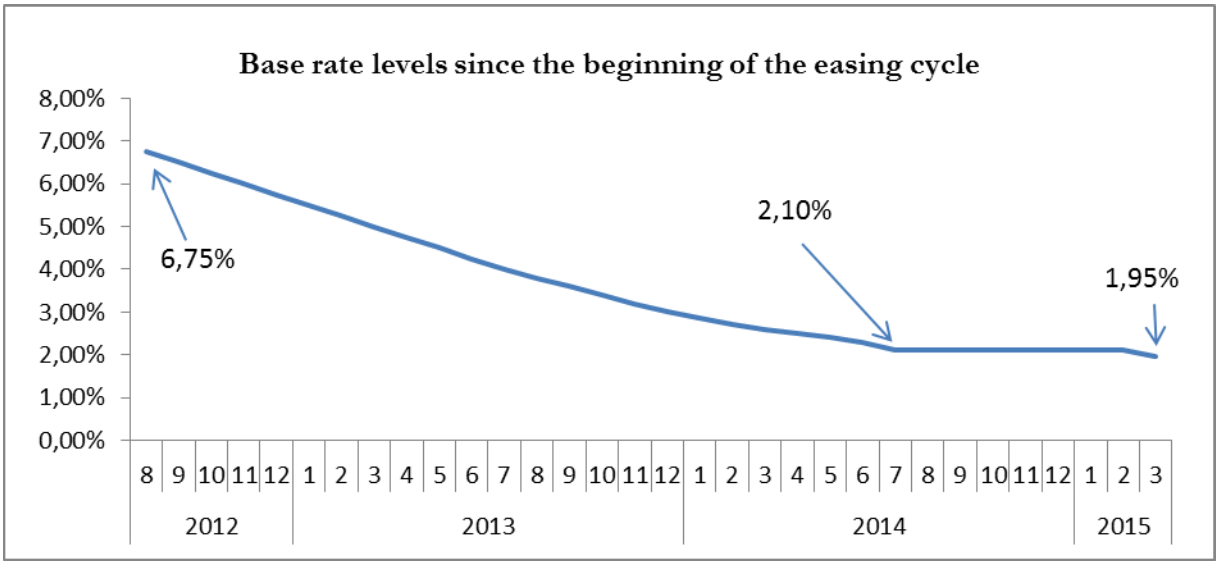
MINISTRY
FOR NATIONAL ECONOMY

Central bank base rate lower again after remaining unchanged for seven months

The 3.6 percent economic growth recorded in 2014 proves that Hungary's economic performance has been stable. This was one of the achievements that prompted Standard&Poor's to revise upward by one notch the country's credit rating. The predictable economic environment had also made it possible for the National Bank of Hungary (MNB) to further reduce the base rate, after which the forint exchange rate saw strong appreciation.

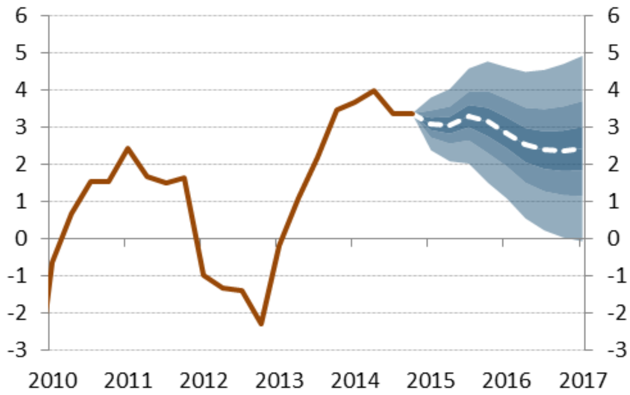
At the rate setting meeting of the MNB on 24 March 2015, the bank decided to cut by 15 basis points and thus the base rate fell to 1.95 percent. The base rate was lowered for the last time to 2.1 percent at the end of July 2014. Since the beginning of the easing cycle at the end of August 2012, the base rate had been lowered altogether by 4.65 percentage points to 2.1 percent, and after it had been left unchanged for seven months, it was reduced again to the current level. In the opinion of market operators there is even more manoeuvring room for future cuts.



Source: National Bank of Hungary (MNB)

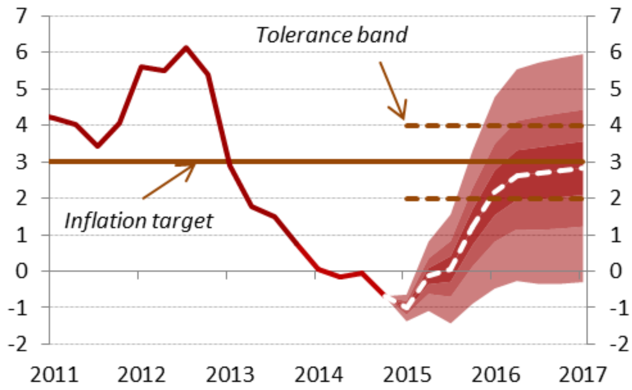
Data published by the MNB inflation report also signal that there is a real opportunity for further easing. One of the main reasons is that global raw material prices are expected to remain moderate and this will prevent the rate of inflation from reaching the inflation target. However, rebounding household consumption and rising wages are having an opposite effect on core inflation. It has been among the Government's plans to revise the wage and benefit system for the police, prison staff, tax and customs as well as disaster management employees and to launch a career model for public sector welfare employees with the aim of optimizing remuneration. Low inflation further fuels domestic consumption growth and thanks to rising wages in real terms household demand will continue to boost economic expansion. Low base rates are also driving household consumption. Parallel to wage increases, it is reasonable to expect that the level of employment will also rise as a result of improved corporate profitability. These factors will, in turn, facilitate further dynamic growth.

Fan chart of the GDP forecast (%)



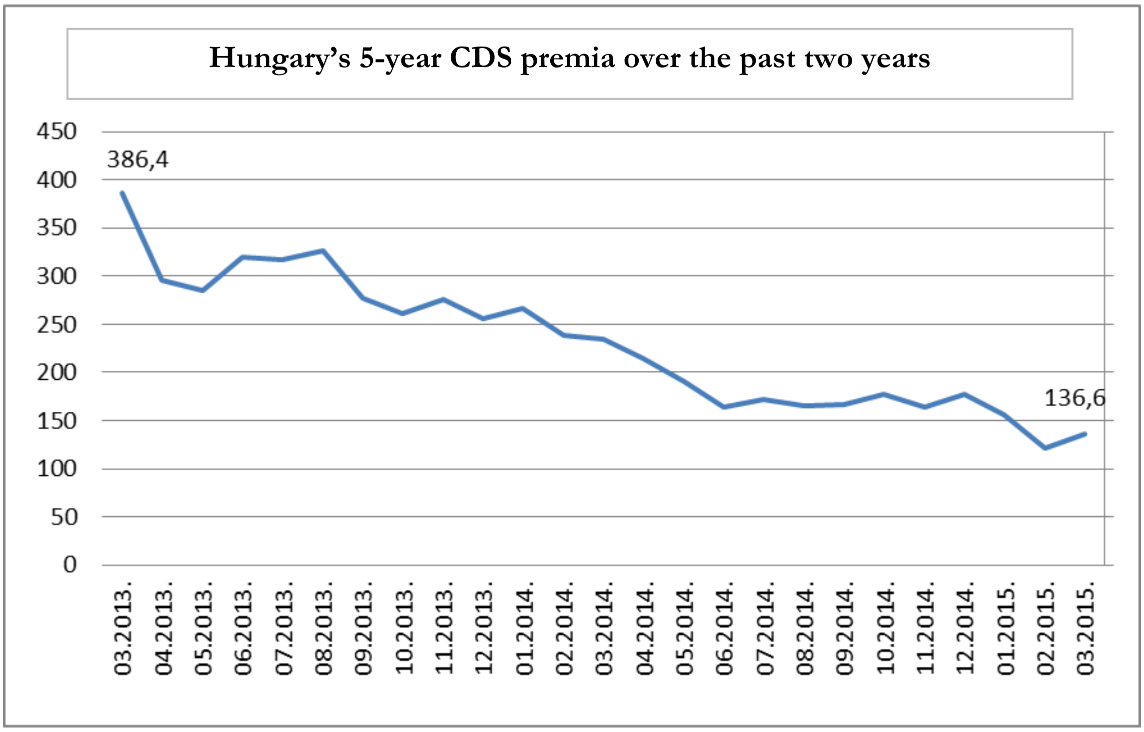
Source: MNB

Fan chart of the inflation forecast (%)



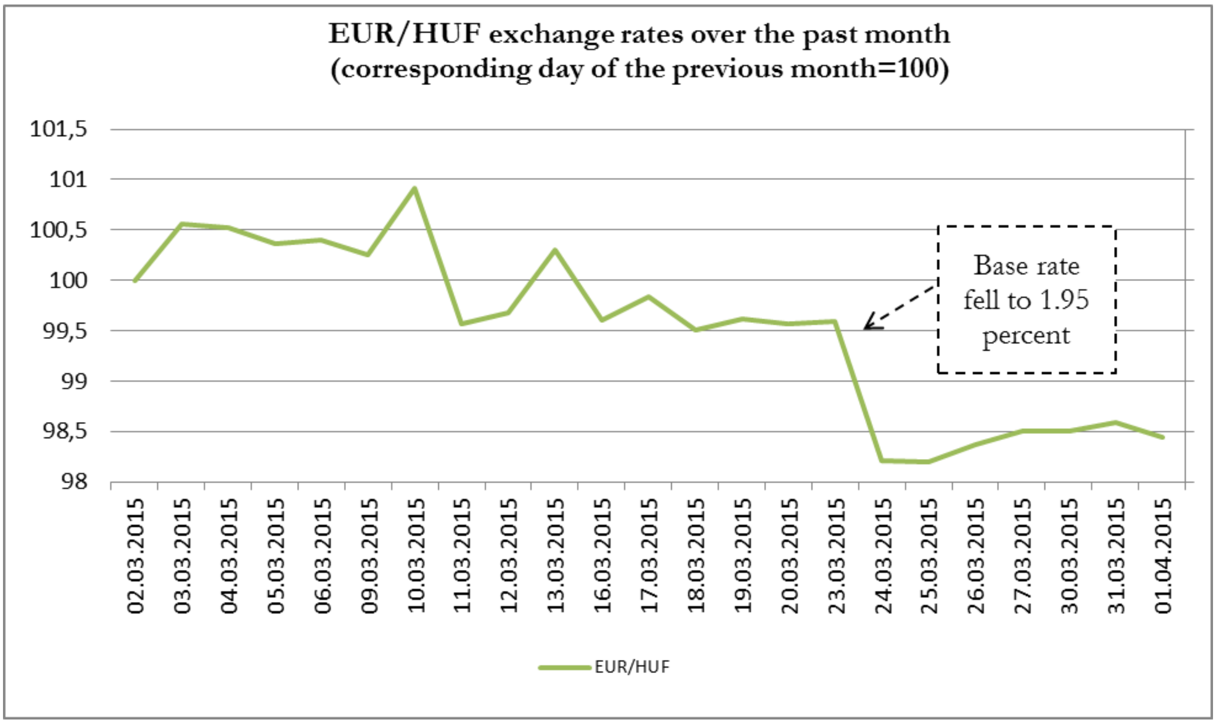
Source: MNB

The latest MNB prognosis is predicting 3.2 percent economic expansion this year, and 2.5 percent for 2016. The Government's measures aiming to safeguard households against external exchange rate risks are also underpinning growth: the extra income generated by the forint conversion of forex loans is also expected to be spent on consumption and even on investment. The improvement of risk indicators such as five-year CDS premia and the S&P upgrade have also put the country in a more favourable light: while Hungary's five-year CDS premium was close to 387 points at the end of March 2013, by now it has fallen to almost one-third of that level, to 136.6 points.



Source: Reuters

As a small country with an open economy, Hungary has been paying special attention to the international financial environment and the MNB has taken a cautionary stance concerning base rate decisions. However, in light of the market reaction to the latest, modest easing there is still room for further cuts or even for launching a new easing cycle. This has been confirmed by forint exchange rate moves, for example the appreciation that followed the latest cut, when EUR/HUF fell by 3 forints. The below chart shows the month-on-month moves of the forint exchange rate.



Source: Reuters

The forint exchange rate has also gained over the past quarter. Although the Hungarian national currency is mainly influenced by international factors, high net external financing capacity and the subsequent decline in the level of external debt is having a favourable impact on the forint exchange rate. The MNB predicts that lower EUR/USD levels will have a stimulating effect on the exports of EU countries, among them on those of Hungary. The depreciation of the euro is expected to boost the vehicle manufacturing industry, a major economic factor within Hungary, and the volume of vehicle industry exports. These developments provide growth opportunities for large foreign enterprises active in Hungary as well as related suppliers and Hungarian exporters.