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Analyst background discussion
26 September 2023

BACKGROUND DISCUSSION AFTER THE MONETARY COUNCIL’S 26 SEPTEMBER 2023 DECISION

MAIN MESSAGES: MONETARY POLICY DECISIONS

- **With a decrease of 100 basis points in the effective interest rate, the Monetary Council concluded the normalisation of the extraordinary interest rate environment.**
- **Following decision today, the base rate at 13 percent will become the effective central bank interest rate. The reserve account will be available to banks without an upper limit remunerated at the base rate.**
- **In addition, according to the Council's decision, the interest rate corridor became symmetric, with a band of +/- 100 basis points around the base rate.** The utilisation of the instruments defining the corridor is low, therefore this is a technical decision.
- **Domestic inflation is without a doubt on a decline; however, it still remains unacceptably high. To achieve price stability in a sustainable manner, monetary conditions need to remain tight.**
- **We are not on autopilot! The Council is taking a step-by-step, cautious approach, assessing incoming macroeconomic data, the outlook for inflation and the developments in the risk environment, and it will take decisions based on these factors.**
- **Clear communication is key!** The MNB regularly publishes flash analyses on the evolution of main macroeconomic indicators.

MAIN MESSAGES: MONETARY POLICY DECISIONS

- In line with the Monetary Council's decision today, the central bank's set of monetary policy instruments will be **changed and simplified.**
    - **The reserve account** will be **available to banks without an upper limit** and therefore it **becomes the main monetary policy instrument from 1 October.**
    - The interest-bearing part of the reserve account **will be remunerated at the base rate.**
    - The MNB discontinues the O/N deposit quick tender at the end of September.
    - The Bank will announce **the long-term deposit facility and the central bank discount bill** at the base rate in the coming period.
    - The **one-day FX-swap quick tenders** remain an important element of strengthening the monetary transmission; therefore, the central bank will continue to use the instrument. The **lower bound of the interest rate corridor serves as a guidance** regarding the interest paid on FX-swap quick tenders.

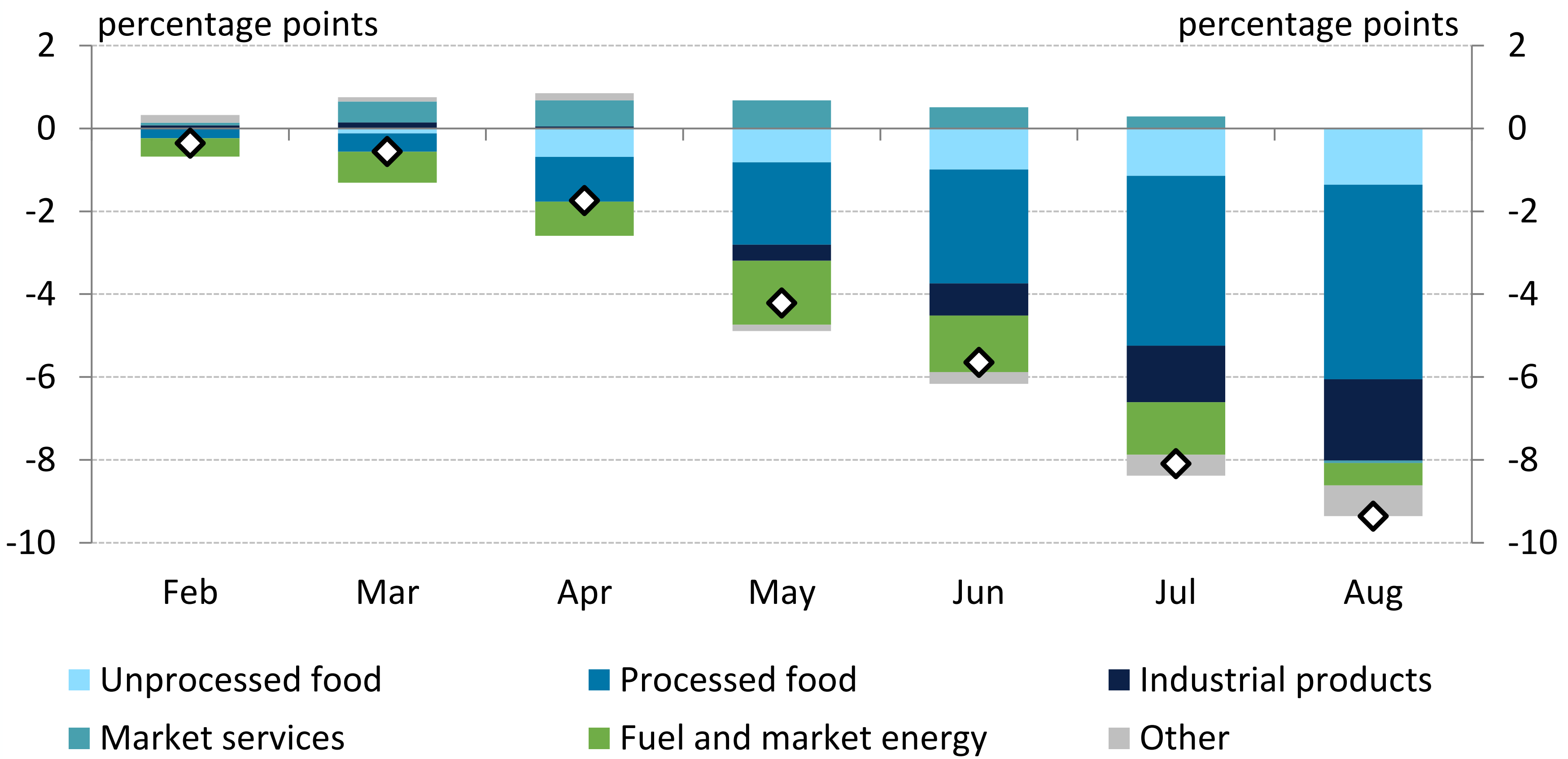
MAIN MESSAGES: MACROECONOMIC ASSESSMENT AND OUTLOOK

- **Disinflation is widespread and general. Inflation is expected to be in the range of 7-8 percent** at the end of the year, which is still high, so disinflation must continue in 2024.
- The inflation path expected for next year has shifted upwards slightly due to the carry-over effect of higher fuel prices. **Annual inflation may fluctuate between 17.6–18.1 percent in 2023, 4.0–6.0 percent in 2024 and 2.5–3.5 percent in 2025.**
- **With the acceleration of disinflation, the domestic real interest rate will move to positive territory in September, then it will continue to rise gradually.**
- Based on high-frequency data, **a gradual increase in domestic economic performance has begun in the third quarter.**
- **Hungary's economic performance is expected to be in the range of (-0.5)–0.5 percent. In 2024 and 2025, Hungary's GDP is expected to expand by 3.0–4.0 percent.**
- **The current account deficit** is expected to fall **below 1 percent of GDP in 2023 following a significant improvement outstanding even by European standards**, with the balance expected to improve further over the forecast horizon.
- In the Monetary Council's assessment, **inflation risks are on the upside, while the outlook for growth is characterised by downside risks.**

MACROECONOMIC ASSESSMENT AND OUTLOOK

STRONG DISINFLATION IS TAKING PLACE…

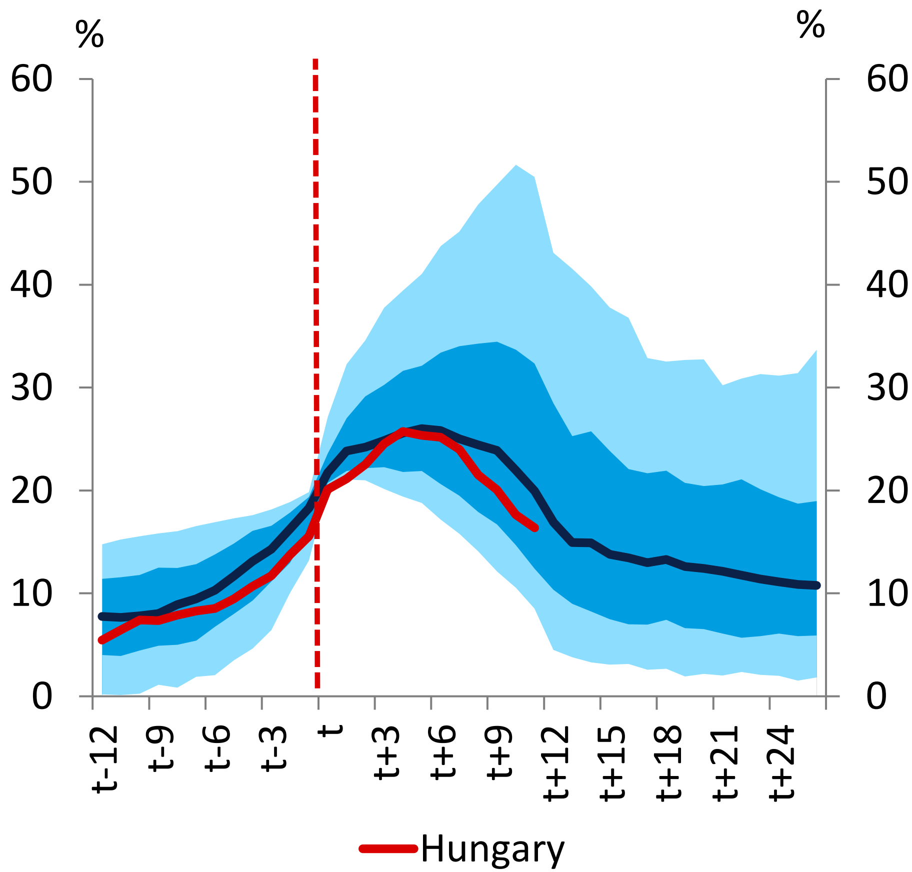
… as a result of the Government's measures to strengthen market competition and the stabilising effect of monetary policy in financial markets.

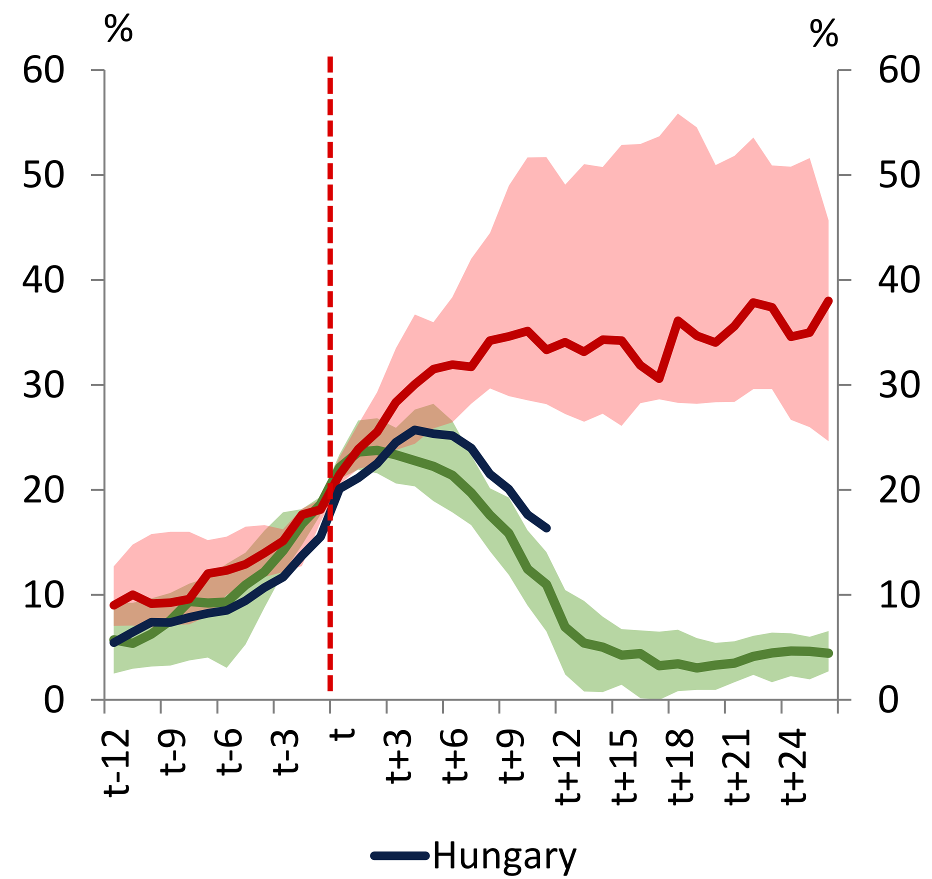


DECOMPOSITION OF THE CHANGE IN INFLATION COMPARED TO THE PEAK VALUE IN JANUARY 2023

Source | HCSO, MNB

THE DISINFLATION SHOWS SIMILARITIES WITH COUNTRIES PREVIOUSLY DISINFLATING SUCCESSFULLY



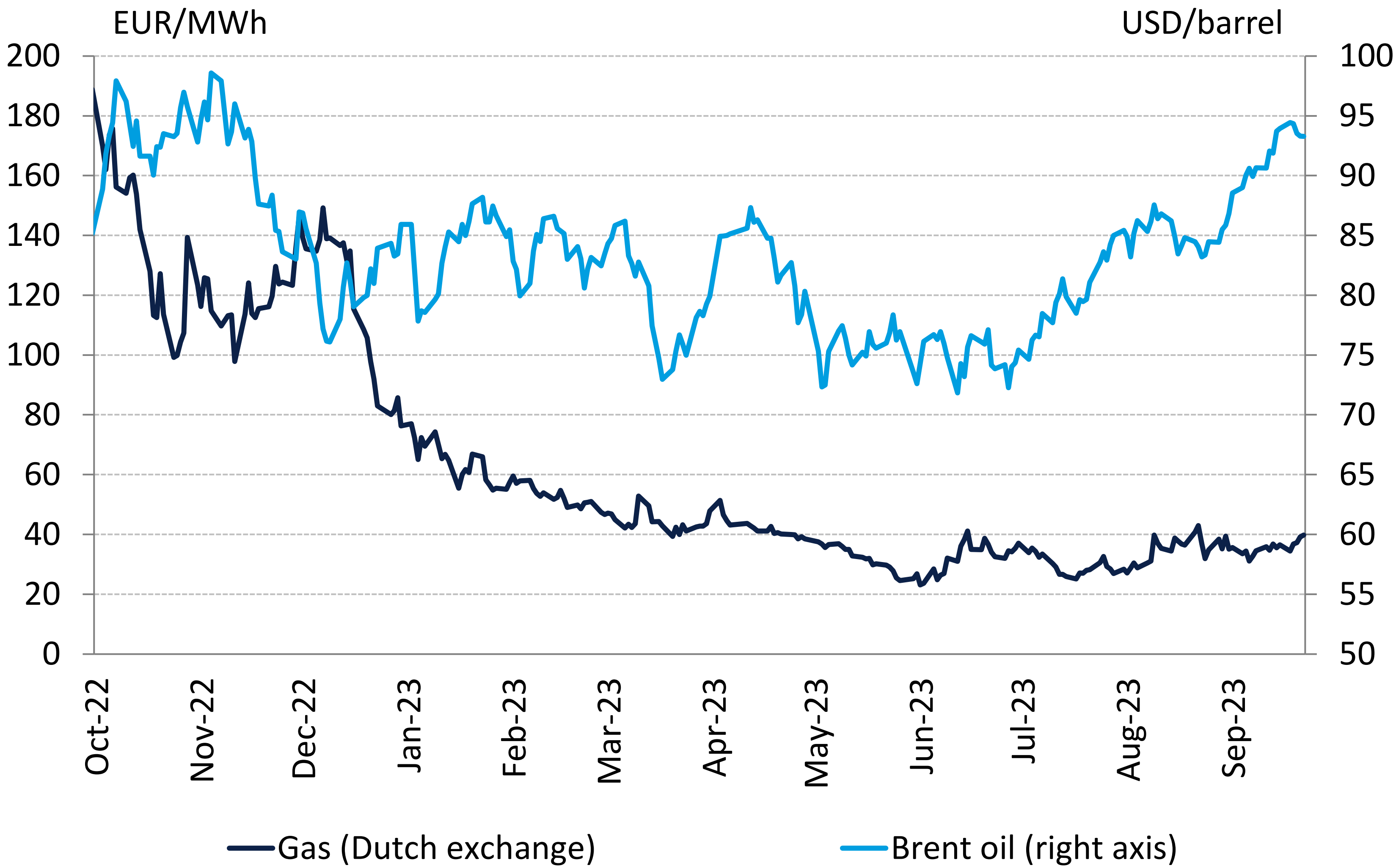


DISTRIBUTION OF MONTHLY INFLATION EPISODES ABOVE 20 PERCENT: ALL EPISODES (LEFT PANEL), SUCCESSFUL AND UNSUCCESSFUL DISINFLATIONS (RIGHT PANEL)

Note | he 10th, 25th, 50th, 75th and 90th percentiles are shown in the figure on the left. The 25th, 50th, and 75th percentiles are in the figure on the right. The solid line is the 50th percentile (median). Green: successful, red: unsuccessful cases. Time t denotes the month during which inflation rose above 20 percent, in the case of Hungary, September 2022.

Source | HCSO, World Bank, MNB calculations

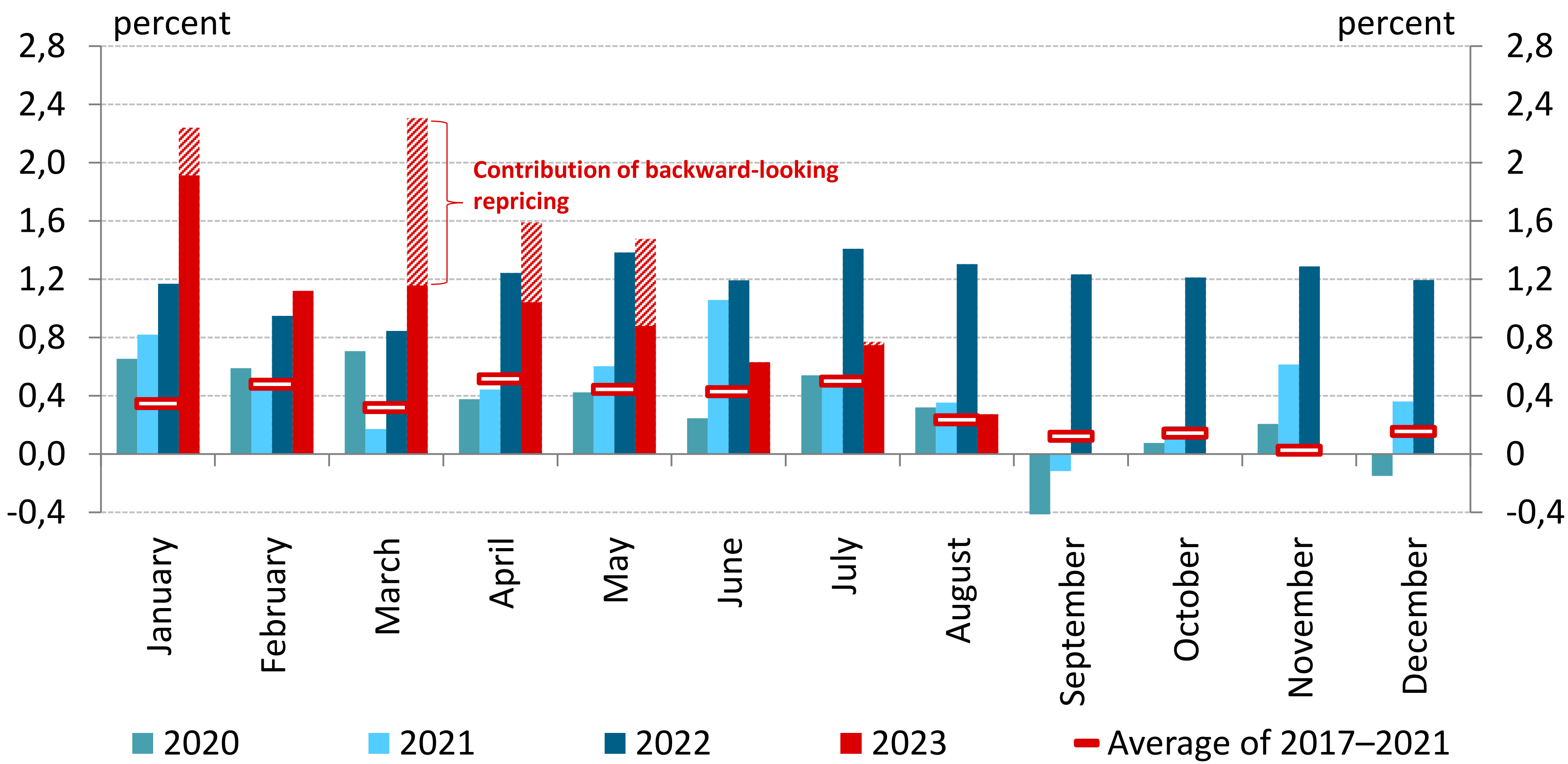
THE RECENT RISE IN OIL PRICES IS CAUSING UPWARD INFLATIONARY EFFECTS



CHANGES IN OIL AND GAS PRICES

Source | Bloomberg

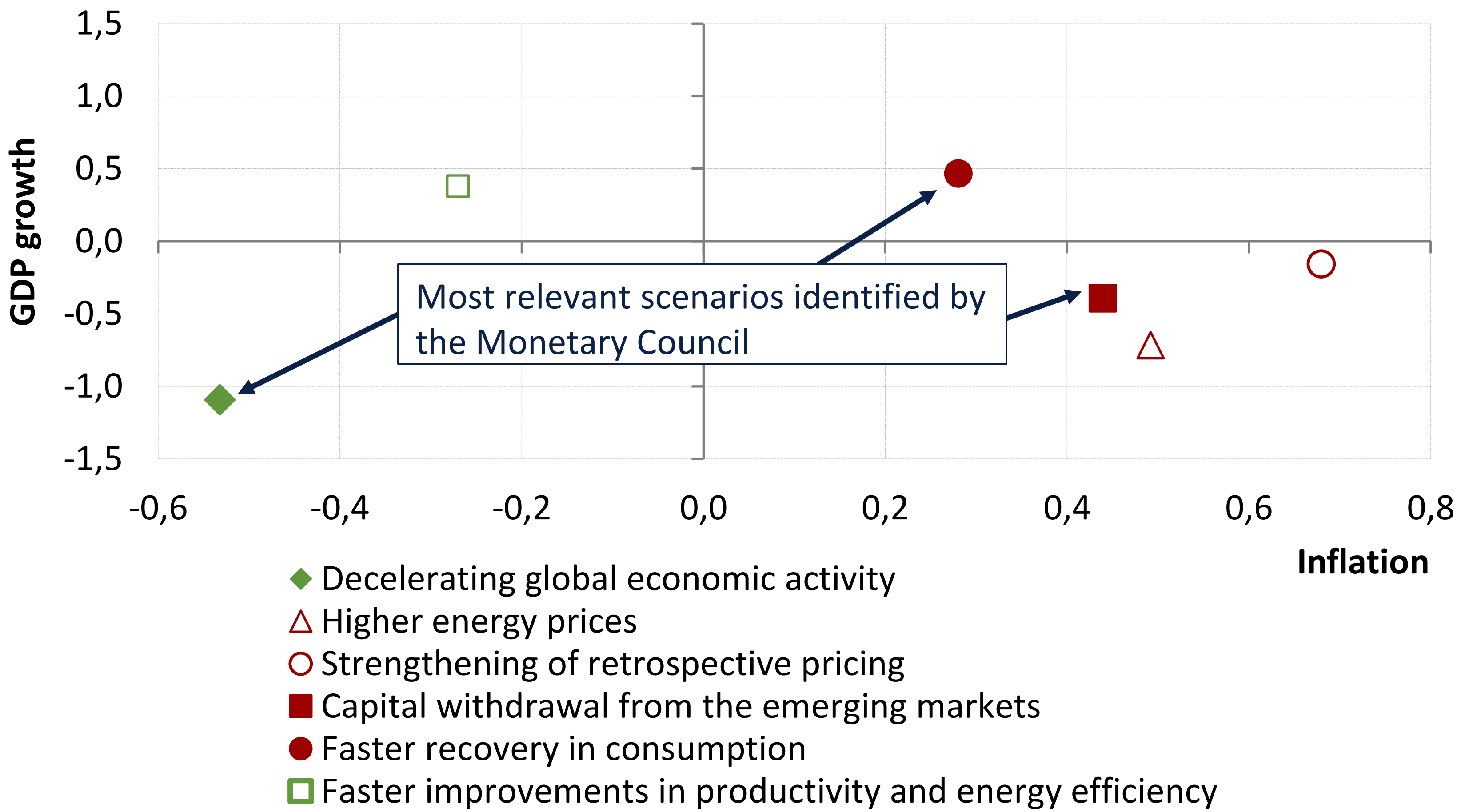
BACKWARD-LOOKING REPRICING IS ONE OF THE SOURCES OF THE PROFIT-DRIVEN INFLATION



MONTHLY REPRICING OF MARKET SERVICES

Note | Tax-adjusted, seasonally unadjusted monthly change.
Source | HCSO, MNB

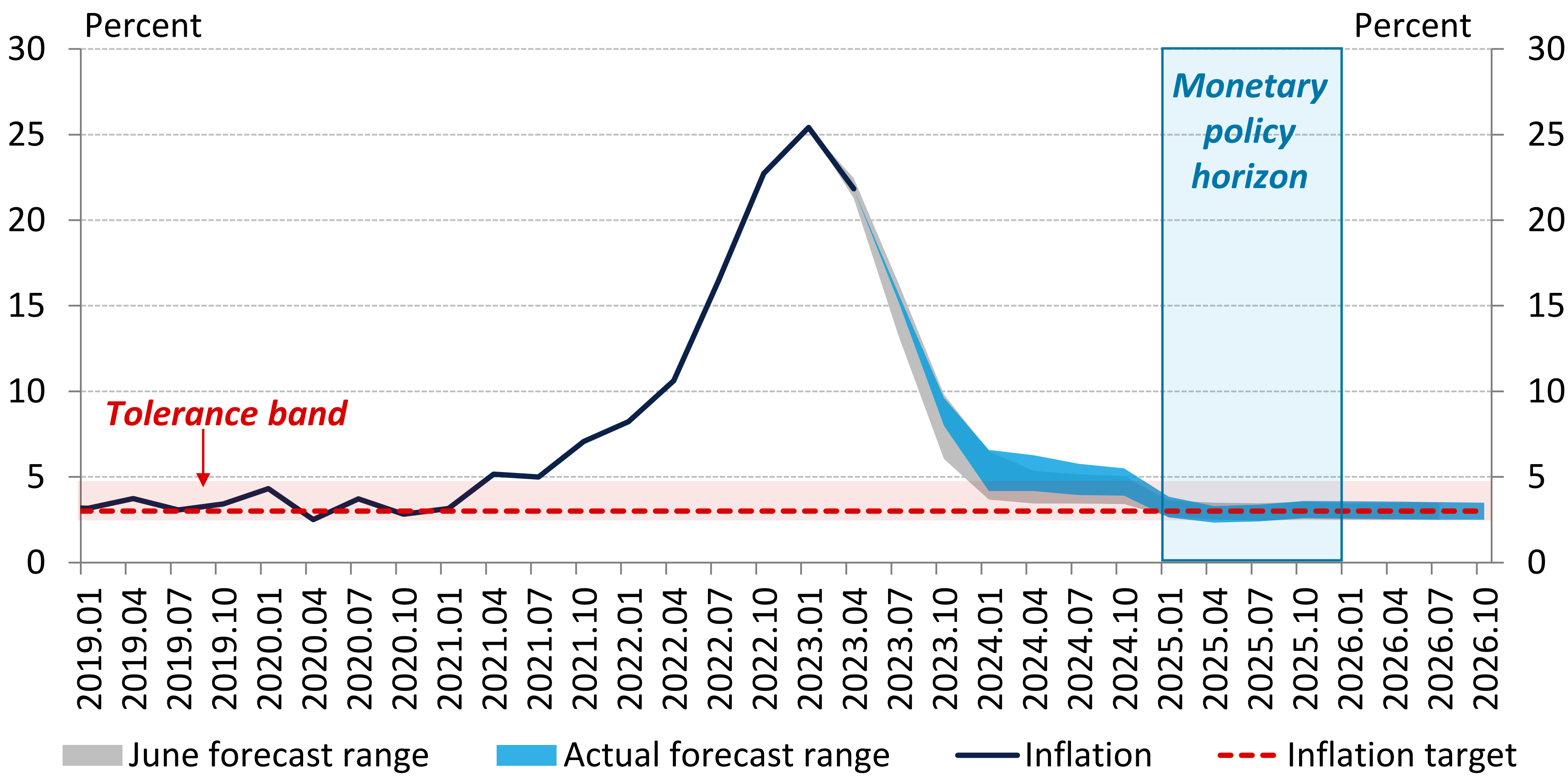
RISKS TO THE BASELINE INFLATION PATH HAVE SHIFTED UPWARDS



RISK SCENARIOS (SEPTEMBER 2023)

Note | The risk map presents the average difference between the inflation and growth path of the alternative scenarios and the baseline forecast over the monetary policy horizon. The red markers represent tighter and the green markers represent looser monetary policy than in the baseline forecast.
Source | MNB

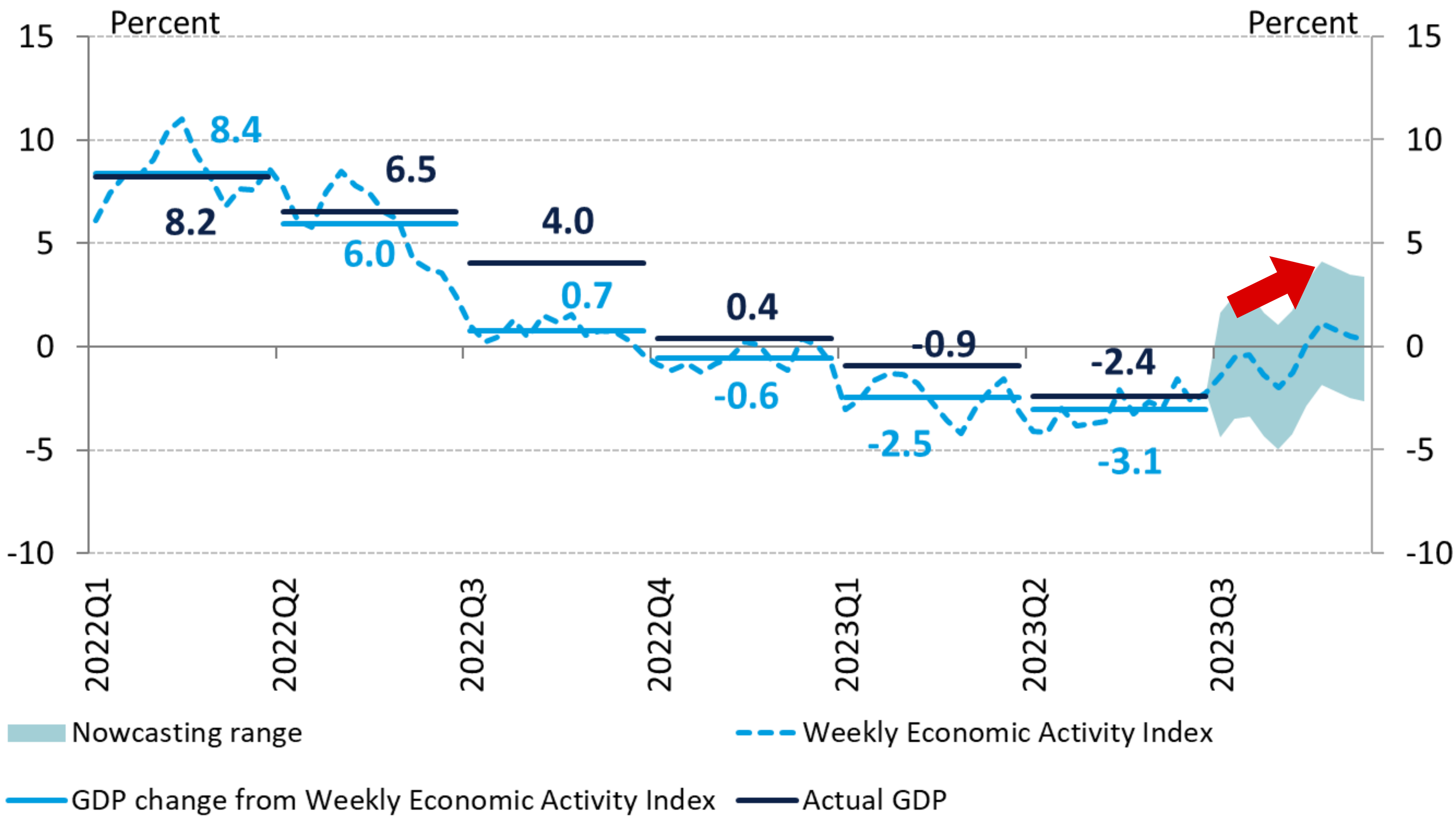
INFLATION WILL BE 17.9% IN 2023 AND 4.0-6.0% IN 2024, WITH THE TOLERANCE BAND EXPECTED TO BE REACHED IN 2025



INFLATION FORECAST

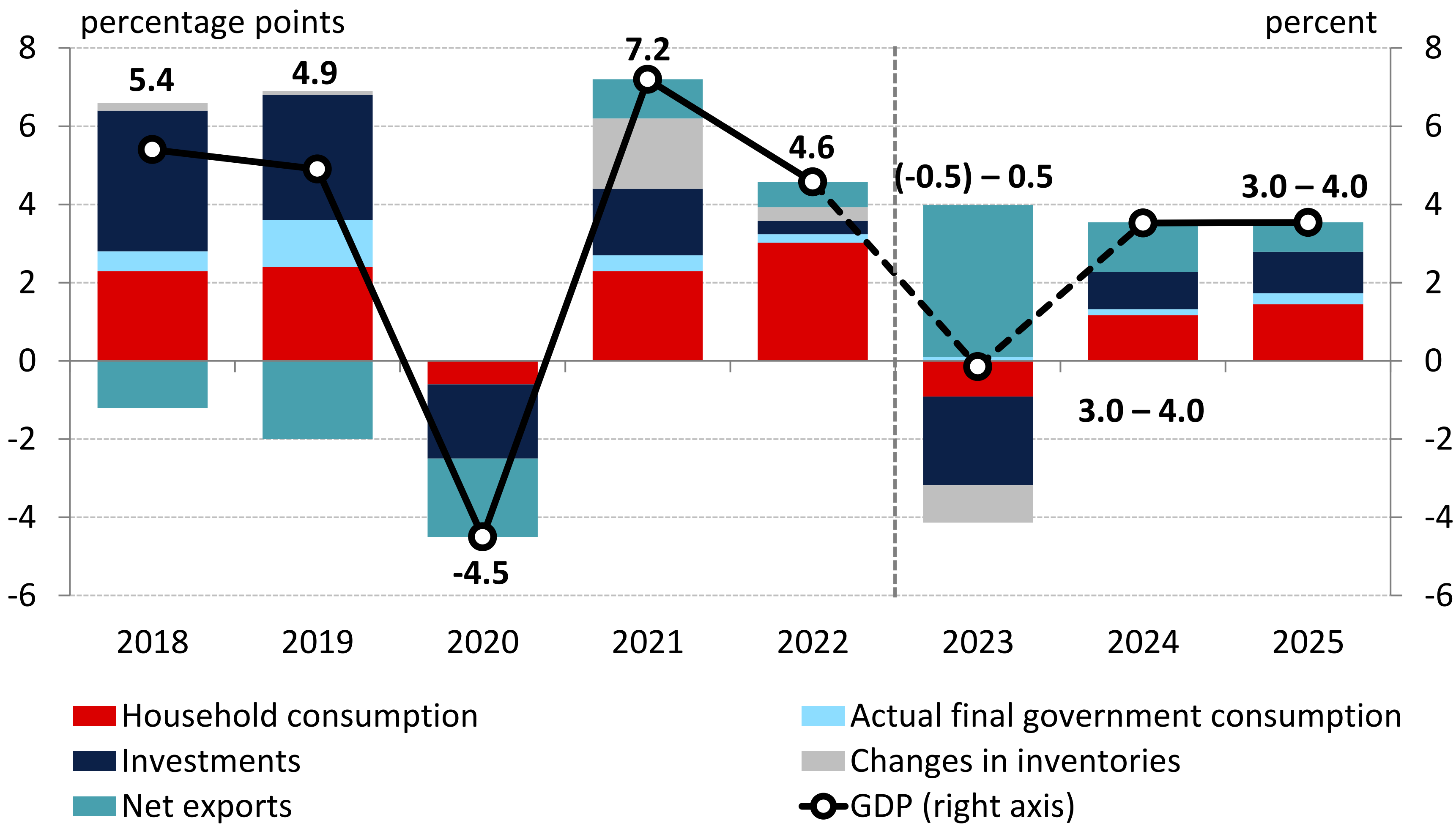
Source | HCSO, MNB

WITH A NOTICEABLE DECREASE IN INFLATION, GROWTH GRADUALLY PICKED UP IN THE THIRD QUARTER



WEEKLY GDP-TRACKER
Source | HCSO, MNB

BALANCED ECONOMIC GROWTH IS EXPECTED FROM NEXT YEAR

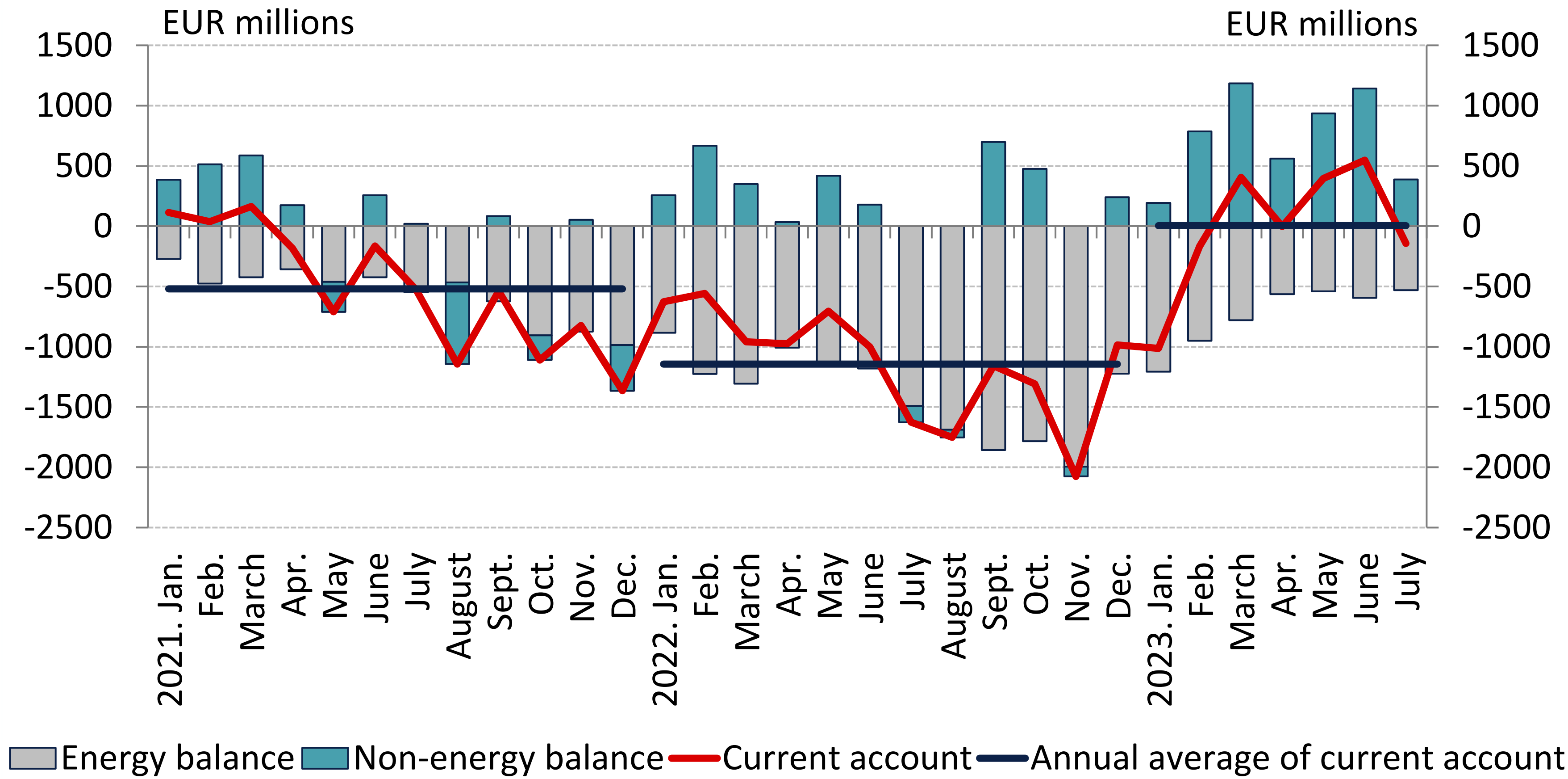


EXPENDITURE SIDE DECOMPOSITION AND FORECAST OF GDP

Source | HCSO, MNB

OUR EXTERNAL POSITION CONTINUED TO IMPROVE RAPIDLY AND SIGNIFICANTLY

The current account deficit will fall to below 1 percent of GDP in 2023 following a significant improvement outstanding even by European standards.

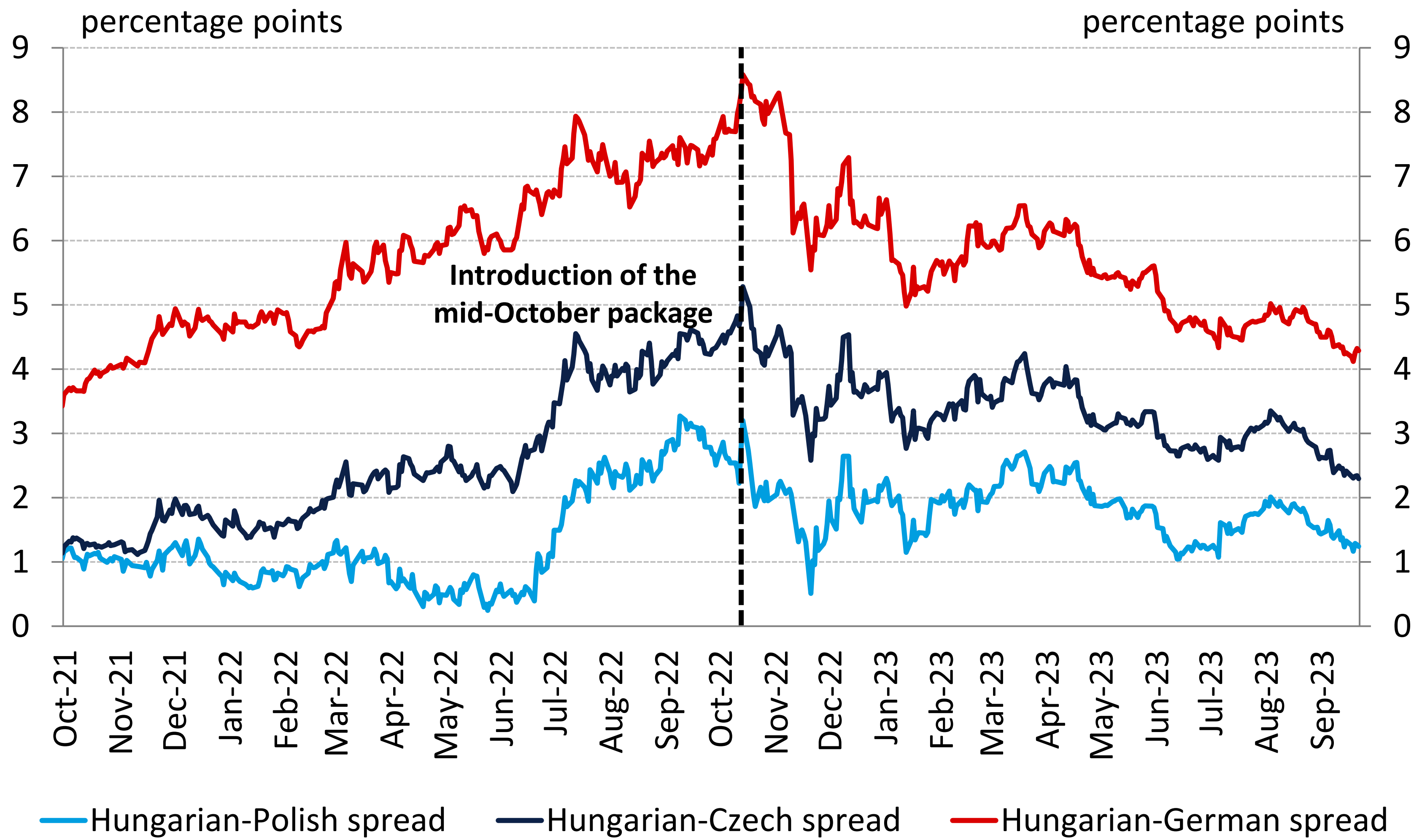


DEVELOPMENTS IN CURRENT ACCOUNT AND ENERGY BALANCE

Note | The July value of the energy balance is estimated.

Source | HCSO, MNB

OUR GOVERNMENT BOND SPREADS HAVE FALLEN SIGNIFICANTLY



DEVELOPMENTS IN DOMESTIC SPREADS OVER 10-YEAR GERMAN AND REGIONAL GOVERNMENT BOND YIELDS

Source | MNB, Bloomberg

MONETARY POLICY

THE GAP BETWEEN THE INTEREST CONDITIONS OF ONE-DAY DEPOSIT TENDERS AND THE BASE RATE HAS BEEN CLOSED

The package of measures of mid-October 2022 stabilised financial markets and triggered disinflation. The steps significantly strengthened the exchange rate and contributed to the decline in government bond market yields.

The gap between the interest conditions of one-day deposit tenders and the base rate has been closed.

The highlighted aspects have been realized: **gradual and cautious interest rate cut**.

Clear, understandable, well-communicated steps.

Financial markets remained stable.

Interest rate expectations developed in line with the central bank's guidance all the way.

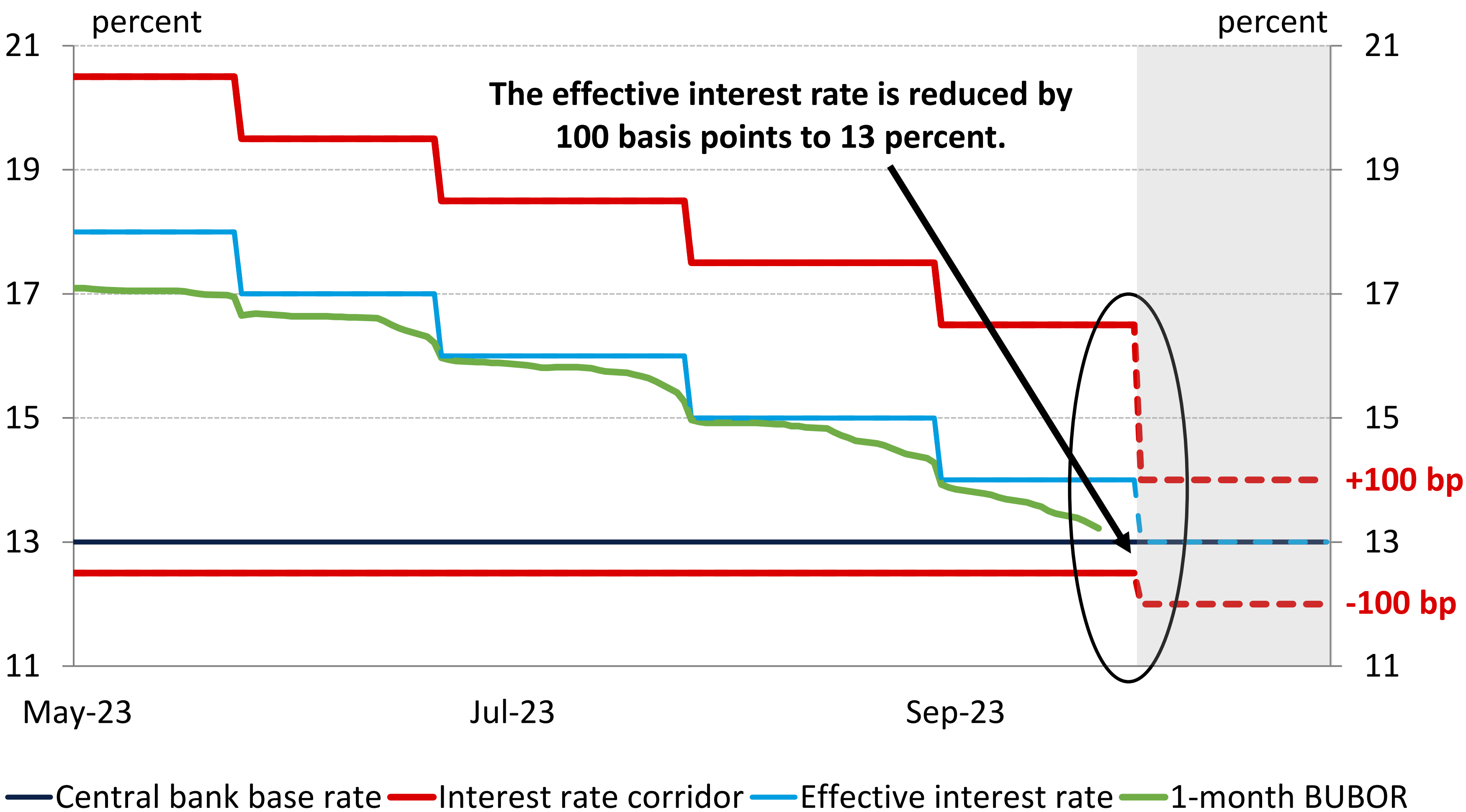
INTEREST RATE DECISION OF MONETARY COUNCIL IN SEPTEMBER

Central bank instrument	Interest rate	Previous interest rate (percent)	New interest rate (percent)
Central bank base rate		13.00	**13.00**
O/N deposit rate	Central bank base rate minus 1.00 percentage point	12.50	**12.00**
O/N collateralised lending rate	Central bank base rate plus 1.00 percentage point	16.50	**14.00**

With effect from 27 September, **the interest paid on optional reserves is to be equal to the base rate**, which is therefore lowered by 100 basis points, from 14 to 13 percent.

In addition, according to the Council's decision, the interest rate corridor became symmetric, with a band of +/- 100 basis points around the base rate. The utilisation of the instruments that determine the interest rate corridor is low, so this is a technical decision.

THE INTEREST RATE CORRIDOR HAS NARROWED AND BECOME SYMMETRIC



DEVELOPMENT OF MNB INTEREST RATES AND 1-MONTH BUBOR

Source | MNB

THE CENTRAL BANK'S SET OF MONETARY POLICY INSTRUMENTS WILL BE CHANGED AND SIMPLIFIED

27 September **2 October** **January 2024**

The gap between the interest conditions of O/N deposit tenders and the base rate has been closed.

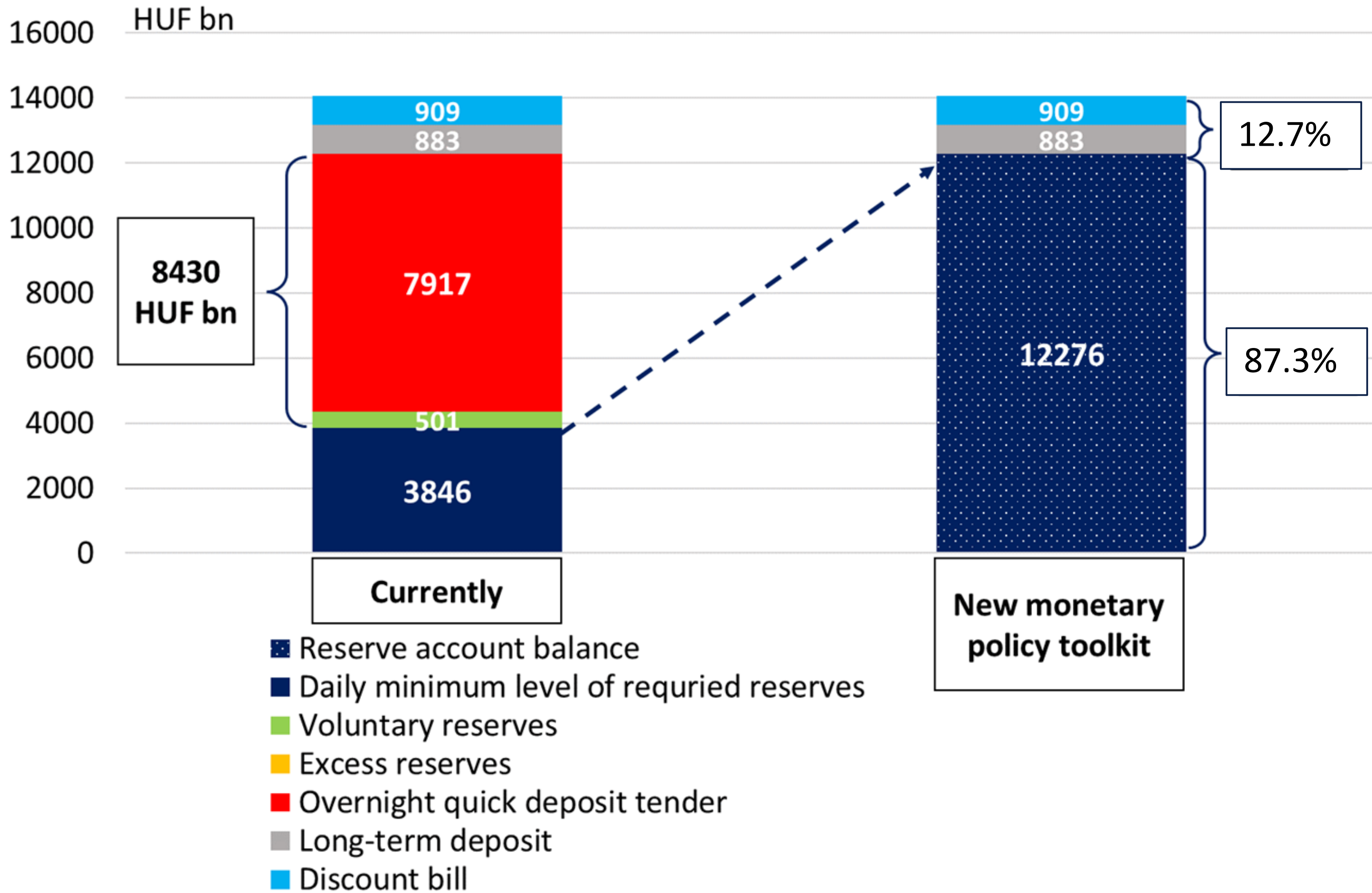
O/N deposit quick tender announced at base rate.

The MNB pays interest equal to **the central bank base rate** on reserve account balances exceeding the required reserve amount (**excess reserves**).

The optional required reserve ratio will cease, the required reserve ratio is uniformly 10 percent.

The interest paid on central bank discount bill and long-term deposit will be the base rate. The bottom of the interest rate corridor serves as guidance regarding the interest rate paid on FX-swap quick tenders.

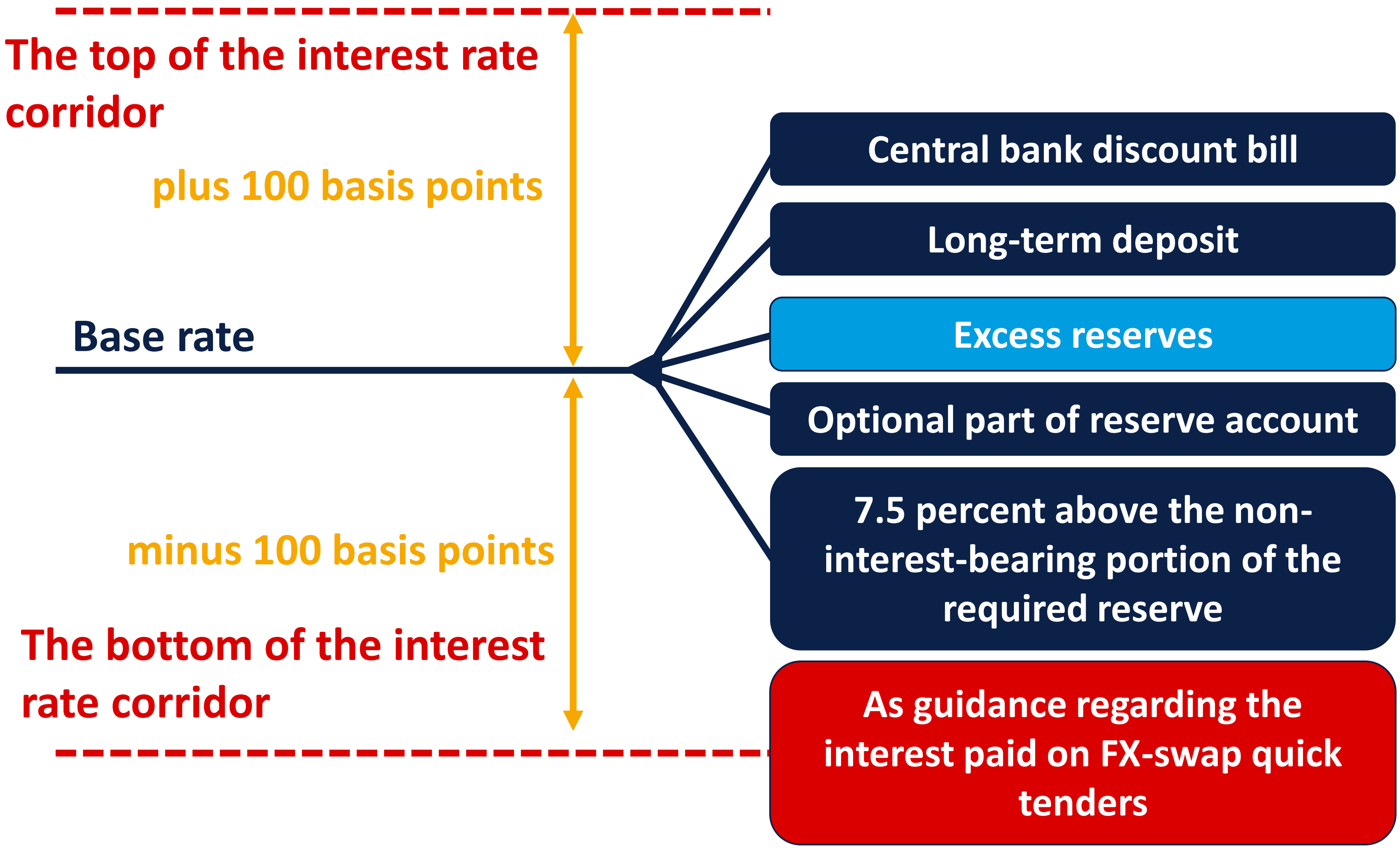
ON THE MAIN STERILISATION INSTRUMENT, I.E. THE RESERVE ACCOUNT, THE MNB ACCEPTS UNLIMITED DEPOSITS AT THE BASE RATE



THE SCHEMATIC IMPACT OF SIMPLIFYING INSTRUMENTS BASED ON THE AVERAGE STOCK OF CENTRAL BANK FORINT DEPOSITS IN AUGUST 2023

Source | MNB

STRENGTHENING THE KEY NATURE OF THE BASE RATE INCREASES THE EFFECTIVENESS OF MONETARY TRANSMISSION



+ The central bank does not pay interest on 2.5 percent of the reserve base.

THE MNB CONTINUES TO USE A CAUTIOUS APPROACH

Inflation target

Annual inflation is expected to reach the 7–8 percent territory towards the end of the year, but it is necessary to maintain tight monetary conditions in order to achieve the 3 percent inflation target.

Financial market stability

Ensuring financial market stability is the condition for achieving price stability.

Caution and data-driven mode

The Council takes a step-by-step decision on interest rates based on a cautious approach, depending on incoming data, factors affecting the inflation path and developments in the risk environment.

Preliminary communication

Clear communication promotes consistency between central bank decisions and interest rate expectations. As part of this, the MNB publishes regular flash analyses of key macroeconomic indicators.

„Following today's decision, ***the gap between the interest conditions of one-day deposit tenders and the base rate has closed****. Therefore, the normalisation of the extraordinary interest rate environment introduced in October 2022 has been concluded and thus monetary policy enters a new phase. In order to achieve price stability in a sustainable manner, monetary conditions need to remain tight.* ***With the appearance of risks surrounding global disinflation and volatility in international investor sentiment, a cautious approach to monetary policy is warranted.*** *The Council is constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment, and it will take decisions on changes in monetary conditions based on these factors, if warranted."*

THANK YOU FOR YOUR KIND ATTENTION!