# Analysis of the expected utilisation of households' impending significant interest income

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**In 2025, an unprecedented amount of interest will be paid to retail investors. The majority of the payments is related to the inflation-linked Premium Hungarian Government Security (PMÁP). In case of these securities, inflation compensation related to the year 2023 will be paid next year. The two most interesting topics in coming months to discuss are; what retail investors plan to do with the several hundred billions interest income from PMÁP due in 2025 and retail investors reaction to the repricing of these securities. ÁKK expects the majority of interest payments to be reinvested in government securities and that the stock of retail securities will not drop because these instruments are still competitive relative to other savings products.**

## Significant payments following the inflation in 2023

An unprecedented amount of interest payments will be paid to retail investors in 2025, with the largest part of it related to inflation-linked retail securities. These securities pay annually the yearly average inflation rate of the preceding year in addition to the interest premium. Next year, **interest payments related to the 17.6% inflation rate in 2023 are due**.

Following these interest payments, PMÁP series will pay interest based on 2024 inflation. This interest rate will almost certainly be significantly lower, since average inflation amounted to 3.6% for the first ten months of the year. NBH expects yearly average inflation for 2024 to bein the range of 3.5% - 3.9%.

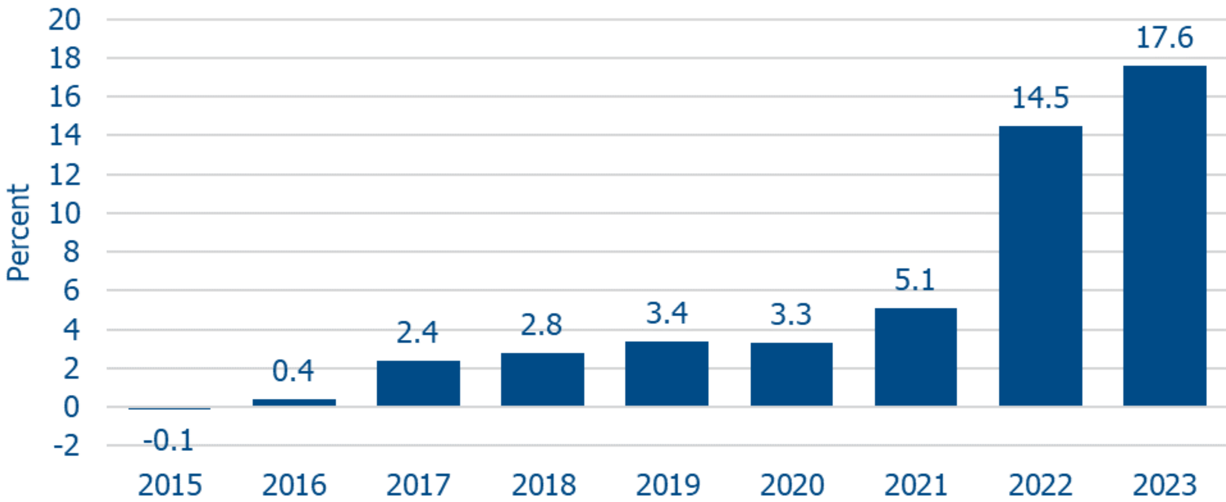


*Figure 1: Yearly average inflation rate (source: HCSO)*

PMÁP pays an interest premium in the range of 0.25% - 1.50% depending on the series. During the past years, the product became popular for paying a real rate on top of inflation. The total outstanding stock of PMÁP exceeds HUF 7,000 billion. Interest payments will start with series 2033/I on January 20, 2025.

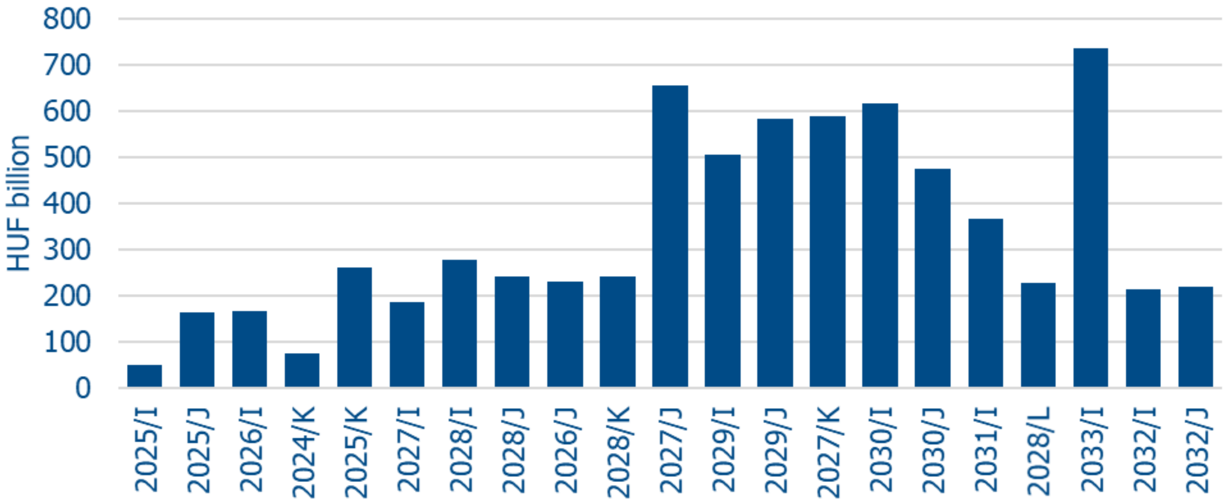


*Figure 2: Outstanding stock of PMÁP series on October 31, 2024 (Source: ÁKK)*

Interest payments related to PMÁP amount to HUF 1,279 billion in 2025. In addition, three series will mature with a total outstanding amount reaching HUF 475 billion. As a result a total amount of HUF 1,754 billion will be paid related to these securities. 73% of interest payments and maturities will be due in the first quarter and 96% in the first half of the year. Consequently, **households will receive a sum exceeding 2% of GDP in the course of a few months**.

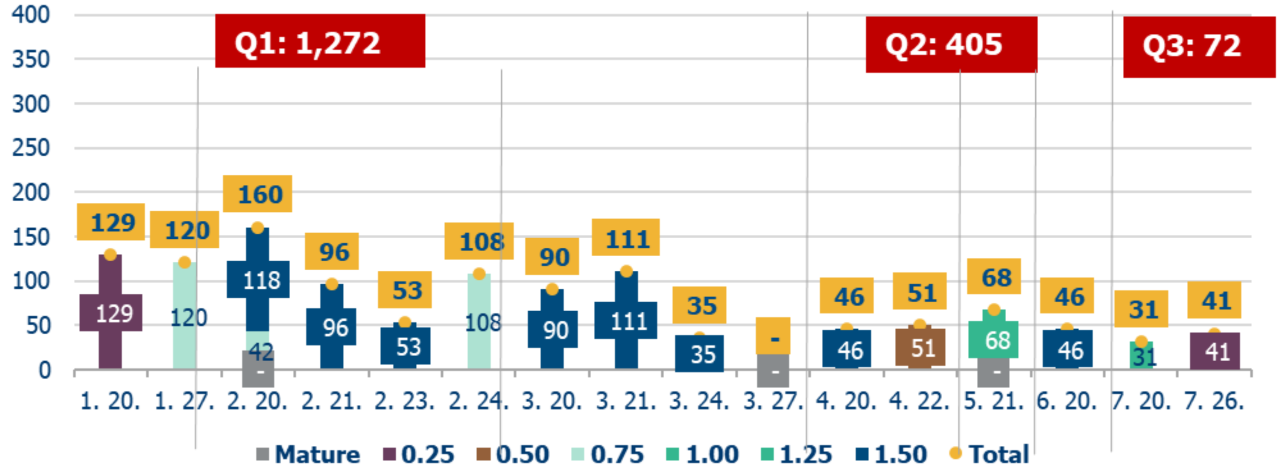


*Figure 3: Interest payments and maturities related to PMÁP (HUF billions) in 2025 sorted by date of interest payment / redemption date, and sorted by premium; based on outstanding amounts as of September 30, 2024*

## Investors utilisation of the sum received

Significant government securities redemptions raise two important questions in coming months. First, how will retail investors utilise the interest payments they receive. Second, how they will react to the repricing of these securities, i.e. will lower interest rates result in liquidation of the PMÁP series.



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Interest payments can be reinvested on the retail government securities market, can finance consumption or can even be reinvested in other types of investments. The majority will probably remain savings, and **according to the expectations of ÁKK, government securities**.

What happens after repricing is another separate question. Government securities can become less attractive due to lower interest rates. The question is, whether or not investors are able to find better alternatives to redirect their savings. In other words, if there is a low risk, liquid investment product in Hungary with yields exceeding the current 6% - 7% interest rates of retail government securities. Such investment products are hard to find. **Ex post yields of investment funds – broadly considered as primary competitors – decreased recently**. Yields of money market funds and bond funds exceeding 10% are scarce in 2024, with the average yields at around 5%. Thus, in spite of lower interest rates, retail government securities are still competitive compared to other investment products, because their yields decreased as well. A handful of funds of other types (shares, total return and composite) are still able to post double-digit yields, but the associated risk is higher. It is doubtful, that retail investors previously buying low risk government securities, will be willing to take significantly higher risks. Empirical evidence most certainly does not imply that.

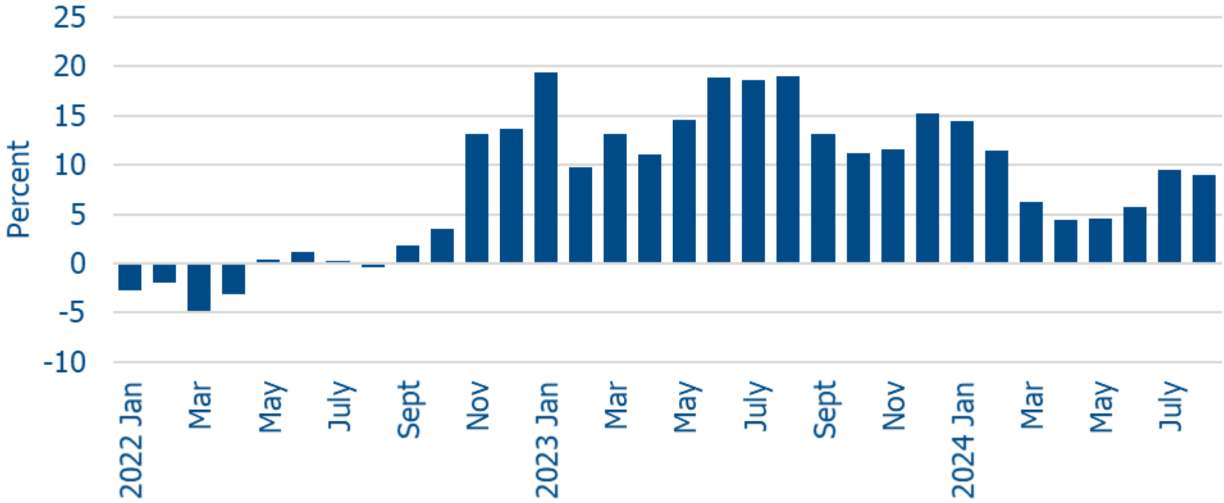


*Figure 4: Ex post 12-month yields of bond funds (annualised three-month data as of the end of month, Source: BAMOSZ)*

## Some examples, one an incorrect parallel

It is not the first time a significant restructuring is impending in a short time on the retail government securities market. Therefore an overview of past experiences and their applicability to current situation is worth looking into.

A slightly similar case, the introduction of MÁP Plusz led to an outflow of capital from PMÁP in 2019. The outstanding amount of PMÁP peaked at HUF 2,831 billion in August 2019 and the stock decreased to HUF 2,144.9 billion by the end of 2021. That means, the stock decreased by only 24.2% during a roughly two and a half year period of time when a new product offered more attractive conditions, consequently, some retail investors chose MÁP Plusz instead of PMÁP. **Three quarters of total stock remained in the inflation-linked security and the rest was invested typically in other government securities**. Subsequently, the stock of PMÁP almost doubled in one year as a result of accelerating inflation.



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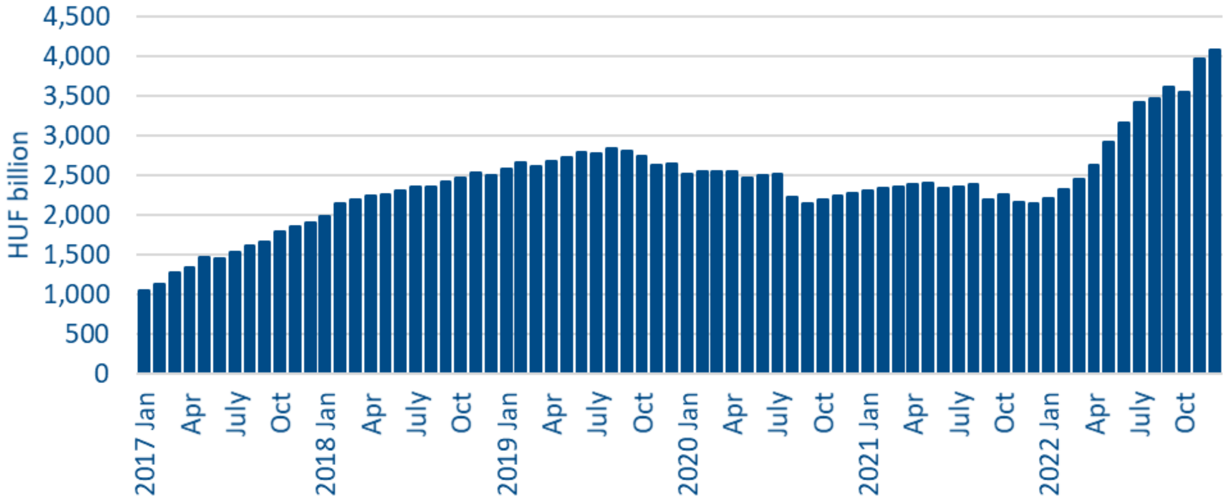


*Figure 5: Stock of PMÁP between 2017 and 2022*

The attrition of MÁP Plusz is seemingly an obvious analogy. The stock of the former hallmark product decreased from HUF 6,000 billion in January 2022 to around HUF 656 billion by now. However most of the capital outflow from this product was reinvested in other government securities, typically PMÁP. Moreover, **past experience related to MÁP Plusz may not apply to current situation**, because the two products differ significantly. The accelerating inflation made the yield of PMÁP more attractive relative to the previous hallmark product. Consequently, investors made a rational decision by restructuring their government securities portfolio. PMÁP is a long-term investment granting a positive real yield permanently. It is a good choice for investors seeking protection against inflation. MÁP Plusz on the other hand is a more liquid retail government security by design. Once each year, this security is redeemable without loss of capital. As a result, capital outflow is much more feasible.

The third example refers to investment funds, one of the most important competitors of retail government securities. Following the lower rate environment, yields of funds decreased significantly, as mentioned earlier. After double-digit yields over the past two years, yields exceeding 10% is hard to find currently. The average yield for 2024 of money market funds and bond funds (prime competitors of retail government securities) is around 5%. Net asset value of publicly available open-end money market funds barely dropped since the beginning of the year despite lower yields. Bond funds even experienced capital inflow, as net assets value increased from HUF 5,234 billion to HUF 5,992 billion until the end of September. Net issuance data does not imply mass capital flight in case of these funds even though they are not posting double-digit yields any more. Money market funds might have experienced a moderate outflow, but bond funds' net inflow amounted to HUF 443 billion during the first nine months of the year according to data compiled by Association of Hungarian Investment Funds and Asset Manager Companies (BAMOSZ).

Ever since the inflation peaked, ÁKK introduced a sales cap in case of all retail government securities. Large-scale PMÁP investors should also take this into consideration. In case they liquidate their government securities, they may not be able to re-invest their savings in the same amount, assuming they seek a hedge against inflation. If they intend to realise a positive real rate on the long-term, it is not necessarily feasible to sell their PMÁP holdings now.

As seen above empirical evidence does not support **an intense capital outflow of retail government securities following the interest payments and repricing of PMÁP**. Even if a retail investor is unhappy with the lower yield PMÁP offers, it is likely to be reinvested primarily in other government securities, because these are still highly competitive relative to other investment products. Currently, there is no liquid, low risk investment offering significantly higher yield than retail government securities.



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