MINUTES
OF THE MONETARY COUNCIL MEETING
28 MARCH 2023

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Article 3 (1) of the Central Bank Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines the achievement and maintenance of price stability as the Magyar Nemzeti Bank's primary objective. 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.

Global economic growth had slowed further in the fourth quarter of 2022; nevertheless, GDP growth had been more favourable than expected in most EU countries. The global growth outlook continued to be characterised by duality. The escalation of market concerns related to certain banks, the prolonged Russia-Ukraine war and the generally rising interest rate environment caused downside risks. By contrast, the mild winter weather and the favourable level of gas storage facilities mitigated the adverse effects of the energy crisis in Europe, which pointed to an improvement in the outlook for growth.

Inflation had been moderating slowly but clearly in an increasing number of countries. The slowdown in global economic activity, weakening demand, the correction in global energy and commodity prices and the fall in international freight costs pointed to a further decline in global inflation.

Investor sentiment had deteriorated since the Monetary Council’s last policy decision. From mid-March, the escalation of concerns about the stability of certain banks had led to an increase in global risks and, as a result, expectations about future actions of the world’s leading central banks had changed significantly and the risk assessment of emerging market assets had deteriorated.

In March, the Federal Reserve (Fed) and the European Central Bank (ECB) had raised interest rates by 25 and 50 basis points, respectively. Reacting to financial market turbulences in the wake of bank failures, the Fed had launched a new funding scheme and improved liquidity by introducing dollar swap lines through a cooperation with several central banks. In its press release, the ECB had emphasised that the euro area banking sector had been resilient, with strong capital and liquidity positions. Central banks in the CEE region had not changed monetary conditions since the MNB’s February policy decision.

The Hungarian economy had grown by 4.6 percent in 2022. Growth dynamics had slowed down in the last quarter of the year. Based on detailed data, GDP had grown by 0.4 percent in the last three months of the previous year relative to a year earlier, with industry and market services being the main contributing sectors. By contrast, the significant decline in agricultural output had acted as a brake on growth. In January, the volume of retail sales and construction output had fallen significantly, while industrial production had decreased to a smaller extent. Based on surveys, production prospects had improved overall in the past month, while the household confidence indicator was still at a low level. The labour market remained tight, and the unemployment rate was low.

The time profile and structure of domestic GDP was expected to be characterised by a duality this year. Output growth would be weighed down mainly by domestic demand factors, as high inflation reduced the purchasing power of household incomes, which in turn caused a further slowdown in consumption. Rises in corporate costs and the uncertain demand outlook were expected to result in the postponement and rescheduling of investments. Economic growth was expected to pick up again from the second half of the year as inflation declined markedly and investment recovered. Both internal and external factors might make a positive contribution to growth in 2024. Hungary's GDP would increase by 0.0–1.5 percent in 2023, by 3.5–4.5 percent in 2024 and by 3.0–4.0 percent in 2025.

Domestic inflation had peaked in January 2023. In February, annual inflation had been 25.4 percent and core inflation had stood at 25.2 percent. Inflation had slowed by 0.3 percentage points compared to the previous month, to which the decline in fuel prices and the slowdown in the price dynamics of processed food had contributed the most. Food price inflation had slowed for the second consecutive month in February, reflecting a slight moderation in the annual index of both processed and unprocessed food. Inflation expectations continued to be elevated; however, corporate price expectations for retail sales and services had been below their peak values of last summer for several months.

In the coming months, the consumer price index was expected to decrease slowly at first, then at an increasingly rapid pace. Tight monetary conditions were expected to have broader disinflationary effects, leading to a substantial slowdown in inflation. There had been a significant decline in energy and commodity prices as well as in international freight costs, tensions in value chains had eased, and the slowdown in global economic activity had also acted as a restraint on external inflation. The decline in domestic demand had reduced companies' room for manoeuvre regarding price increases, and actions of the Hungarian Competition Authority acted in the direction of an increasingly disciplined pricing behaviour. The consumer price index would return to the central bank tolerance band in 2024. Inflation was projected to be 15.0–19.5 in 2023, 3.0–5.0 in 2014 and 2.5–3.5 in 2025.

Based on preliminary financial accounts data, the deficit target for 2022 had been met. The fiscal deficit would continue to decline in the coming years. The fiscal deficit was projected to be 3.9

percent in 2023, while the plans for 2024 and 2025 were 2.5 and 1.5 percent, respectively. The decline in energy prices helped to contribute to meeting the deficit targets; however, tight budget management was necessary to achieve the targets. Based on preliminary data, the government debt ratio had decreased to 73.6 percent of GDP by the end of 2022, and it was expected to decline to 69 percent this year and close to 65 percent by the end of the forecast horizon. The current account deficit would decline steadily from 2023, it had improved by EUR 0.9 billion in January 2023 from a low of EUR 1.7 billion last November, reflecting buoyant exports, the slowing growth in imports due to a slowdown in investment and consumption dynamics, in addition to an improvement in the energy balance driven by a decline in energy prices. In parallel with a normalising global economic environment and the utilisation of new export capacities built recently, the trade balance would continue to improve in 2024. As a result, the current account deficit would halve in 2023 and the country's net lending will turn positive again towards the end of the forecast horizon.

Since mid-October 2022, the risk assessment of the Hungarian economy had improved. However, concerns about certain participants of the global banking system had increased uncertainty in international financial markets, which had led to strong volatility in emerging markets. The MNB closely monitored the extent and persistence of changes in the risk environment.

The capital and liquidity position of domestic banks were stable; banks continuously complied with regulatory requirements with robust buffers based on regularly performed stress tests and were able to meet the economy's financing needs. Financial market turbulences had been accompanied by a general decline in bank share prices around the world. However, the stability of the European banking sector had improved significantly in the past decade, due in part to much stricter regulation than before.

Following the review of macroeconomic and financial market developments as well as the March Inflation Report projection, the Monetary Council discussed the details of its March monetary policy decision. In the Council's assessment, the outlook for global growth continued to be characterised by duality. In the Council members' view, concerns related to the stability of certain American and European banks emerged as another external risk factor, while the protracted Russia-Ukraine war and the generally rising interest rate environment still carried downside risks. However, the mild winter weather and the easing of energy-related issues in Europe improved the outlook. Members noted that inflation had started to decline in an increasing number of countries and several factors pointed to a further slowdown in global inflation.

Discussing domestic real economic developments, the Monetary Council concluded that the economy had slowed further in the last quarter of 2022. In the context of this year's economic growth, several members drew attention to the duality of the time profile and structure. As regards the time profile, some members stressed that the pace of the decline in inflation and the revival of investments would be crucial in determining when growth would return. In the context of structural duality, a few members pointed out that this year's output was weighed down by domestic demand items, while net exports were expected to make a positive contribution to growth. In terms of external balance developments, the Council concluded that a trend-like improvement had started at the end of last year. The current account deficit was expected to halve in 2023 and the country's net lending to turn positive again from 2025.

Council members agreed that domestic inflation had peaked in January. After January, food price inflation had slowed also in February, indicating a continued decline in inflation. Members were unanimous in arguing that in the coming months, inflation would fall slowly at first, and then at an increasing pace. Several Council members underlined the strengthening effect of monetary policy, disciplining pricing decisions. Tight monetary conditions were fuelling disinflation in a growing number of markets and product groups. Some members pointed out that based on international experience, the rapid reduction in high inflation might be achieved through disciplined and coordinated economic policy. With regards to inflation, decision-makers welcomed the increasingly active actions of the Hungarian Competition Authority.

Council members were in agreement that financial market stability had strengthened in different sub-markets as a result of the overnight central bank facilities introduced last autumn and central bank measures to absorb interbank forint liquidity on a long-term basis. However, the Council shared the view that the events affecting the global banking system in recent weeks had led to strong volatility in emerging markets. As a result, decision-makers were closely monitoring the extent and persistence of these effects as well as the related potential changes in the risk assessment of the Hungarian economy. In the context of developments related to banks in developed markets, Monetary Council members generally highlighted that the domestic banking sector's capital and liquidity indicators were exceptionally stable and domestic banks were excelling in complying with regulatory requirements.

The Council agreed that the increase in the reserve requirement ratio effective from 1 April would simultaneously strengthen financial stability and monetary transmission. Some Council members stressed that the system of tiered interest rates, under which the MNB pays the one-day deposit quick tender rate on optional reserves, encouraged an increase in the share of liquidity tied up on a long-term basis.

Council members were unanimously of the view that improving the effectiveness of monetary transmission and supporting market stability would be key to achieving price stability in the future. Decision-makers argued that, in the coming period, it was necessary to use the regular central bank discount bill auctions as well as the long-term deposit tender, and, of the instruments to achieve market stability, one-day deposit quick tenders and FX swap transactions. The Council agreed that the euro swap instrument related to energy imports had achieved its objective, and therefore, as energy prices normalised, members decided that the facility should remain available until the end of March. Nevertheless, some members highlighted the importance that the Bank continuously monitored the effects of foreign currency conversions resulting from the coverage of energy imports in the future as well and would be ready to use the euro swap instrument again if warranted.

In the Monetary Council's assessment, a patient approach was still warranted in the shaping of monetary conditions. Accordingly, all Council members argued that it was essential to maintain the current level of the base rate over a prolonged period and to continue to apply an 18 percent interest rate on the overnight deposit instrument. Some members pointed out that looking ahead, the proper functioning of monetary policy transmission and the stability in different sub-markets were essential to achieve price stability. The Council agreed that it was necessary to take into account persistent changes in risk perceptions when setting the conditions of the overnight instruments introduced in mid-October.

The Monetary Council left the base rate unchanged at 13 percent at its meeting on 28 March 2023. The current level of the base rate was adequate to manage fundamental inflation risks. The O/N deposit rate and the O/N collateralised borrowing rate were left unchanged at 12.5 percent and 25 percent, respectively.

The Monetary Council highlighted four alternative scenarios around the baseline projection in the March Inflation Report. The risk scenario featuring decelerating global economic activity presumed growth and inflation paths that were lower than the baseline scenario. The scenario presenting an increase in the risk of second-round inflationary effects presumed a higher inflation path and a somewhat higher growth path compared to the baseline scenario. In the alternative scenario presuming capital withdrawal from the emerging markets, higher inflation was accompanied by more moderate growth. As a result of the more cautious consumer behaviour, the risk scenario assuming lower consumption resulted in a lower inflation and growth path compared to the baseline scenario.

There had been a general and broad-based increase in the yield environment as a result of the MNB's instruments introduced last autumn to absorb interbank forint liquidity on a long-term basis, i.e. the revised reserve requirement system, the one-week discount bill and the long-term deposit tender. These measures had led to a sustained improvement in monetary policy transmission, and therefore, based on this positive experience, the MNB would continue to use these instruments in the next period in order to achieve the goal of price stability.

Consistent with its earlier announcement, the Monetary Council would further tighten the effect of required reserves on interbank liquidity by raising the reserve requirement ratio and changing its interest rate structure from 1 April. According to the January decision, the required reserve ratio would rise to 10 percent. In addition, pursuant to the Council's February decision, a system of tiered interest rates would be applied to the reserve account, which encouraged increase in the share of liquidity tied up on a long-term basis further enhancing monetary policy transmission.

In addition to strengthening monetary policy transmission, the MNB would use one-day deposit quick tenders and FX swap transactions in the coming period in order to ensure financial market stability. Furthermore, the Bank promoted financial market stability by using its euro liquidity providing swap instrument and its central bank discount bill with maturities extending through the end of the quarter.

In the Monetary Council's evaluation, the euro swap instrument related to energy imports had contributed effectively to achieving stability in the foreign exchange market. The decrease in energy market prices in recent months resulted in a gradual improvement in the energy balance. In line with this, there had been a significant decline in energy importing companies' need for foreign currency hedging. Taking into account the purpose of the instrument and financial market developments, the Monetary Council had decided that the instrument would remain available until 31 March 2023. The Magyar Nemzeti Bank would closely monitor the effects of foreign currency conversions resulting from the coverage of energy imports and would be ready to use the euro swap instrument again if warranted.

In the Monetary Council's assessment, it was necessary to maintain the current level of the base rate over a prolonged period, which would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. The MNB was constantly assessing incoming data and developments in the outlook for inflation and was ready to take appropriate actions if risks increased. Looking ahead, maintaining market stability and strengthening monetary policy transmission were also key to achieving price stability. The Bank was closely monitoring the effects of increased uncertainty in international financial markets on the risk environment. The MNB would continue to take into account persistent changes in risk perceptions when setting the conditions of overnight instruments introduced in mid-October.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 13.00 percent, **the overnight collateralised lending rate at 25.00 percent** **and** **maintaining the interest rate on the overnight central bank deposit at 12.50 percent:**	8	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, Zoltán Kovács, Mihály Patai, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

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

Péter Gottfried

Csaba Kandrács

Kolos Kardkovács

György Kocziszky

Zoltán Kovács

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 25 April 2023. The minutes of that meeting will be published at 2 p.m. on 10 May 2023.