MINUTES
OF THE MONETARY COUNCIL MEETING
29 AUGUST 2023

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Article 3 (1) of the MNB Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines achieving and maintaining price stability as the primary objective of the Magyar Nemzeti Bank. The MNB's supreme decision-making body is the Monetary Council. The Council convenes as required by circumstances, but at least twice a month, according to a pre-announced schedule. At the second scheduled meeting each month, members consider issues relevant to decisions on interest rates. Abridged minutes of the Council's rate-setting meetings are released regularly, before the next policy meeting takes place. The minutes present the decision-makers' assessment of current economic conditions and the factors they consider when deciding on the base rate. Until December 2013, the Monetary Council presented the information underlying its assessments as part of the abridged minutes. In order to provide more detailed information, background materials will henceforth appear as a separate publication with enhanced content under the title 'Macroeconomic and financial market developments', at the same time as the abridged minutes.

The minutes are available on the MNB's website at:

https://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

The primary objective of the Magyar Nemzeti Bank (MNB) is to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserves financial stability and supports the Government's economic policy, as well as its policy on environmental sustainability.

In line with expectations, economic growth in the European Union had been close to stagnant in 2023 Q2. The US economy had grown more strongly than expected, while growth in China had fallen short of expectations. The global economic outlook continued to be characterised by duality. In the year as a whole, output growth was expected to slow in developed countries. Meanwhile, growth in emerging countries was likely to be similar to last year. In most countries, labour markets were tight. The easing of the energy crisis in Europe pointed to an improvement in the outlook for economic activity on the Continent. However, the ongoing Russia-Ukraine war and the persistently high inflationary environment were posing downside risks to growth.

Global inflation rates had continued to fall. The slowdown in global economic activity, the correction in energy and commodity prices and the fall in international freight costs pointed to a further decline in inflation rates. However, core inflation indicators, generally falling at a slow pace, suggested that achieving price stability again was expected to be a protracted process.

Global risk appetite had fallen since the July policy decision. Investor sentiment had been driven by US macroeconomic data releases and developments related to the slowdown in Chinese economic growth. Domestic financial markets had shown a stronger reaction than regional ones to changes in international sentiment and movements in the dollar exchange rate. Oil and European gas prices had risen amidst high volatility over the past month. The uncertainty due to the Russia–Ukraine war continued to have a negative impact on investor sentiment.

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Hungary's GDP had declined by 2.4 percent year-on-year in 2023 Q2. Based on preliminary data, the main contributor to the downturn in domestic economic performance had been the decline in industrial output and market services, while agricultural performance and that of the health and social care sectors had moderated the decline. In June, industrial and construction output as well as the volume of retail sales had continued to fall. Of the manufacturing sub-sectors, production volumes had increased in vehicle production and in the manufacture of electrical equipment. The household confidence indicator remained at a low level. The labour market remained tight, the unemployment rate was low.

In the first half of 2023, declining real wages, rising corporate costs and cautious consumer and investment decisions had all contributed to a contraction in domestic demand, while net exports had supported output growth. From the second half of the year, real wages, rising again in line with falling inflation, were expected to support a pick-up in GDP growth. This year's economic performance was expected to be improved by the correction in agricultural growth.

The decline in domestic inflation had accelerated in July. Consumer prices had risen by 17.6 percent in annual terms and core inflation had stood at 17.5 percent. The consumer price index had fallen by 2.5 percentage points compared to June, primarily reflecting a slowdown in the price dynamics of processed food and manufactured goods. Core inflation had slowed across a wide range of products and services, so the indicator had declined by 3.3 percentage points from the previous month. In July, the annual price index of market services had decreased again. Inflation expectations of both households and companies had continued to fall.

In the coming months, domestic inflation and core inflation would continue to decrease at a rapid pace. During 2023, the disinflationary effect of tight monetary policy, falling global commodity prices, declining domestic consumption and the Government's measures to strengthen market competition would become increasingly apparent. The pace of disinflation continued to accelerate. As a result, inflation was expected to decline to the single digit range during the autumn. The consumer price index was expected to return to the central bank tolerance band in early 2025.

The fiscal deficit would continue to decline this year. The budget appropriation for the 2023 deficit was 3.9 percent. The government debt ratio was expected to fall from 73.3 percent at the end of 2022 below 70 percent by the end of 2023, driven by nominal GDP growth and a declining deficit.

The rapid improvement in the external balance had continued. At nearly EUR 550 million, the current account had registered a significant surplus in June 2023, primarily due to a trade surplus of EUR 1.7 billion, a record level. The trend-like improvement in the external balance had been driven by the more favourable energy balance and terms of trade, the adjustment of domestic demand and stable export growth. This year, the current account deficit was expected to be more favourable than projected in June, being below 2 percent of GDP as the trade balance improves. In parallel with the utilisation of new export capacities built recently and a normalising global economic environment, the trade balance and net lending would continue to improve in 2024.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its August monetary policy decision. Council members assessed data on global economic growth in the second quarter and the outlook for global growth. Several members pointed out that the outlook for economic activity in major economies was surrounded by uncertainty. The general opinion of the Council was that global inflation continued to fall but core inflation indicators remained high.

In assessing inflation data for July, decision makers underlined that the rapid decline in domestic inflation had continued. Council members highlighted that there had been a broad-based slowdown in inflation, with prices falling in nearly one-third of the consumer basket on a monthly basis. Decision makers stressed that looking ahead, the pace of disinflation would continue to accelerate, and as a result, the consumer price index was expected to fall noticeably below 10 percent in the autumn. However, several members highlighted the importance of a cautious approach, as world oil prices had risen, and disinflation in market services had started later and at a slower pace. Some members pointed out that the effects of tight monetary conditions had played a decisive role in domestic disinflationary developments. Two-thirds of the decline in price growth since January was attributable to market developments affected by monetary policy. It was noted by several members that disinflation had to continue in 2024 in order to achieve price stability.

Discussing domestic real economic developments, the Monetary Council concluded that the decline in economic performance had continued in the second quarter. Some decision makers emphasised that agricultural performance and that of the health and social care sector had moderated the decline. The Council agreed that the main reason behind the economic decline had been the contraction in domestic demand arising from high inflation. It was the unanimous view of members that high-frequency data suggested that economic growth might pick up gradually from the second half of the year, which was supported by rising real wages in parallel with declining

inflation and a correction in agricultural production. Decision makers highlighted that the trade surplus had been at a record high in June. In the Council's assessment, the record improvement in the current account this year was primarily driven by domestic adjustment due to subdued household consumption, the sale of stocks accumulated earlier, a rise in the services balance and favourable export sales. Some members pointed out that this year, the current account deficit was expected to be more favourable than projected in June, being below 2 percent of GDP as the trade balance improves.

Decision makers underlined that domestic financial markets had recently been more sensitive to changes in the international environment compared to the region. The Council unanimously agreed that the continued risks, i.e. the persistently high interest rate conditions of the world's leading central banks, negative developments of the Chinese economy and uncertainty caused by the Russia-Ukraine war, warranted a cautious and gradual approach to monetary policy. The persistence of improvements in risk perceptions had to be assessed carefully.

Monetary Council members agreed that it was necessary to maintain tight monetary conditions in order to achieve price stability. The Council unanimously agreed that, at 13 percent, the current level of the base rate ensured that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. Decision makers noted that with the acceleration of disinflation, the domestic real interest rate would soon move to positive territory, which would help to achieve the inflation target.

Members were of the view that it was still necessary to maintain a cautious and gradual approach. Council members agreed that, in taking its decision in August, the central bank should continue to move the interest rate conditions of one-day tenders closer to the base rate at the previous pace for the fourth time in a row. Accordingly, the Monetary Council unanimously decided to reduce the upper bound of the interest rate corridor and the interest paid on optional reserves by 100 basis points to 16.5 percent and 14.0 percent, respectively. Decision makers unanimously indicated that it was warranted to reduce the interest rate on one-day quick deposit tenders and foreign exchange swap tenders by 100 basis points. It was also pointed out by several members that the gap between the interest rate on one-day tenders and the base rate should be closed depending on the improvement in the risk environment, which should also be considered at the next policy meeting. Decision makers indicated that if the improvement in risk perceptions persisted, the Bank would continue to close the gap between the interest rate conditions of one-day tenders and the base rate.

Decision makers agreed that by closing the gap between the interest rate on the one-day quick deposit tenders and the base rate, monetary policy would enter a new phase. In this new phase, monetary policy would still focus on achieving the inflation target and maintaining financial market stability. The Council unanimously argued that in the new phase, the adjustment of interest rate conditions should be decided step-by-step, in a data-driven manner and in a cautious approach. Several members pointed out that the new phase would provide an opportunity to further simplify the monetary policy toolkit, where continuity would play an important role. Decision makers were of the view that the evolution of disinflation and Hungary's risk assessment should be monitored closely.

In the Monetary Council's assessment, it was necessary to maintain tight monetary conditions in order to achieve price stability. At its meeting on 29 August 2023, the Council left the base rate unchanged at 13 percent. The current level of the base rate was adequate to manage fundamental inflation risks. With the acceleration of disinflation, the domestic real interest rate would soon move to positive territory, which would help to achieve the inflation target.

The Monetary Council continued to normalise the interest rate environment at the previous pace in August. In accordance, the Council decided to reduce the interest paid on optional reserves by 100 basis points, from 15 to 14 percent at its meeting on 29 August 2023, with effect from 30 August. In addition, the O/N collateralised lending rate serving as the upper bound of the interest rate corridor was lowered by 100 basis points to 16.5 percent. In the Council's assessment, it was also warranted to reduce the interest rate on one-day quick deposit tenders and foreign exchange swap tenders by 100 basis points.

In the Monetary Council's assessment, looking ahead, strengthening monetary policy transmission was also an important factor of achieving price stability. For this reason, the Bank would use the instruments to absorb interbank forint liquidity on a long-term basis in the coming period.

In the Monetary Council's assessment, maintaining the current level of the base rate would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. Looking ahead, financial market stability was also key to achieving price stability. In the current environment, a cautious and gradual approach was warranted. The MNB was constantly assessing the effects of international financial market developments on the domestic risk environment, incoming macroeconomic data and developments in the outlook for inflation. If the

improvement in risk perceptions persisted, the Bank would continue to close the gap between the interest rate conditions of one-day tenders and the base rate.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 13.00 percent, reducing the overnight collateralised lending rate to 16.5 percent and maintaining the interest rate on the overnight central bank deposit at 12.50 percent:	7	Éva Búza, Péter Gottfried, Csaba Kandrács, Zoltán Kovács, György Matolcsy, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

The following members of the Council were present at the meeting:

Éva Búza

Péter Gottfried

Csaba Kandrács

Zoltán Kovács

György Matolcsy

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 26 September 2023. The minutes of that meeting will be published at 2 p.m. on 11 October 2023.