

4. SPECIAL TOPICS

4.1. Background to the reduction of the inflation target

As an inflation-targeting central bank, the Magyar Nemzeti Bank (MNB) regularly reviews its monetary policy framework in light of global and domestic macroeconomic developments and its long-term strategy. Based on international experience, there has been a convergence in the elements of inflation-targeting frameworks, including the target measure, flexibility (the tolerance band), the monetary policy horizon and the mandate. At the same time, central banks' practices differ more markedly with regard to the inflation target, partly depending on the level of economic development. The key elements of the MNB's inflation-targeting framework are consistent with international best practices; however, the level of the inflation target is higher than that prevailing both in the euro area and in the region. Against this background, the review of the medium-term inflation target was at the centre of the process.

In reviewing the inflation target, the Monetary Council conducted a detailed assessment of nominal and real economic convergence, international practices, and, on this basis, the appropriate level of the inflation target for the domestic economy. Based on this, the Monetary Council decided to set the central bank's medium-term inflation target at 2.5 percent from 1 January 2028, over the monetary policy horizon, while leaving the symmetric ± 1 -percentage-point tolerance band around the inflation target unchanged.

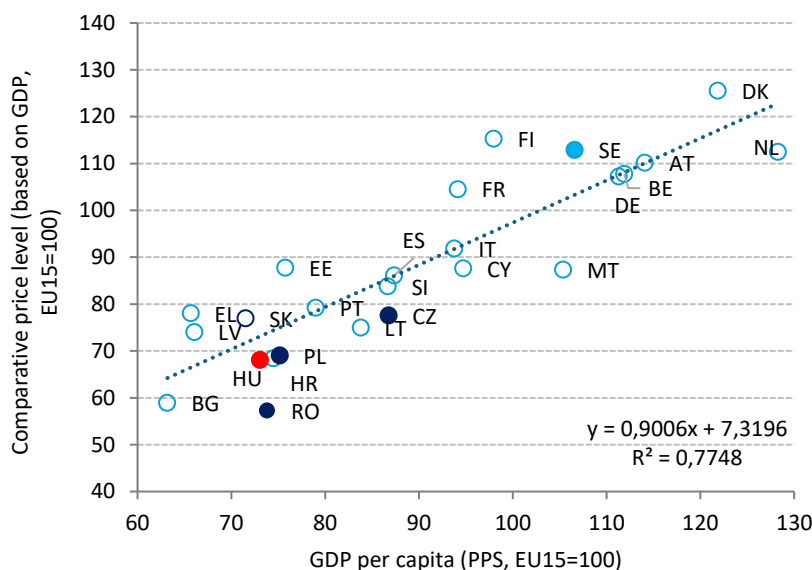
This analysis sets out the background to the decision and summarises the key analytical considerations and findings underpinning the review of the inflation target.

4.1.1. Macroeconomic considerations in determining the inflation target

In the practice of inflation-targeting central banks, price stability means maintaining a low but positive rate of inflation. A moderate and predictable increase in consumer prices minimises the welfare costs of inflation, while facilitating adjustment to distortions arising from nominal price and wage rigidities and providing monetary policy with room for manoeuvre in the face of the zero lower bound on nominal interest rates and deflationary risks. Accordingly, central banks in developed economies generally pursue an inflation target of 2 percent or close to 2 percent.

The level of the inflation target partly reflects the level of economic development of the economy concerned. A positive relationship can be identified between the level of economic development and the price level of economies (the Penn effect), which can also be observed among the Member States of the European Union (Chart 4-1). Real economic convergence leads to price level convergence (real appreciation), meaning that the price level in emerging economies gradually converges towards the higher price level observed in developed economies. Higher inflation can be an important channel of price level convergence in emerging economies, therefore their central banks often pursue inflation targets somewhat higher than the 2-percent targets, or targets close to 2 percent, typically observed in developed economies.

Chart 4-1: Comparative price level as a function of relative development (2024)

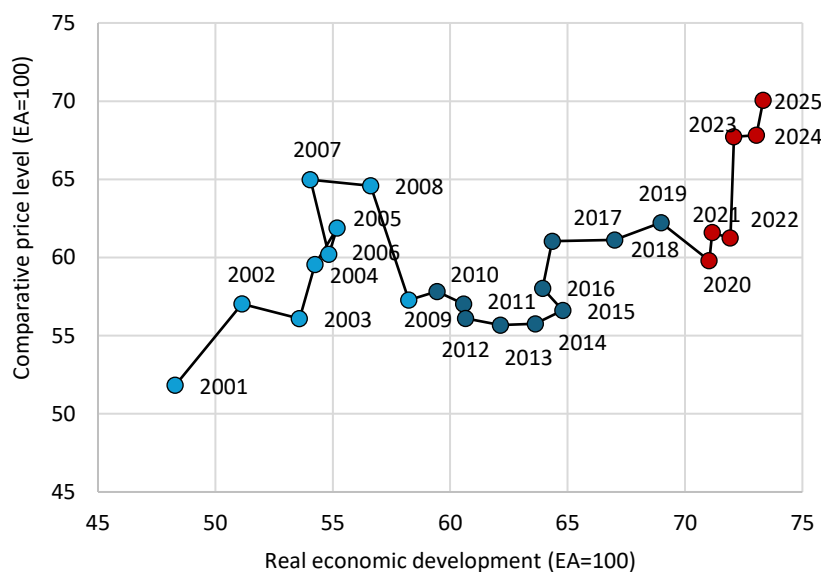


Note: Countries using the euro or maintaining an exchange rate peg to the euro are indicated by open circles. The region is shown in dark blue, while Hungary is shown in red.

Source: Eurostat, MNB

Over the past decades, the domestic price level has converged significantly towards the euro area average (Chart 4-2). Based on purchasing power parity data, the domestic price level has reached more than two-thirds of the average price level in the euro area; however, the extent of price level convergence varies significantly across individual product and service groups. The price level of consumer goods has converged significantly more towards the euro area average (82.0 percent) than that of services (60.6 percent). The latter is reduced by public services provided directly to households free of charge. These fall outside the scope of the goods and services covered by the consumer price index; consequently, the relative price level of non-government services may be significantly higher. The price level of items relevant from an inflation perspective has therefore moved closer to the euro area average than indicated by purchasing power parity-based data. The higher price level warrants a slower pace of price level convergence.

Chart 4-2: Developments in the comparative price level and real economic convergence in Hungary

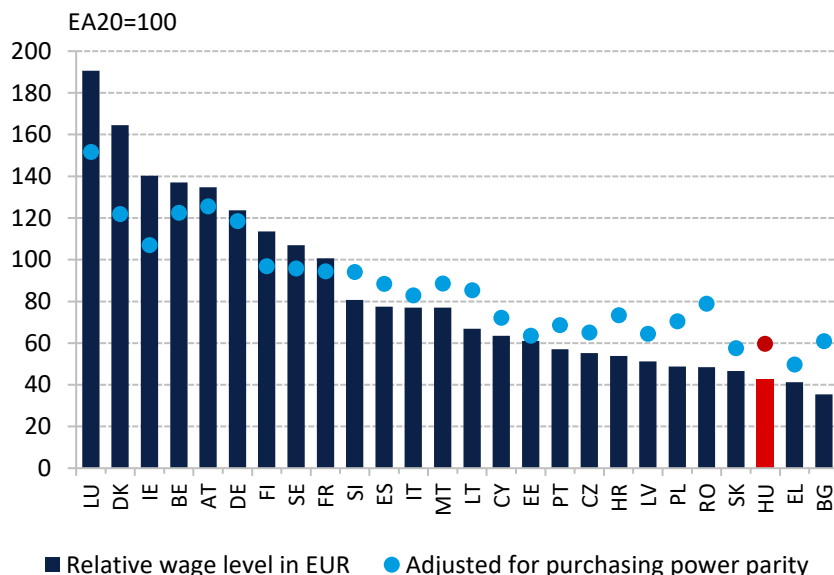


Source: Eurostat, MNB

The domestic wage level is significantly below the euro area average. Based on 2024 data, domestic wage levels amount to 42 percent of the average wage level in the euro area when measured in euros, while they reach 60 percent when

adjusted for purchasing power parity (Chart 4-3). Domestic nominal wage growth significantly exceeds that of regional countries, suggesting that Hungary's relative position may have improved from 2025 onwards. Over the past decade, Hungary has experienced gradual wage convergence. At the same time, the domestic wage level remains significantly below that of other EU Member States, meaning that wage convergence may continue over the long term.

Chart 4-3: Relative wage levels in the European Union countries (2024)

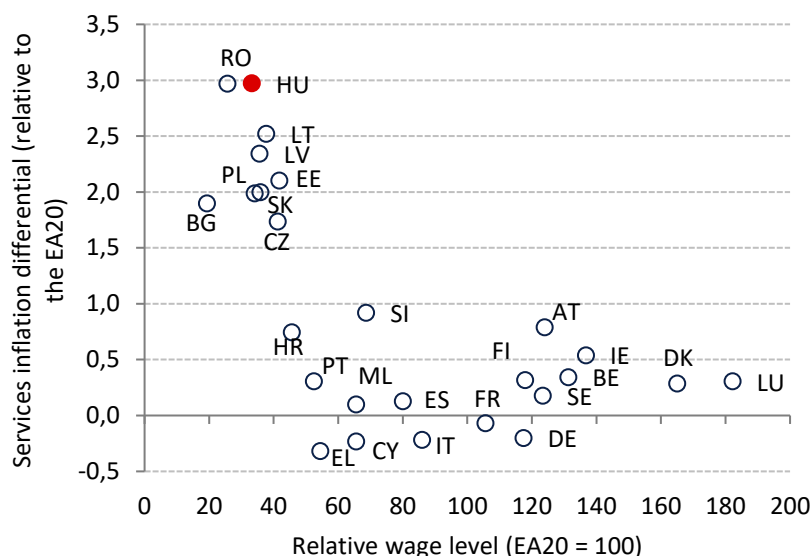


Note: Annual gross average earnings for full-time employment.

Source: Eurostat, MNB calculation

In general, countries characterised by relatively low wage levels experience higher services inflation. It can be observed that in the Central and Eastern European countries that joined the European Union after 2004 and have wage levels below the euro area average, wage convergence has been accompanied by services inflation above the euro area average (Chart 4-4). The further gradual price level convergence associated with continued real economic convergence may primarily affect services. In the case of the Hungarian economy, the price convergence process presents a heterogeneous picture. The price level remains significantly below the euro area average primarily in the case of services. Looking ahead, stronger wage convergence in the services sector is expected to increase inflation primarily in market services. At the level of the consumer price index, the nominal exchange rate can offset the services sector's excess inflation relative to developed economies. This economic policy decision (between a higher inflation rate and an appreciating nominal exchange rate) is invariant in the sense that, in both cases, the real exchange rate appreciates.

Chart 4-4: Wage levels relative to the Eurozone and the differential in services inflation in EU countries

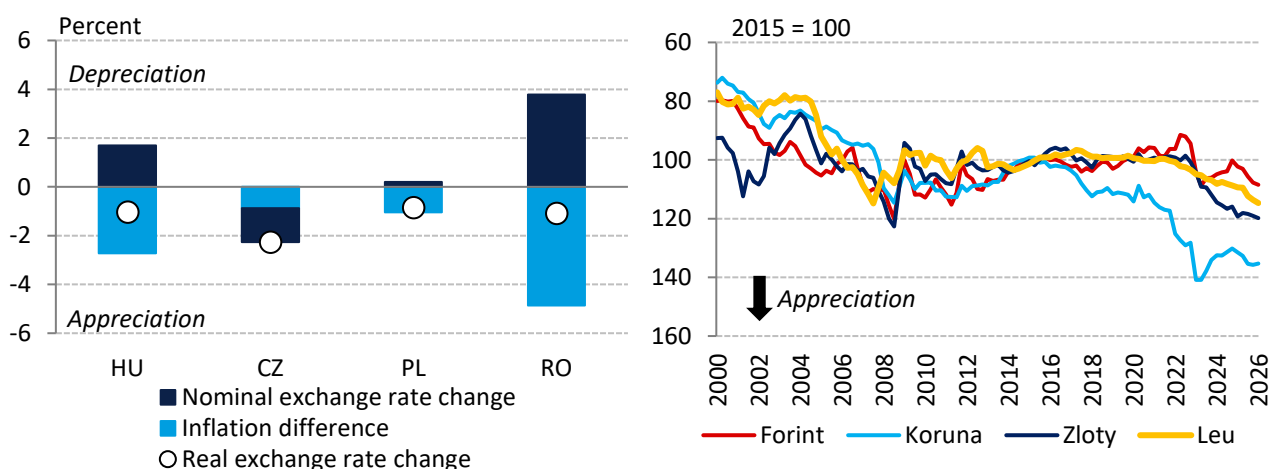


Note: The horizontal axis shows the average annual gross wage for full-time employment in EUR, while the vertical axis shows the HICP for services.

Source: Eurostat, MNB calculation

The real appreciation observed in converging economies can occur through two nominal channels: first, through an inflation differential, when domestic inflation is higher than that of the reference economy; second, through the appreciation of the nominal exchange rate. A given degree of real appreciation can occur either alongside a higher inflation differential and a depreciating domestic currency or alongside a lower inflation differential and an appreciating currency. In the region, Hungary and Romania have been characterised by a combination of high inflation differentials and nominal depreciation over the past decades, while a similar degree of real appreciation took place in Poland alongside a stable nominal exchange rate and in Czechia alongside an appreciating nominal exchange rate and moderate inflation differentials (Chart 4-5, left panel). Examining the time series data on real appreciation over a longer period shows that Hungarian appreciation has been volatile over time but has remained below that of the region overall (Chart 4-5, right panel). An inflation target 0.5 percentage point higher than that of the euro area provides room for price level convergence to partially continue through the inflation differential, thereby avoiding an excessive burden on the real economy in the short term.

Chart 4-5: Decomposition of the real exchange rate based on the consumer price index (left panel) and the real effective exchange rate (right panel)

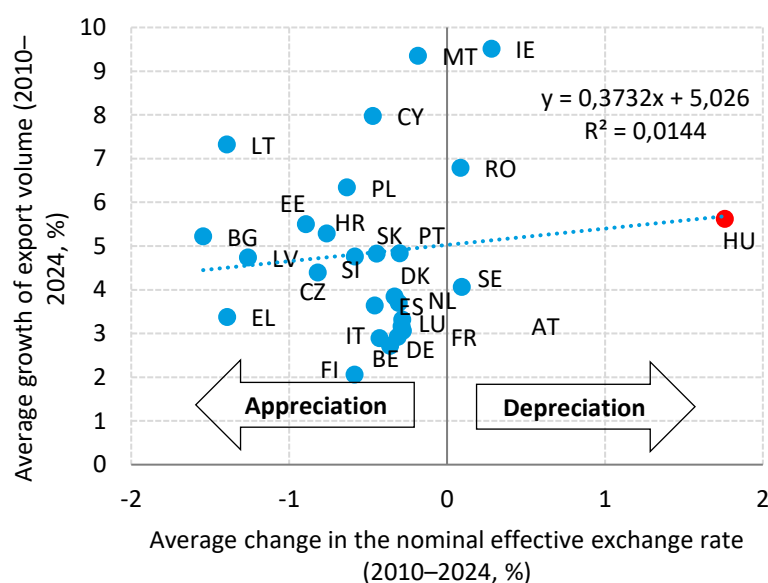


Note: Left panel: annual average (2001–2025), relative to the euro. Right panel: effective exchange rate calculated based on exchange rates against 37 trading partners.

Source: Eurostat, MNB

The pass-through of the nominal exchange rate to consumer prices has strengthened in the 2020s compared to the previous decade, while its effects on the real economy have been moderate and materialised primarily in the short term. In the short term, nominal variables may have real effects due to price rigidities and stickiness; once these have dissipated, it can be assumed that the classical dichotomy holds in the long term, i.e. nominal and real variables are independent. A good example of this is the development of exports, where price competitiveness considerations may play a role in the short term; however, the nominal exchange rate is neutral with regard to export performance in the long term. No clear relationship can be identified between the exchange rate paths of EU countries and their export performance. The majority of countries recorded export growth despite significant appreciation, while Hungary's export performance did not increase at a faster rate than that of countries following different exchange rate paths, despite significant depreciation (Chart 4-6). The countries in the region have also maintained their ability to attract investment in conjunction with exchange rate appreciation and/or stability. Furthermore, faster and stronger exchange rate pass-through has an effect on consumption and investment opposite to that on exports, meaning that the real economic impact of changes in the exchange rate is close to neutral even in the short term.¹

Chart 4-6: Relationship between export volume and changes in the nominal exchange rate (2010–2024)



Note: Effective exchange rate calculated on the basis of exchange rates against 37 trading partners.

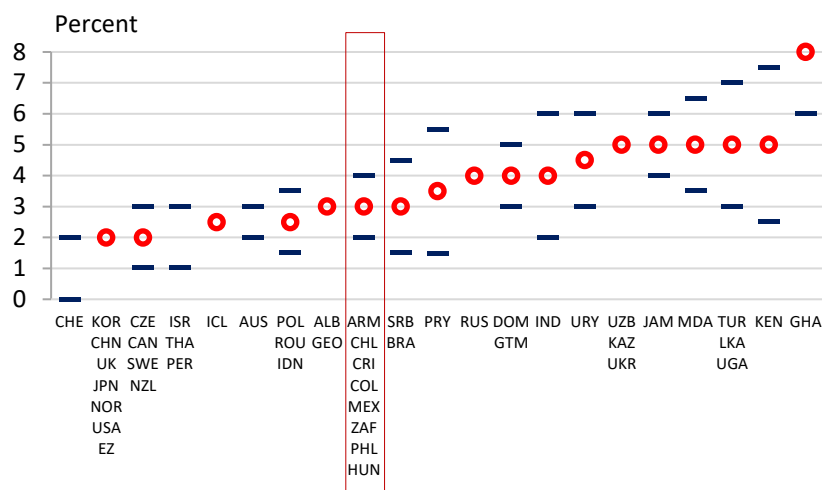
Source: Eurostat, MNB

4.1.2. The inflation target level in international comparison

In international practice, the level of the inflation target pursued by central banks varies and partly reflects the level of economic development of the country concerned. Developed economies typically pursue lower inflation targets than emerging economies (Chart 4-7). Among the globally significant central banks, both the Federal Reserve and the European Central Bank (ECB) have an inflation target of 2 percent. Among the central banks in the region, the Czech National Bank also pursues an inflation target of 2 percent, complemented by a ± 1 -percentage-point tolerance band. At a somewhat higher level, the central banks of Poland and Romania have set their inflation targets at 2.5 percent. By contrast, the central banks of several emerging economies pursue a 3-percent inflation target (e.g. Armenia, Chile, Colombia, Mexico and South Africa).

¹ Balatoni – Soós (2023): Changing world, changing impact – The macroeconomic impact of the exchange rate.

Chart 4-7: Inflation targets of inflation-targeting central banks

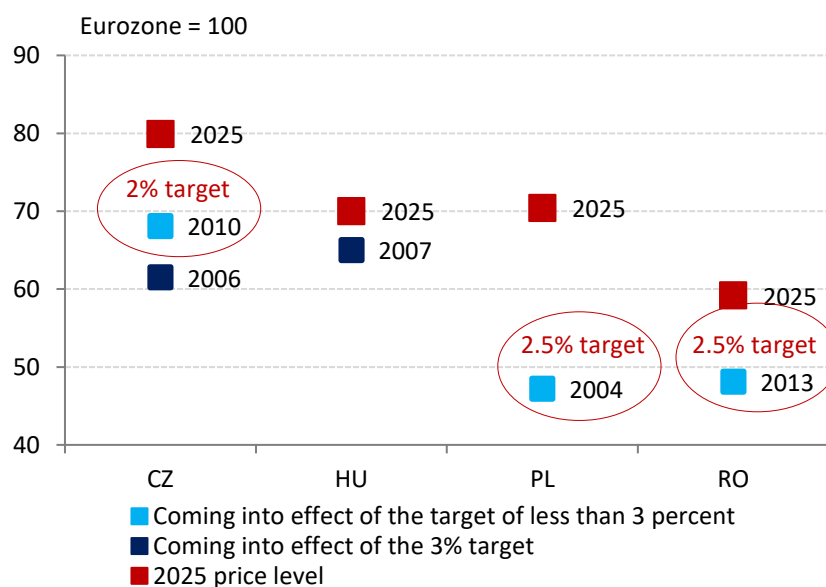


Note: The Federal Reserve and the ECB are not formally inflation-targeting central banks, but in practice, they apply elements of inflation targeting.

Source: Central banks' websites

Reducing the inflation target represents convergence towards regional and ECB practices. Given the current level of domestic price level convergence of around 70 percent, the countries in the region already pursued lower inflation targets, and their price level convergence continued even with a lower target (Chart 4-8). In the long term, a higher inflation target warrants a higher yield curve than in the region, due to higher nominal interest rates and inflation premia. This results in higher financing costs for the economy. A lower inflation target is consistent with lower inflation and nominal interest rates in the long term.

Chart 4-8: Relationship between GDP-based price-level convergence and inflation targets in the region



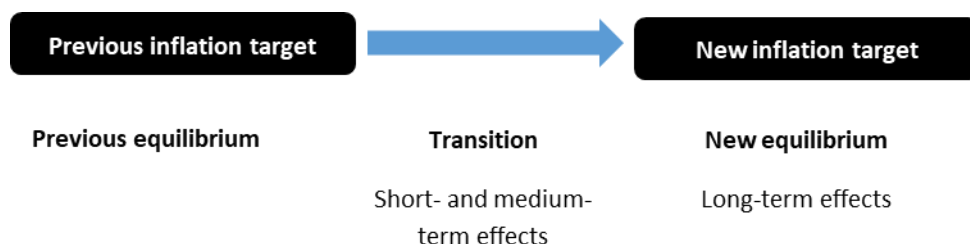
Source: Central banks' websites, Eurostat

4.1.3. Macroeconomic transition to a new inflation target

Following a change in the inflation target, achieving the new inflation target in an economy typically does not occur immediately, as the adjustment takes time. A reduction in the inflation target primarily affects the economy by shifting the nominal anchor. During the transition period, the economy moves towards a new nominal equilibrium, which may give rise to real economic and welfare impacts through the allocation of resources and income.

When quantifying the real economic effects, it is necessary to distinguish between the transition period and the long-term effects. It is not sufficient to examine how the economy operates under the new inflation target. In the short term, particular attention should be paid to the transition and the path towards the new (equilibrium) state (Chart 4-9).

Chart 4-9: Process of achieving the new inflation target



Source: MNB

The following section presents the path along which the economy transitions from the previous 3-percent inflation target to the new 2.5-percent inflation target as the inflation target is changed. In the new equilibrium, economic developments are consistent with the new inflation target. During the transition period – the period between the old and new equilibria – the economy undergoes an adjustment process. With simulations, we quantify the economic effects resulting from the shift between the two states.

We assess the impact of the reduction of the inflation target using a modelling framework widely used in international central banking practice.² We developed our own version of this theoretical framework which incorporates the key channels of monetary policy transmission. In an idealised, frictionless case, a reduction in the target is immediately incorporated into expectations if economic agents are perfectly forward-looking and there is no information asymmetry. In this case, nominal variables do not affect real economic variables, as prices adjust immediately and the nominal exchange rate immediately moves onto its new equilibrium path. In reality, however, this does not happen instantaneously. Within the model framework, the new inflation target of monetary policy is incorporated into economic agents' expectations through a learning process, with agents gradually adjusting to the new target. The real economic impacts of the reduction in the inflation target depend primarily on the speed of this process. If economic agents' expectations adjust rapidly, the real economic impact is smaller. If the adjustment is slower and more protracted, the adverse effect on GDP growth may be greater.

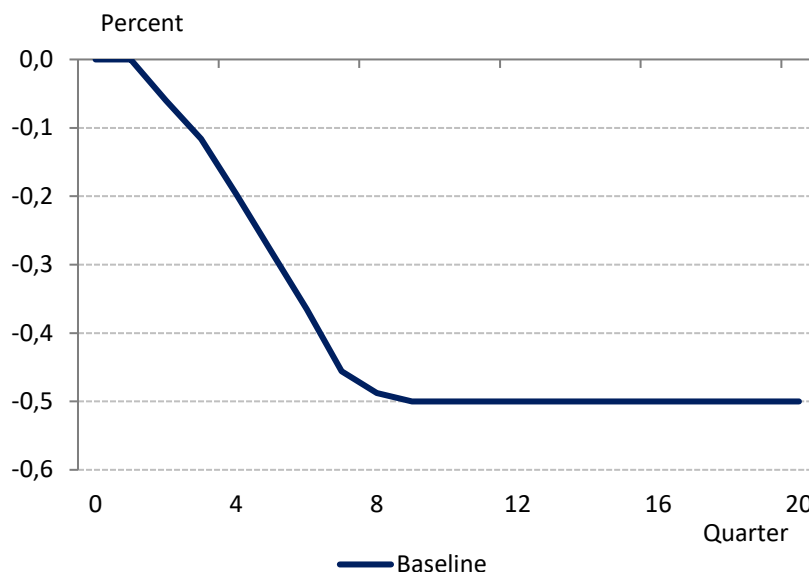
The real economic sacrifice during the transition period is, in line with the international literature, defined as the cumulative GDP loss incurred during the adjustment to the new equilibrium. The magnitude of this sacrifice manifests through several channels. First, it depends on the (price and wage) rigidities present in the economy. Second, it depends on the speed of adjustment, i.e. how quickly the newly announced target becomes embedded in economic agents' expectations (expectations channel). With lower price and wage stickiness, adjustment can occur more rapidly. The real economic sacrifice is minimised if the announced target is quickly incorporated into economic agents' expectations.

Reducing the inflation target from 3 percent to 2.5 percent and fully incorporating the change into expectations and the inflation path may take approximately one and a half to two years (Chart 4-10). Economic agents adjust to the central bank's new inflation target through a learning process. During the transition period, the annual rate of price growth gradually declines in parallel with the moderation of expectations until it reaches the new inflation target. A reduction in the inflation target can raise the forward-looking real interest rate, even without changes in nominal interest rates. These somewhat higher real interest rates may, in turn, dampen consumption to a small extent and reduce investment and demand for credit. In the short and medium term, GDP may be temporarily and marginally lower, but the reduction in the

² In economics, this is known as a dynamic stochastic general equilibrium (DSGE) model. Dynamic, as it captures changes in the economy over time. Stochastic, as it incorporates random shocks that disrupt the economy and push it away from equilibrium. General equilibrium, as it describes the functioning of the economy as a whole. For further details, see: Békési – Köber – Kucsra – Várnai – Világi (2016): The macroeconomic forecasting model of the MNB, MNB Working Paper 2016/4.

inflation target does not affect potential GDP; accordingly, economic activity gradually returns to its previous level in the second half of the adjustment period.

Chart 4-10: Impact of a 0.5-percentage-point reduction in the inflation target on year-on-year inflation

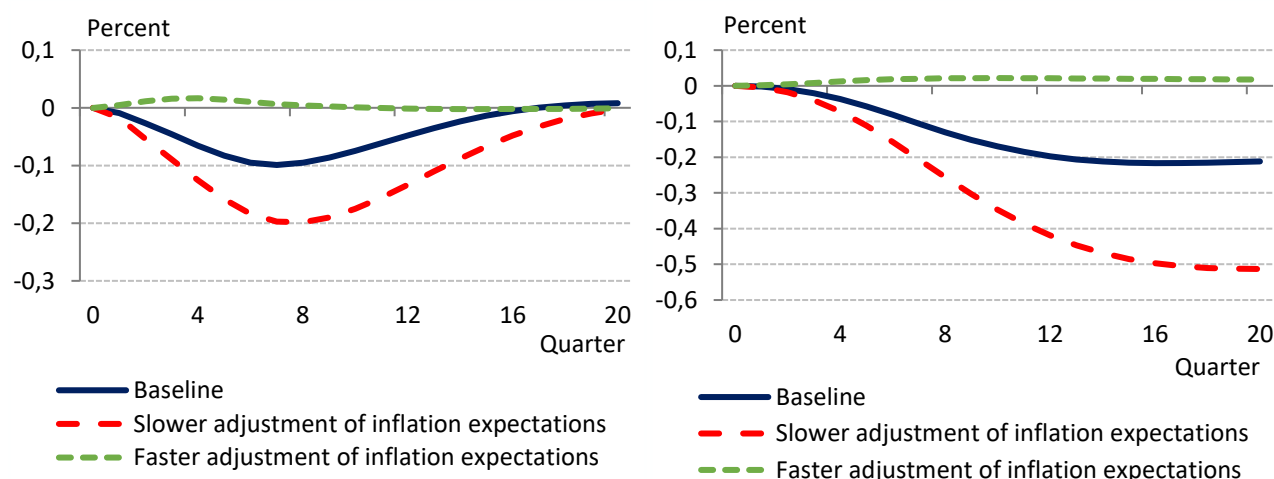


Note: The effect represents the deviation from the baseline path.

Source: MNB calculation

The pre-announced 0.5-percentage-point reduction in the inflation target results in a cumulative real economic sacrifice equivalent to 0.2 percent of one year's GDP as it becomes incorporated into expectations (Chart 4-11, right panel). However, expectations may adjust more quickly or slowly than assumed in the baseline calculations. With slower adjustment, monetary policy can reduce inflation only at the cost of a greater real economic sacrifice. In this case, the expectations channel does not dominate; instead, tighter monetary conditions may be required to reduce inflation expectations. With faster adjustment, the transition period may be achieved without real economic sacrifice, provided that no additional tightening is required.

Chart 4-11: Impact of a 0.5-percentage-point reduction in the inflation target on GDP
(Left: Change in GDP year-on-year, Right: Cumulative real economic sacrifice)



Note: The effect represents the deviation from the baseline path.

Source: MNB calculation

Another important factor in reducing the inflation target is the current inflation environment. It matters whether the economy is currently in a lower- or higher-inflation regime, i.e. whether current inflation is below or above the inflation

target. Currently, inflation in Hungary is below the inflation target, which may contribute to economic agents basing their inflation expectations on the new, lower target as soon as possible. In addition, inflation expectations are currently at historically low levels, which also facilitates rapid adjustment to the new target.

Reducing the inflation target affects not only macroeconomic variables but also the budget and public debt. The impact on the budget balance may be broadly neutral, as the effects on the revenue and expenditure sides largely offset each other. The decline in interest rates resulting from disinflation may reduce budgetary interest expenditure in the short term; however, the more significant reduction is likely to materialise primarily in later years due to slower repricing. The dynamics of the public debt ratio, however, are more sensitive. This is because disinflation may result in somewhat less favourable debt ratio dynamics in the short term. Over the longer term, however, a more stable and credible macroeconomic environment, together with the gradual repricing of lower interest expenditure, contributes to a more sustainable public debt trajectory.

Box 4-1: Experience with the reduction of the inflation target in South Africa

In recent years, there have been few examples of inflation-targeting countries reducing their inflation targets. Last year, the South African Reserve Bank reduced its inflation target, setting the lower bound of the previous 3–6-percent target range as its new inflation target. A few months later, this was also confirmed by the country's Ministry of Finance, which revised the central bank's inflation target range to a 3-percent inflation target with a ± 1 -percentage-point tolerance band.

The effects of the reduction in the inflation target were simulated using central bank models similar to those available at the MNB. Based on the results, South African central bank officials identified the following transitional effects of the reduction in the inflation target:

- Inflation expectations quickly converge towards the new target, reaching it almost fully by the second year, which also supports the decline in inflation. The disinflationary process is supported by slower nominal wage growth.
- Real GDP growth temporarily slows in the first year due to higher real interest rates. The growth effect is small, at around 0.3 percentage point, and is offset by lower nominal interest rates as early as the second year.
- Public debt increases in the first two years, as slower nominal GDP growth has an adverse effect on the debt ratio, but the increase amounts to only 0.1 percentage point in each of the first two years. Lower nominal interest rates are favourable for debt dynamics over the longer term.

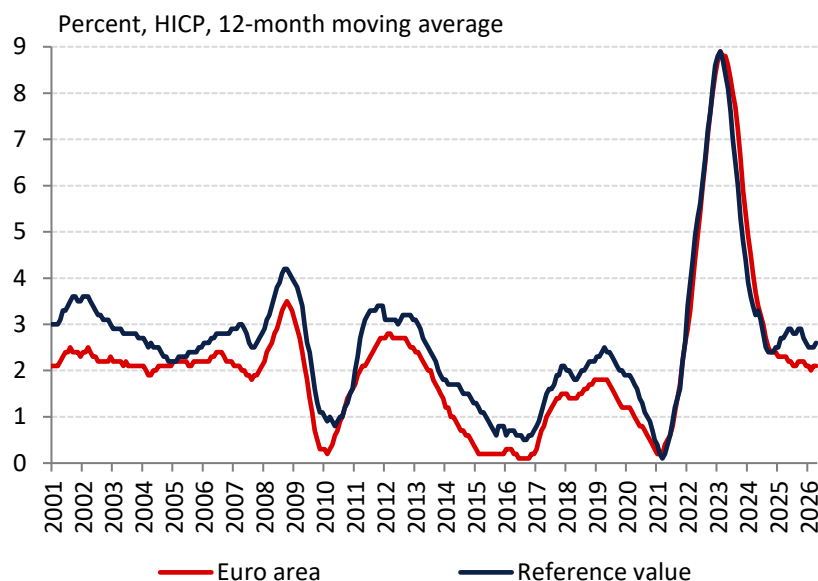
4.1.4. Long-term effects of the reduction in the inflation target

A lower inflation target supports macroeconomic stability. For the Hungarian economy, a 2.5-percent inflation target implies lower inflation, a more predictable economic environment, and lower nominal interest rates and financing costs over the longer term. All of this helps preserve the purchasing power of incomes and the real value of savings, while supporting stronger consumption and investment, thereby contributing to sustainable economic growth. A lower inflation target also brings Hungary closer to the practices of the region and developed economies as well as to meeting the conditions for euro adoption.

The reduction in the inflation target supports compliance with the price stability criterion required for euro adoption.

Adoption of the euro is a commitment undertaken by Hungary upon joining the European Union. Under the price stability criterion, the inflation rate of a Member State seeking to join the euro area may not exceed the average inflation rate of the three EU Member States with the lowest inflation rates by more than 1.5 percentage points. During periods when euro area inflation is in line with the ECB's 2-percent target, the Maastricht threshold typically ranges between 2.4 and 2.7 percent (Chart 4-12). The historical median of the reference value is 2.5 percent. With the achievement of an inflation target of 3 percent, the price stability criterion would have been met in less than one-third of the period, while achievement of a 2.5-percent target would have resulted in compliance with the criterion in approximately one-half of the period. Moreover, a lower inflation target also supports compliance with the other Maastricht criteria.

Chart 4-12: Euro area inflation and the Maastricht price stability reference value

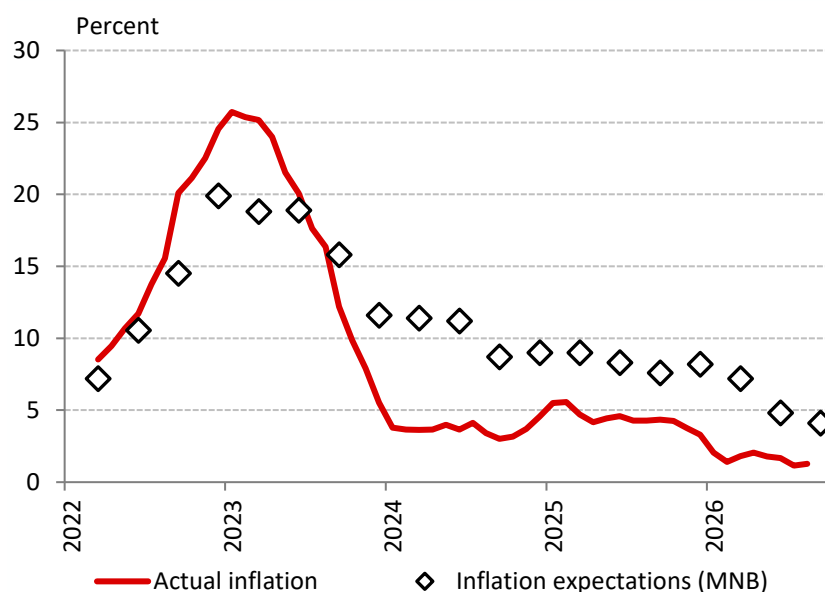


Source: MNB, Eurostat

4.1.5. Inflation environment and factors affecting the achievement of the target

The subdued inflation developments in the recent period, together with the overall favourable domestic inflation outlook, provided appropriate momentum for reducing the inflation target to 2.5 percent. Inflation has declined significantly over the past 18 months and has remained at or below the lower bound of the tolerance band since the beginning of 2026. Gradual disinflation was supported by both domestic and global trends. In addition to current inflation, the inflation outlook is also favourable, with household inflation expectations having declined significantly over the past 18 months. According to the MNB's household survey, inflation expectations have fallen significantly and are also low in level terms: from around 9 percent in 2025 H1, they gradually fell to 4.1 percent by 2026 Q3 (Chart 4-13). According to the Reuters survey, analysts' 1-year-ahead inflation expectations have remained around 3 percent with a decreasing trend since the start of the year. Following the beginning of 2025, corporate price expectations declined to levels close to those observed in the 2017–2020 period. The lower target may further reduce inflation expectations, while the decline in the domestic risk premium and the recent appreciation of the forint support anchoring them at lower levels.

Chart 4-13: Developments in households' 1-year-ahead inflation expectations



Source: HCSO, MNB

Cyclical and structural factors affecting inflation dynamics may influence achievement of the target. Global shocks directly affecting product groups outside the scope of monetary policy (such as changes in energy and food prices) have become more volatile in recent years. The increasing impact of more persistent structural changes (e.g. global trade restrictions, population ageing and the green transition) has become evident in the 2020s. The impact of global and country-specific factors on equilibrium inflation can be monitored through regular reviews of the inflation target.

In addition to a monetary policy commitment, disciplined fiscal policy and nominal wage growth in line with productivity growth are also essential to minimise the cost of real economic adjustment towards the lower target. One of the prerequisites for this is a sustainable fiscal deficit and a gradually declining public debt trajectory. While wage growth has moderated compared to previous years, the low productivity growth and underlying economic developments do not support the current wage growth rate of around 7–8 percent (see Box 1.3 of the September 2026 Inflation Report for further details). With employment close to full capacity, there is limited scope for further growth under a labour-intensive growth model. Looking ahead, a shift from input-driven, extensive growth to a productivity-focused, intensive growth model could provide the basis for further convergence. Wage growth consistent with productivity improvements supports continued wage convergence without generating inflationary pressure from labour costs. Structural transformation is therefore of key importance for macroeconomic stability, as improvements in efficiency and productivity can broadly reduce excess inflation in the economy.

4.1.6. Summary

From 1 January 2028, the MNB will set its medium-term inflation target at 2.5 percent, while maintaining the symmetric ± 1 -percentage-point tolerance band around the inflation target unchanged.

The reduction in the inflation target was supported by nominal and real convergence, while subdued inflation developments in the recent period, favourable domestic inflation prospects and the evolution of inflation expectations provided an appropriate environment for the decision. Looking ahead, the further gradual price level convergence associated with continued real economic convergence may primarily affect services. An inflation target 0.5 percentage point higher than that of the euro area provides room for price level convergence to partially continue through the inflation differential, thereby avoiding an excessive burden on the real economy in the short term.

In analysing the effects, it is particularly important to examine the path along which the economy would transition to the 2.5-percent inflation target following the change in the target. According to the calculations, it may take approximately one and a half to two years for the reduction in the target to be fully incorporated into expectations and the inflation path. Achieving the new inflation target may have a moderate impact on the real economy.

Over the longer term, a lower inflation target implies lower inflation, a more predictable economic environment, and lower nominal interest rates and financing costs for the Hungarian economy. All of this helps preserve the purchasing power of incomes and the real value of savings, while supporting stronger consumption and investment, thereby contributing to sustainable economic growth. The decision brings the inflation target in line with regional practices and closer to the European Central Bank's target, and also supports meeting the requirements for euro adoption.