What’s going on with retail government securities interest rates?

In September and October ÁKK cut the interest rates on retail government securities in two steps, by 25-25 basis points but demand for retail government securities remained adequate. The decisions taken by ÁKK followed changes in the central bank base rate. Interest rate decisions on retail government securities reflect market conditions, funding needs and retail demand in accordance with previous practice.

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Rate cuts everywhere

Somewhat ahead of global trends the National Bank of Hungary (NBH) started cutting the policy rate significantly a year and a half ago. The Monetary Council has reduced base rate to 6.5% from previous extremely high (18%) level in several steps starting in May 2023. The sharp fall in inflation facilitated this.

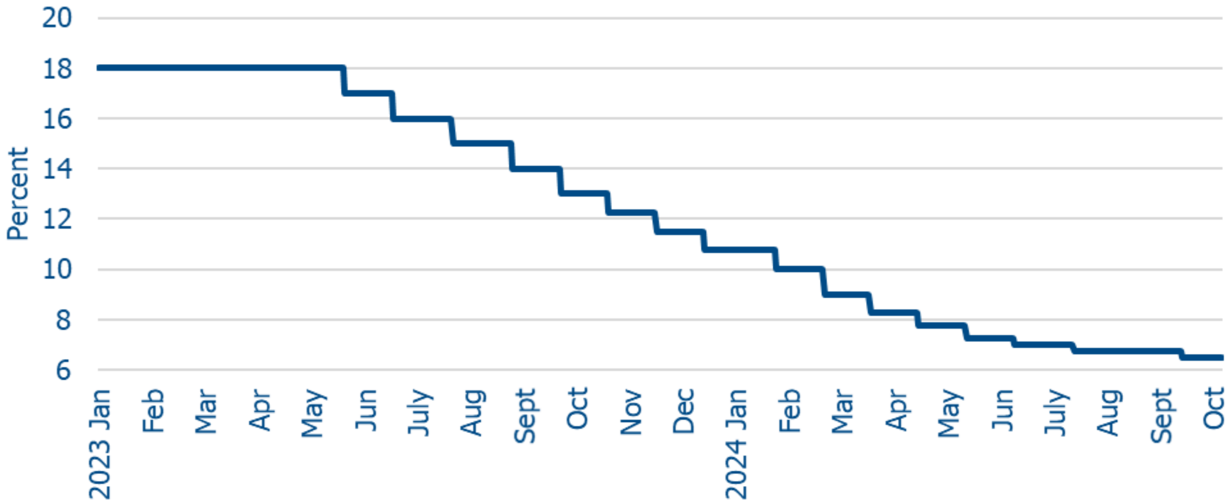

Figure 1: Central bank base rate of the NBH

Interest rate cuts affect the conditions of almost all investment products through monetary transmission, thus government bond market yields, especially T-Bills followed the base rate.

In line with market developments ÁKK has also recently reduced the interest rate on several retail government securities. First, the interest rate on FixMÁP was decreased by 25 basis points from mid-August, then the interest rates on MÁP Plus and physical government securities were also decreased by the same amount in early September. In early October, interest rates on these retail government securities were decreased another 25 basis points. As a result, retail government securities are currently available with the following conditions:

Retail Security	Maturity	Type of interest	Actual interest
Hungarian Government Security Plus (MÁP Plus)	5 years	Fixed, step-up	5.75-6.75% (Effective Yield 6,24%)
Fix Hungarian Government Security (FixMÁP)	3 years	Fixed	6.50% (Effective Yield: 6.67%)
Bonus Hungarian Government Security (BMÁP)	3 and 5 years	Variable,T-Bill-linked	7.35% and 6.91%
Premium Hungarian Government Security (PMÁP)	8 years	Variable, Inflation-linked	7.90%
Babybond	19 years	Variable, Inflation-linked	20.60%
Physical Hungarian Government Security Plus	5 years	Fixed, step-up	5.75-6.75% (Effective Yield 6.23%)
Treasury Saving Security (KTJ)	1 and 2 years	Fix	5.50 (Effective Yield: 5.50%) and 6.00% (Effective Yield: 5.83%)
Euro Hungarian Government Security (€MÁP)	3 years	Variable, EURIBOR-linked	3.488%

Table 1: Current conditions of retail government securities

ÁKK adjusts yields on retail government securities to the institutional yield curve; an added premium is paid to retail investors. The level of premium is based on planned net sales and funding needs. In case higher participation from retail investors is needed, the premium may increase (like in 2022 and 2023) and vice versa (like in 2024). Retail government security yields track the base rate indirectly through changes in institutional yields.

Inflation-linked products (PMÁP, Babybond) still offer real yields relative to the 3% year-on-year inflation rate in September. Inflation-linkers played a significant role in the temporary surge of government interest expenditures, therefore it might be worth looking at them more closely. Inflation-linked government securities are re-priced once a year in line with the average inflation rate of the previous calendar year. Consequently, **the significant increase of inflation combined with the elevated financing need in 2022 and 2023 automatically led to temporary sizeable interest payments of the state related to these retail products, peaking in 2024.** The yearly average inflation rate was 14.5% in 2022 and 17.6% in 2023, with the interest rate premium on top of this in case of PMÁP and Babybond series.

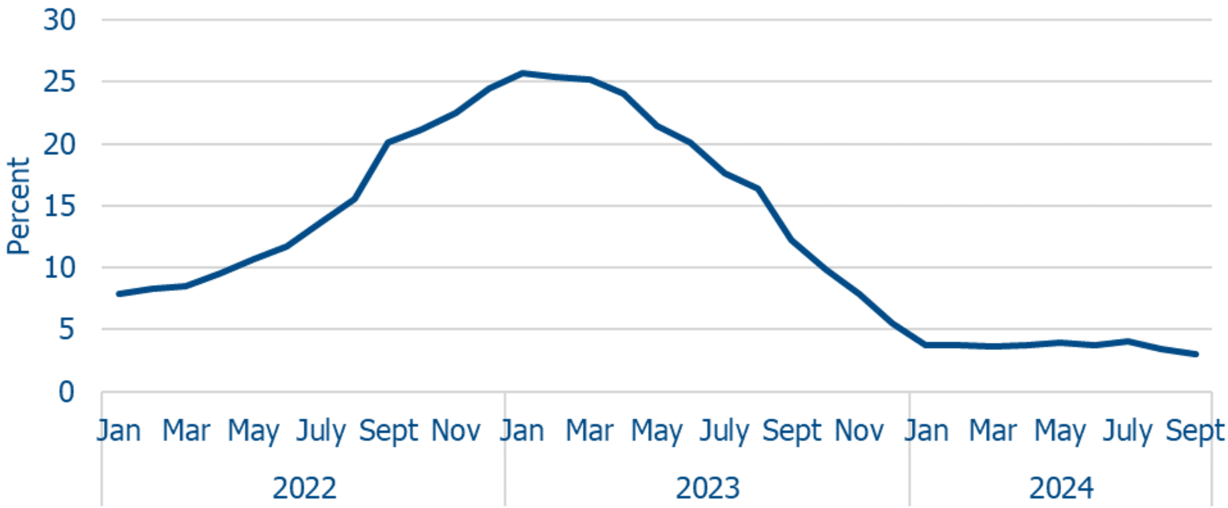

Figure 2: Hungarian inflation (year on year, Source: HSCO)

Inflation averaged 3.67% in the first nine months of 2024. Consequently, interest rates on these retail government securities will almost certainly be substantially lower next year, ending the era of

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double-digit retail interest rates. The 7.90% initial interest rate of PMÁP for the first coupon period was set for this transitionary period.

Government securities are still an attractive investment

ÁKK determines the conditions of retail government securities based on retail demand and funding needs, taking into account the developments in the money market and the benchmark indicator related to the 20-25% share of retail government securities set out in the retail government securities strategy.

Comparing interest rates on retail government securities and institutional bonds with matching maturities implies that **households receive a premium in exchange for financing the state**. The average interest rate premium for retail securities has been in the range of 0.5-1.0% in recent months.

The above institutional benchmark yields are not "set in stone", nevertheless, **ÁKK strives to offer real interest rates to households that are in line with the institutional market** similar to past years.

Main competitors of retail government securities are investments funds and when looking at their 2024 performance year-to-date, it is apparent that yields not only decreased in case of retail government securities. After double-digit annual returns in the last two years, it is hard to find money market and bond funds posting a return above 10% in 2024; their average return being around 5%.

Households has not turned their backs on government securities

Latest data suggests that recent interest rate cuts have not deterred retail investors from buying government securities. The amount of retail government securities sold weekly has not dropped significantly in spite of the 50 basis point cut in total, even though a few weeks has passed, and as a result, effects should be apparent by now.

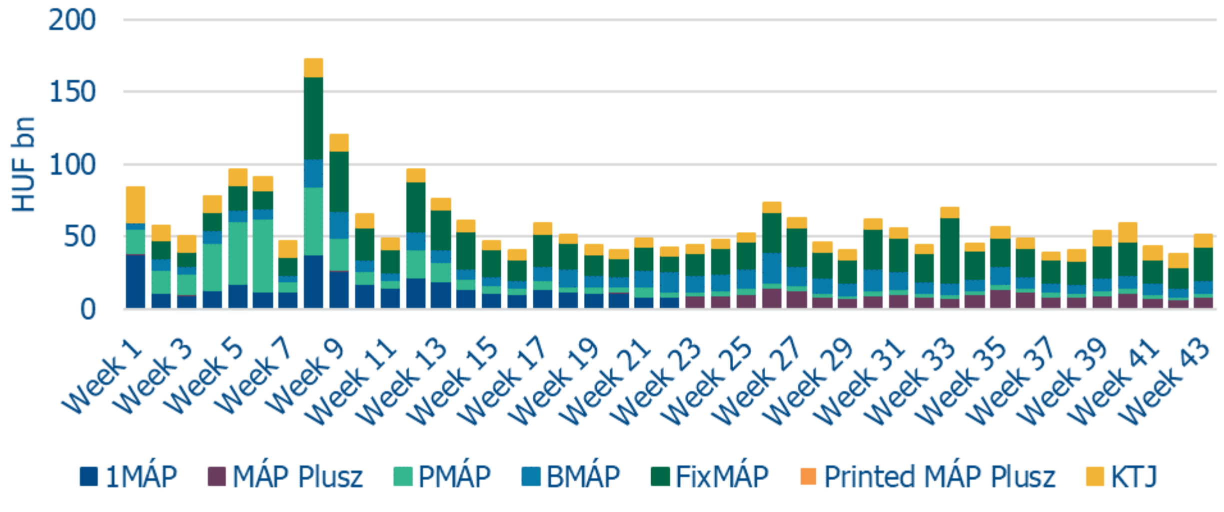

Figure 3: Weekly sales of retail securities

Demand from households dropped slightly in September and October and lower interest rates may have played a role in this but the decline is not significant. Moreover, alternatives to government securities offer significantly lower interest rates compared to the previous period of high inflation and interest rates.

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When looked at monthly sales, no significant decline can be observed in September and October. The net stock increase in September was minimal but it was mainly the consequence of a larger maturity, exceeding HUF 140 billion. In addition, households' savings activity is usually lower in September. Gross sales in October were similar to the previous month.

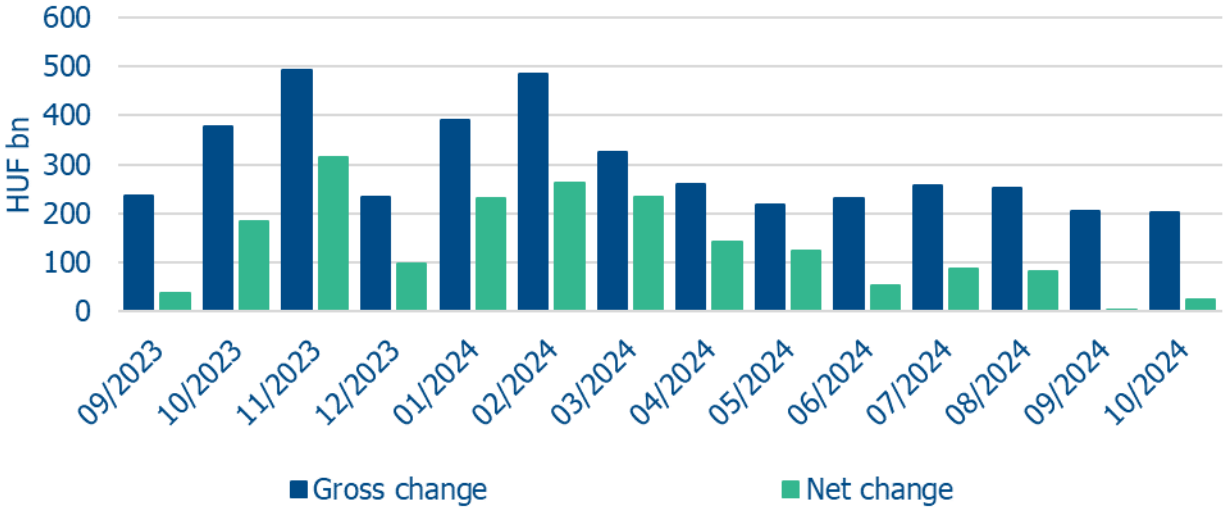

Figure 4: Monthly change in the stock of retail securities

At the same time one should not only focus on most recent transactions, as retail government securities have already been trading at lower interest rates since the peak of inflation. For example, the coupon of the Bonus Hungarian Government Security (BMÁP) is adjusted to the average yield of 3-month T-Bills every three months, while the Fix Hungarian Government Security (FixMÁP) offered an interest rate of 7% when introduced at the beginning of the year. Therefore retail investors could already have gotten used to the gradual decrease of previously double-digit interest rates. In spite of this, the share of government securities relative to savings has not declined significantly. Actually, the share of government securities relative to liquid savings of households is steadily over 20% for years now.

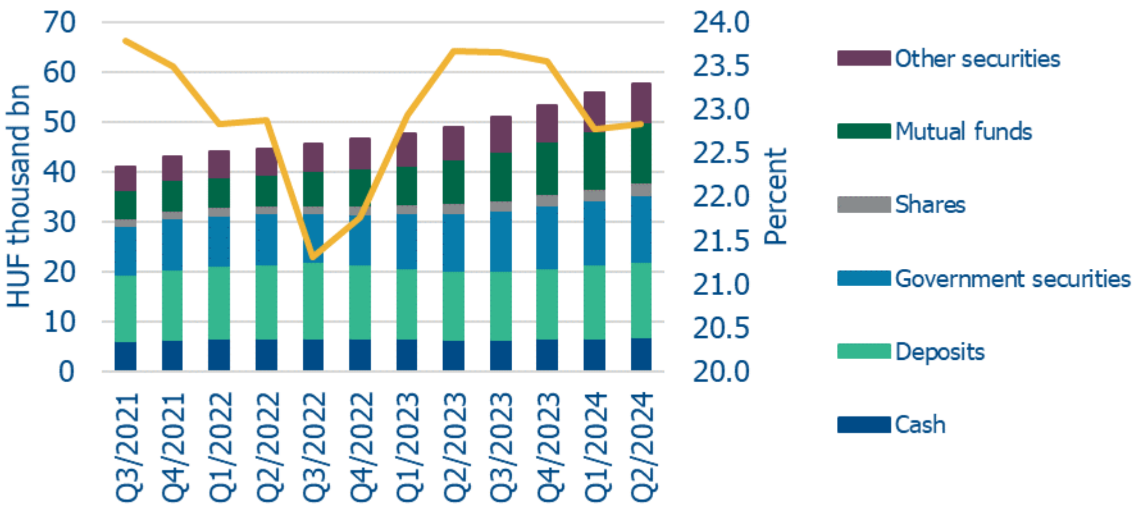

Figure 5: Liquid securities of Hungarian households and the share of government securities (Source: NBH)

Based on the statistics of NBH, the role of government securities within household savings remained strong during the first half of the year, accounting for almost a quarter of liquid securities. Recent transactions confirm (Figure 6) that Hungarian households accepted the lower interest rate

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environment. There was a dip in the first quarter but that was apparently the consequence of sizeable maturities. In the second quarter, more than 16% of new household savings was invested in government securities again.

The stable weight of government securities on the savings market is in line with the objectives of the ÁKK. According to its retail strategy, the focus shifted from further growth to retaining investors, increasing the number of clients and strengthening the portfolio approach. ÁKK does not intend to create a crowding-out effect within savings by further increasing the role of retail government securities. ÁKK's pricing decisions underline the effort ii maintaining the market share.

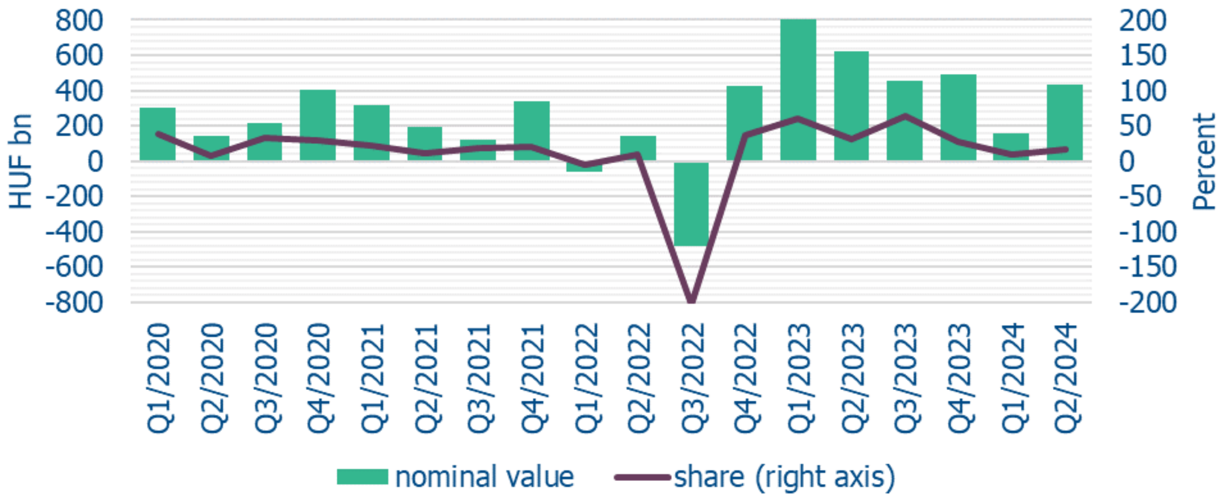

Figure 6: Nominal value of households' quarterly government securities transactions and their share in total transactions (Source: NBH)

More interest rate cuts in the pipeline?

Perhaps the most important current question for investors is what to expect in coming months. In the period ahead, central bank base rate cuts will not imply an automatic change in the conditions of retail government securities. ÁKK will decide on the next steps taking into account money market developments, specifically the evolution of institutional government bond yields.

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