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BACKGROUND DISCUSSION FOLLOWING THE MONETARY COUNCIL'S 23 APRIL DECISION

Analyst background discussion

23 April 2024



MAIN MESSAGES: MONETARY POLICY

- **In April, monetary policy entered a new phase.**
- **Disinflation has been strong and broad-based in the Hungarian economy. Market services inflation is slowly decreasing from a high level, which the Monetary Council is following with special attention.**
- **Historically high foreign exchange reserves and the persistent improvement in the current account balance** have contributed to the strengthening of the country's risk perception; however, **in the deteriorating international sentiment, the risk premium on Hungarian assets has also risen** recently.
- **The Fed's expected interest rate path**, based on market pricings, **shifted further upwards**, while expectations for the path of the ECB's policy rate remained broadly unchanged.
- **The outlook for inflation and increasing risk aversion warrants a further reduction in the base rate at a slower pace than before.** The volatile risk environment warrants a **careful and patient approach** to monetary policy.
- **Preserving the financial market stability remains a priority.**
- At its meeting today, the Council **cut the base rate by 50 basis points to 7.75 percent.**
- **The Council is constantly assessing** incoming macroeconomic data, the outlook for inflation, also developments in the risk environment, and **is proceeding at a slower pace than before, month by month, taking decisions on any further reductions in the base rate in a data-driven manner.**



MAIN MESSAGES: MACROECONOMIC ASSESSMENT AND OUTLOOK

- **Consumer prices have risen 3.6 percent in March** on a year-on-year basis, thus inflation has remained within the central bank's tolerance band this year. **Core inflation has decreased to 4.4 percent** on a yearly basis.
- **Prices are expected to increase at a temporarily higher pace mid-year** due to the backward-looking pricing of market services and base effects.
- Disinflation is being slowed down by **high, slowly decreasing services inflation, which is generally present in the global economy.**
- **Expected interest rate paths of major global central banks have shifted higher** since the start of the year, in parallel with **rising long-term yields in developed markets. Risk aversion towards emerging market currencies has intensified.**
- **The current account surplus has reached a new historical peak.** As a percentage of GDP, the current account is expected to improve moderately in 2024, and to a larger extent over the coming years.
- The general government's budget deficit is expected to decrease in 2024, **the primary balance is projected to reach near equilibrium levels** again after five years.

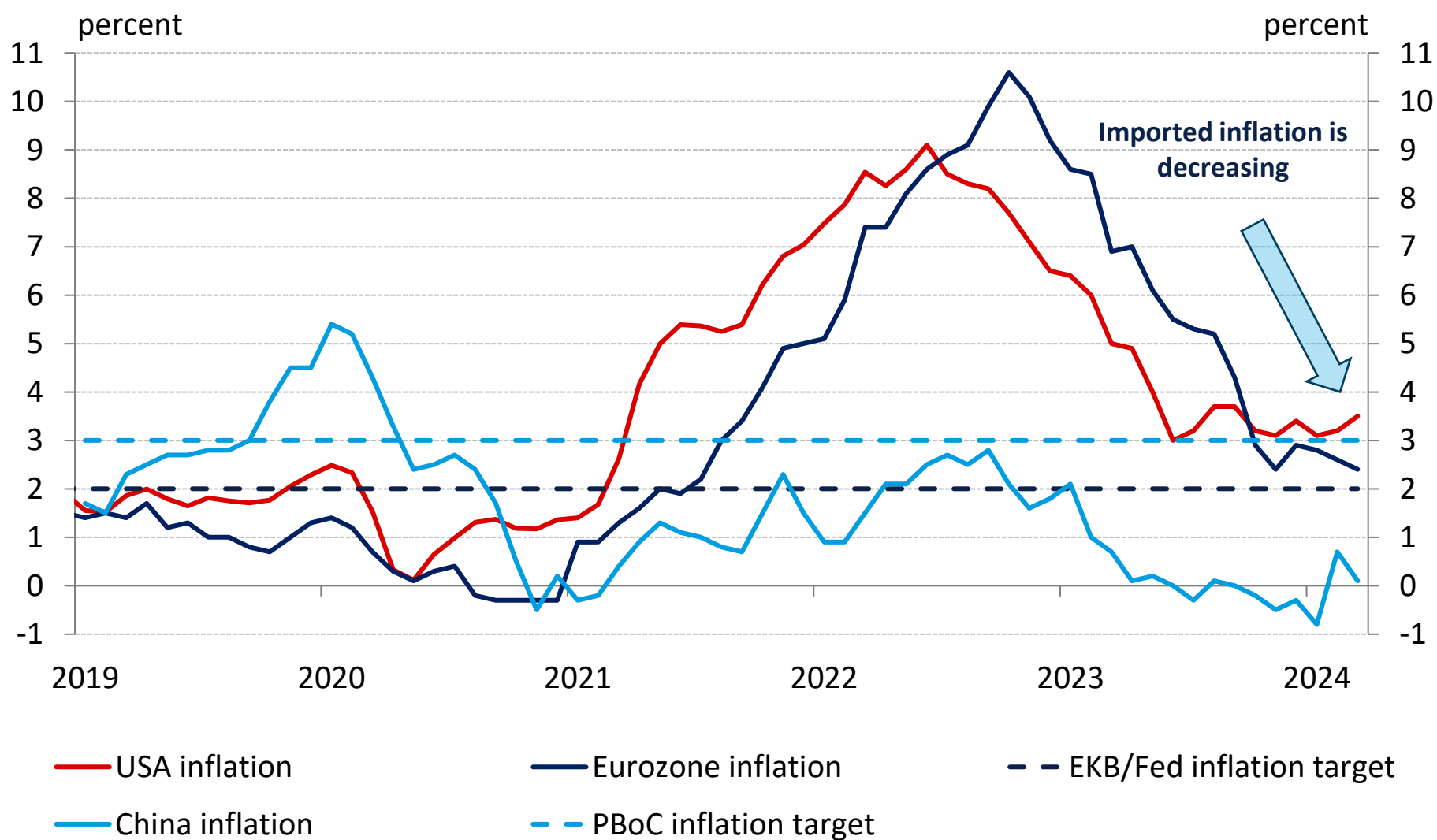


MACROECONOMIC ASSESSMENT AND OUTLOOK





INFLATION HAS REACHED A LOW LEVEL GLOBALLY...

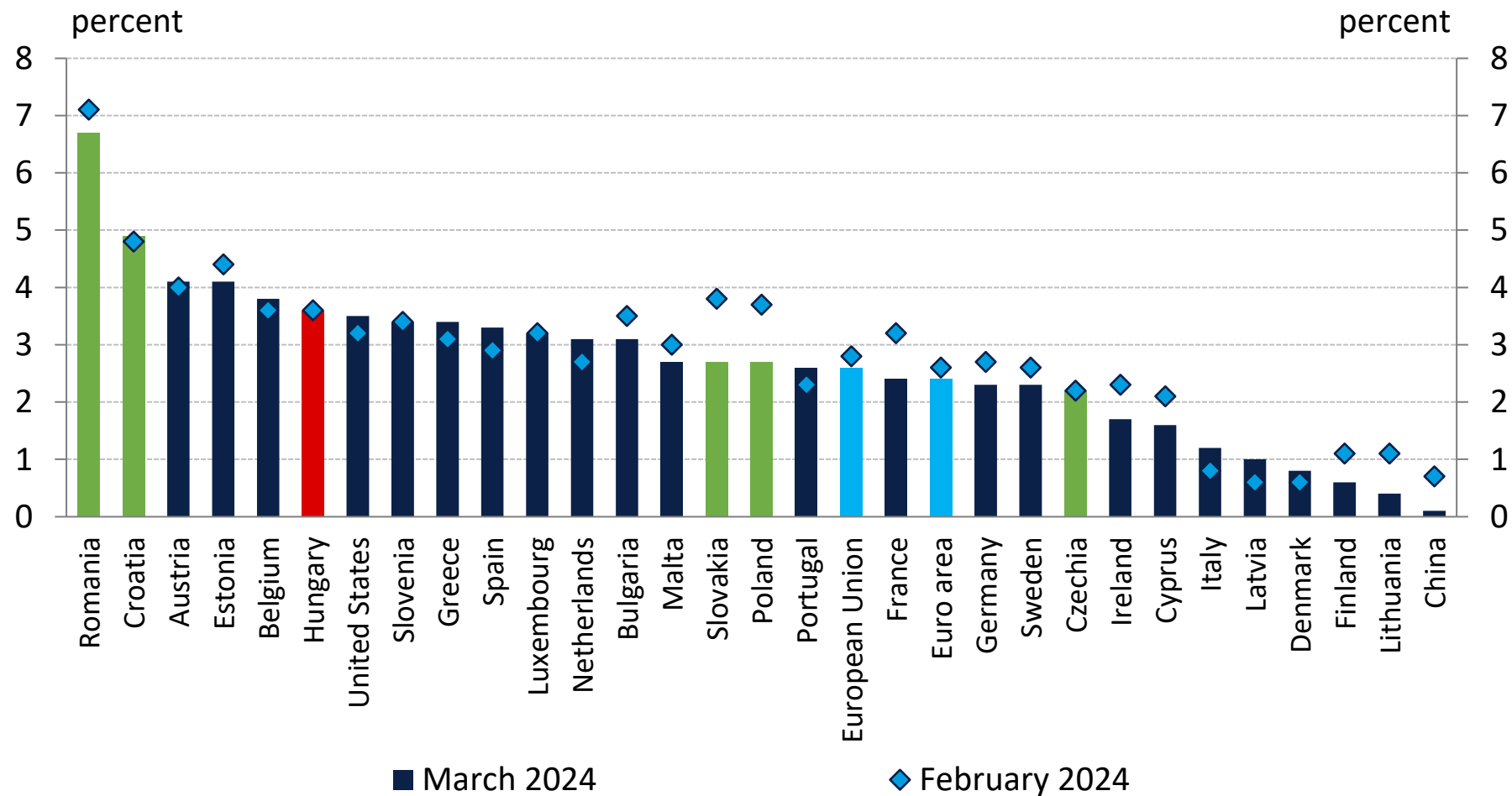


INFLATION IN THE UNITED STATES, CHINA AND THE EURO AREA

Source | Eurostat, OECD



...BUT DISINFLATION HAS SLOWED DOWN



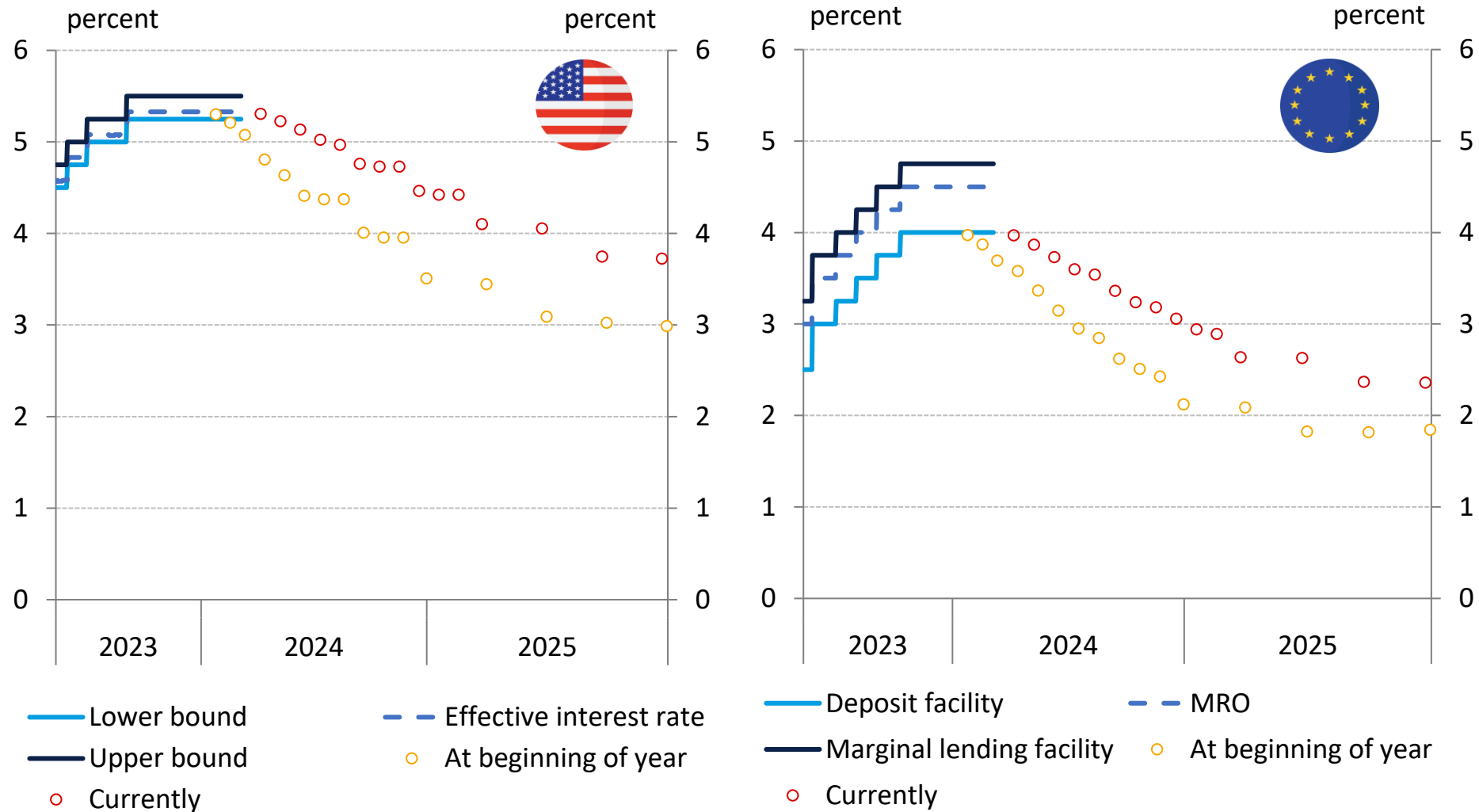
INFLATION IN MARCH AND IN FEBRUARY 2024

Note | Based on HICP data.

Source | Eurostat, MNB



THE FED'S EXPECTED INTEREST RATE PATH HAS SHIFTED FURTHER UPWARDS SINCE MARCH, THE ECB'S PATH HAS NOT CHANGED SIGNIFICANTLY

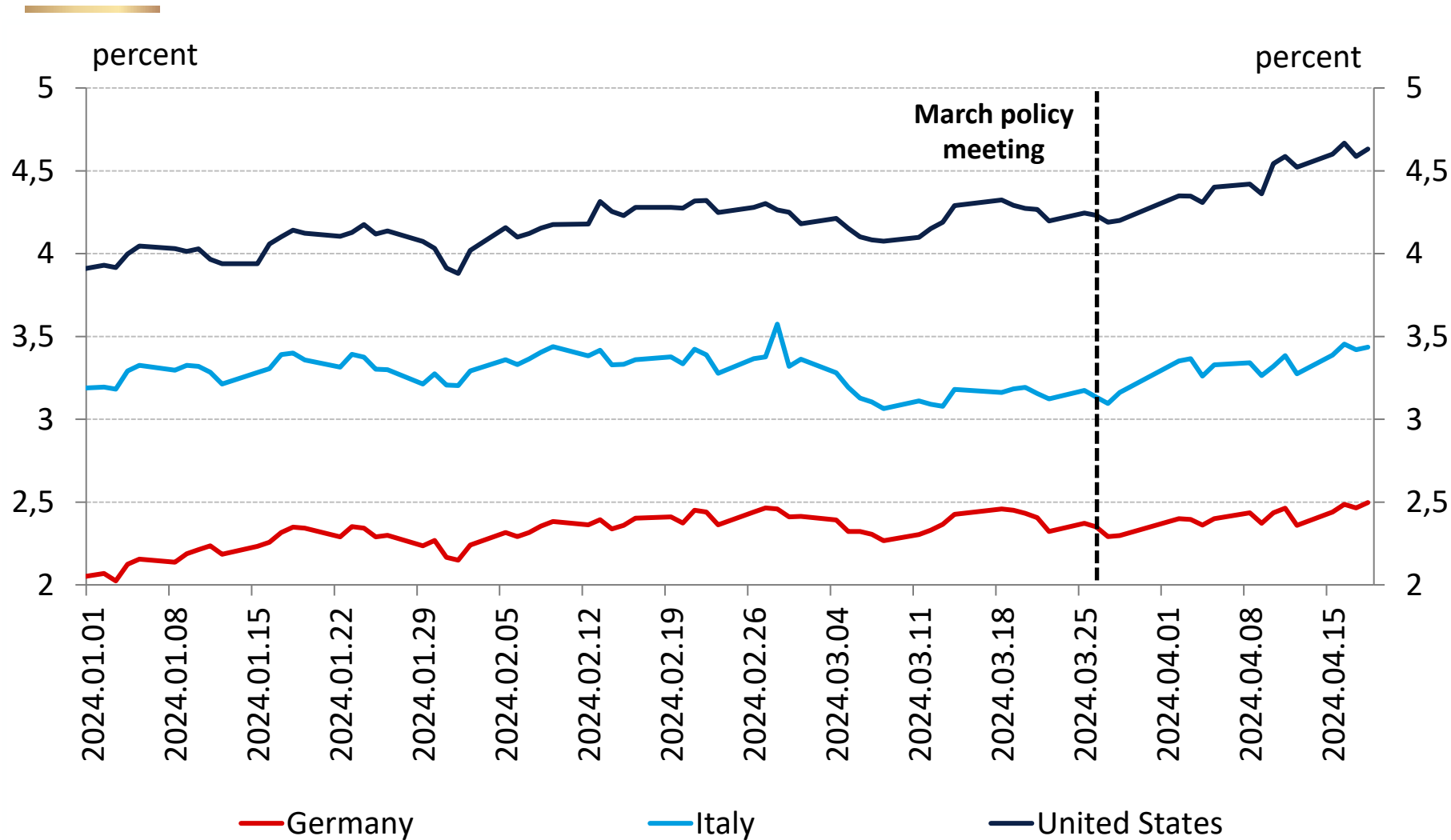


EXPECTED INTEREST RATE PATHS OF THE FED AND THE ECB BASED ON MARKET PRICINGS

Source | Bloomberg



LONG-TERM YIELDS IN DEVELOPED MARKETS HAVE INCREASED

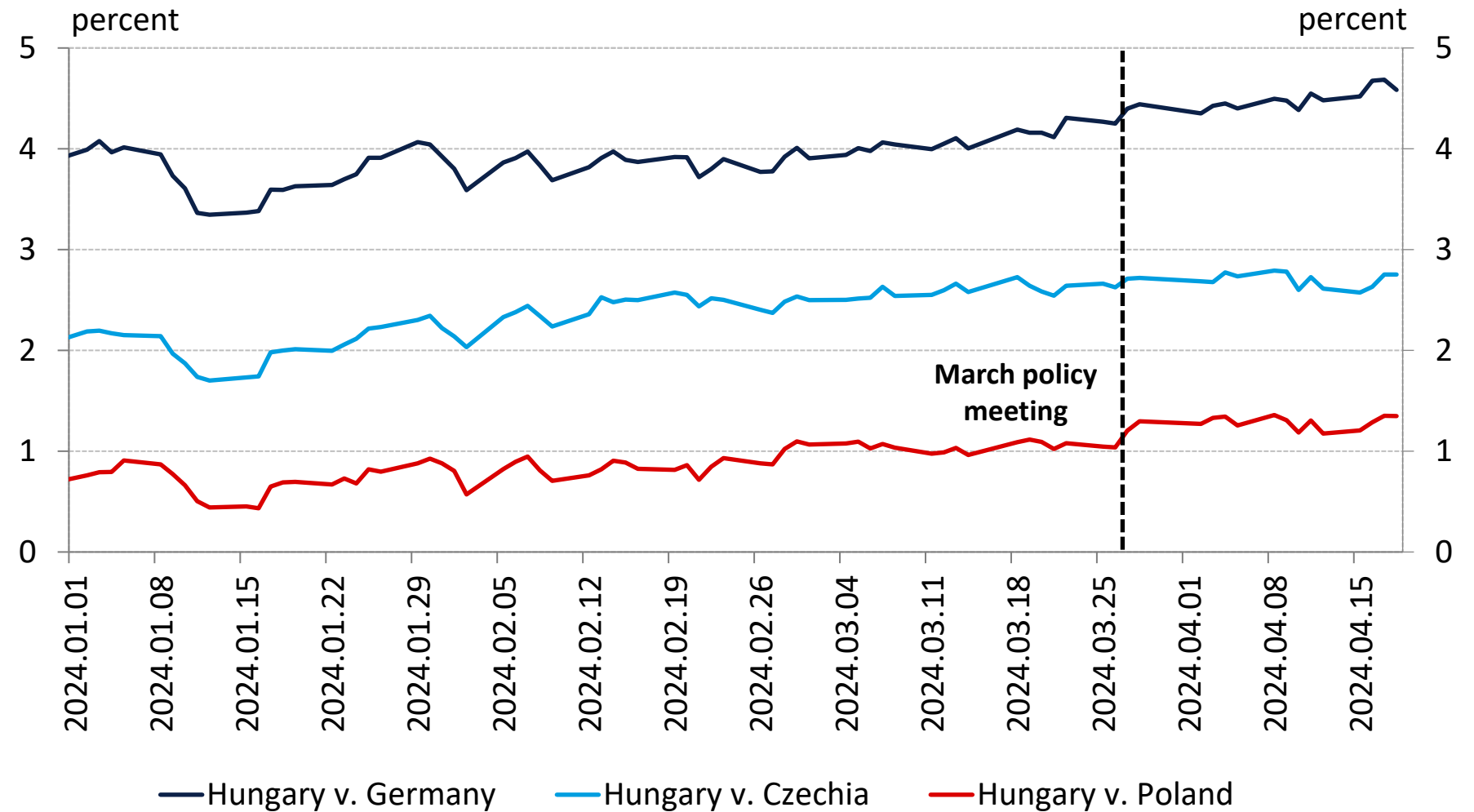


10-YEAR GOVERNMENT BOND YIELDS IN DEVELOPED MARKETS

Source | Bloomberg



HUNGARY'S SPREAD HAS INCREASED AGAINST GERMAN, POLISH AND CZECH 10-YEAR YIELDS

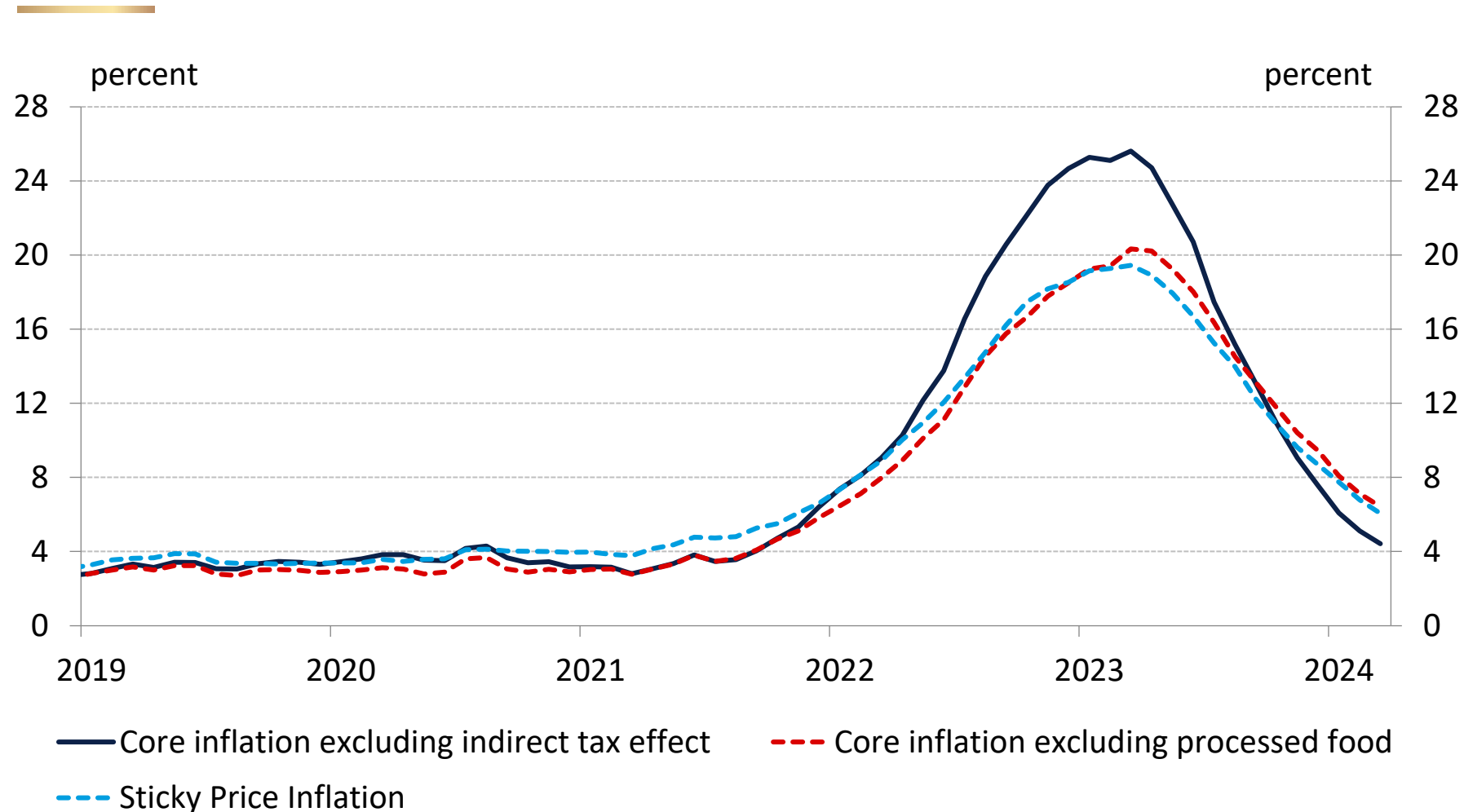


10-YEAR HUNGARIAN GOVERNMENT BOND SPREADS AGAINST GERMAN AND REGIONAL SOVEREIGN YIELDS

Source | Bloomberg



UNDERLYING INFLATION HAS DECREASED FURTHER

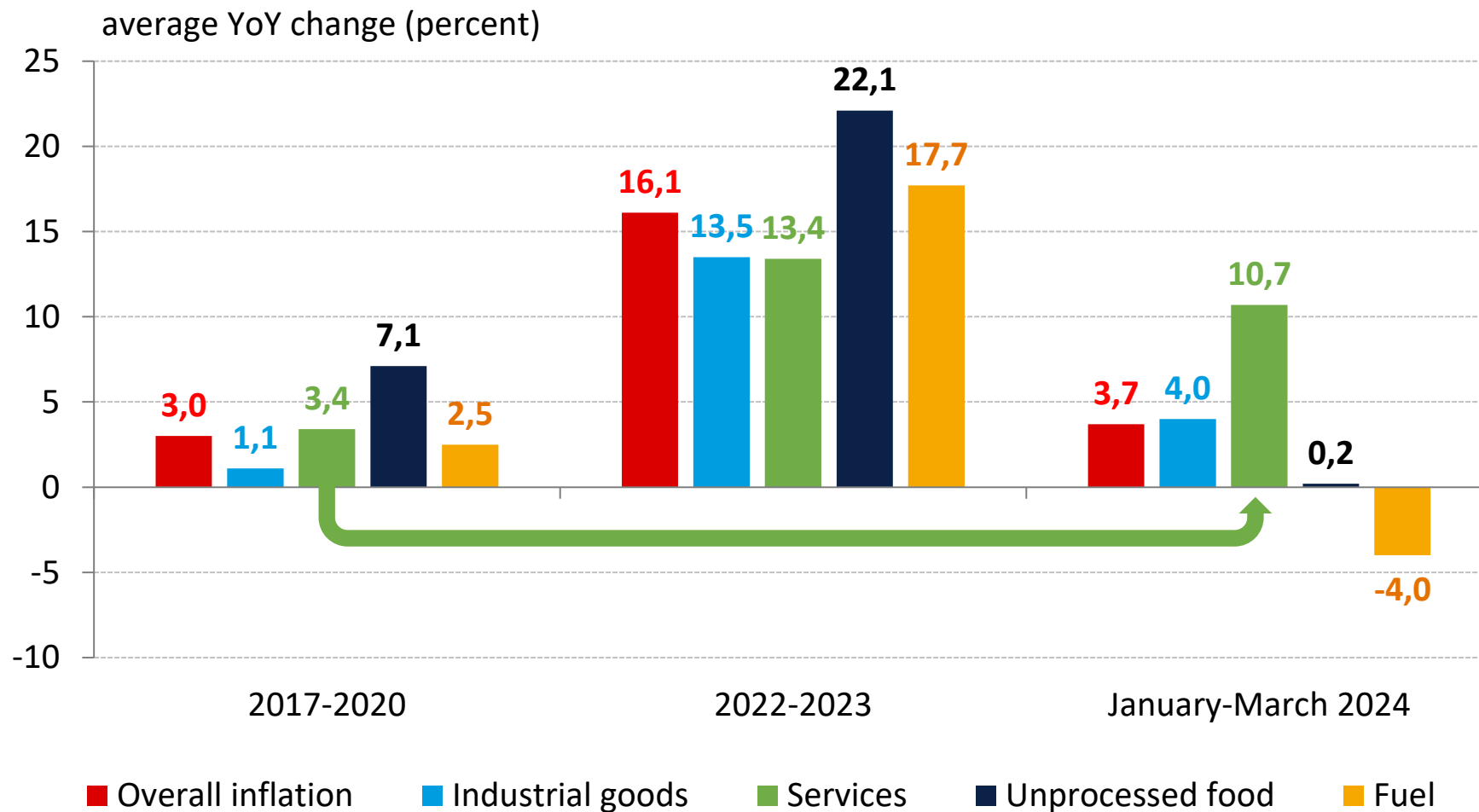


DEVELOPMENT OF UNDERLYING INFLATION INDICATORS

Source | HCSO, MNB



THE COMPOSITION OF INFLATION HAS CHANGED, WITH SERVICES INFLATION AT HIGHER LEVELS

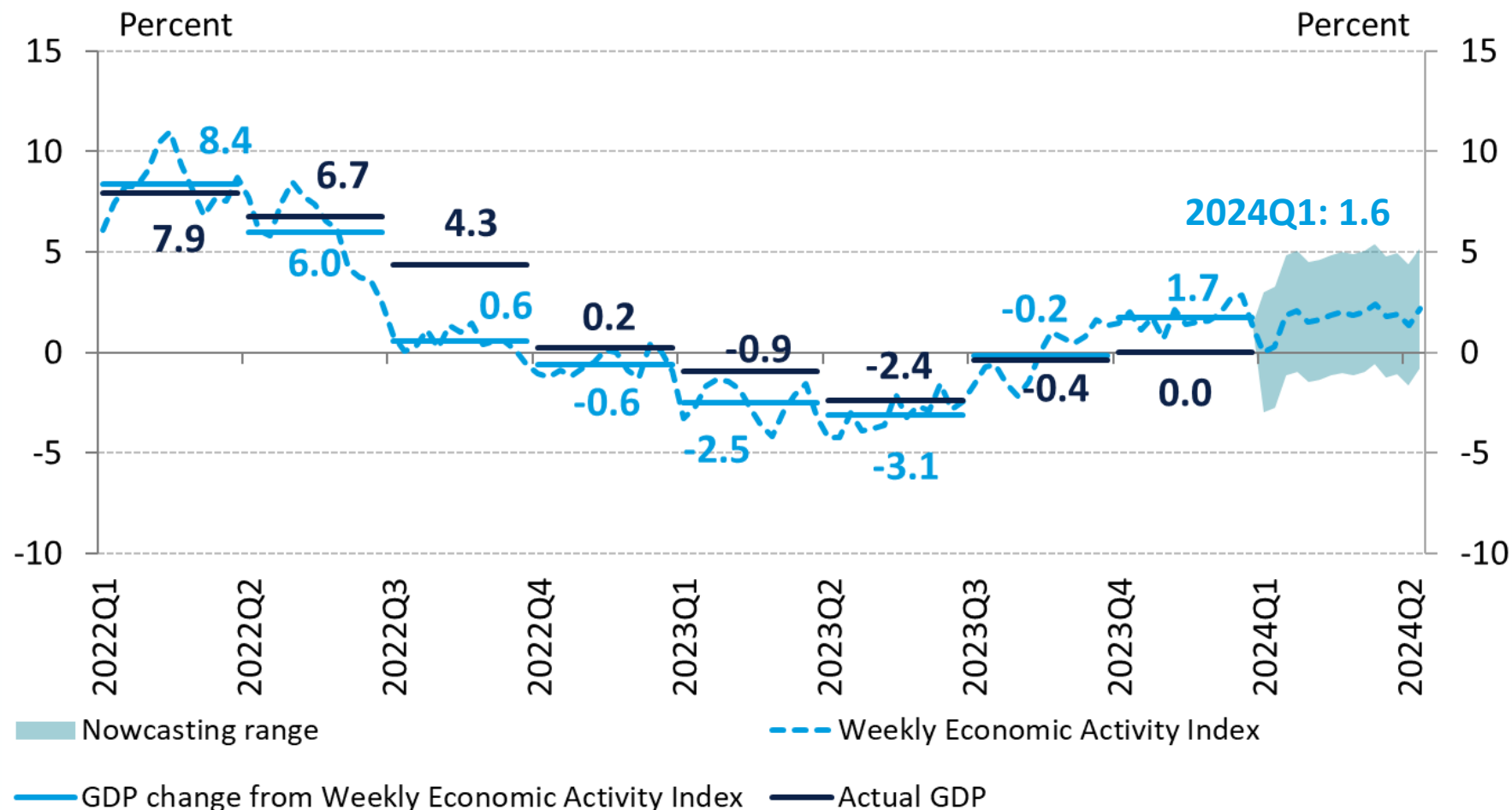


THE AVERAGES OF ANNUAL PRICE INCREASES OF CERTAIN MAIN INFLATION GROUPS IN RECENT YEARS

Source | HCSO, MNB



IN EARLY 2024, A SLOW RECOVERY HAS FOLLOWED THE DOWNTURN OF 2023



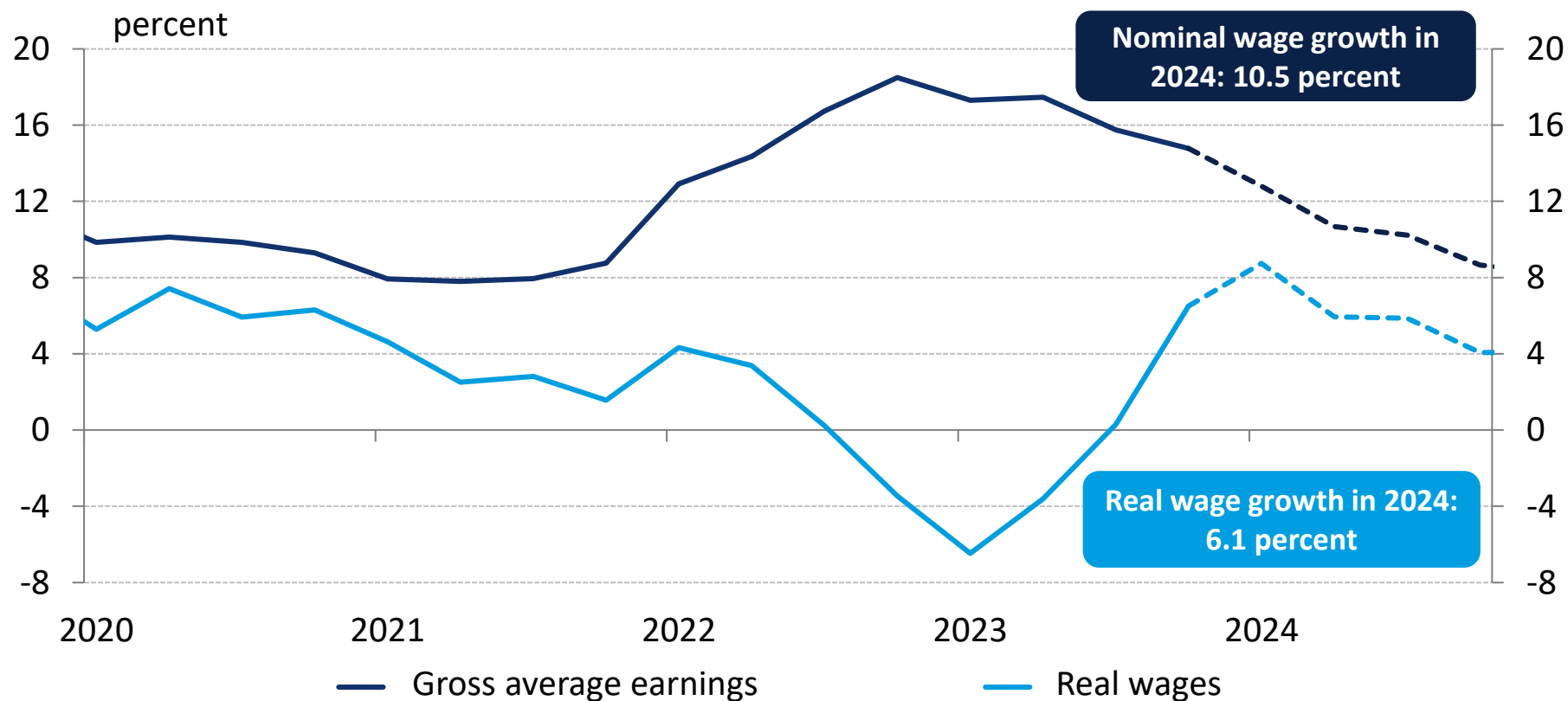
WEEKLY ECONOMIC ACTIVITY INDEX, YOY CHANGE

Source | Calculation by MNB, HCSO



NOMINAL WAGES ARE EXPECTED TO INCREASE AT A SLOWER PACE THAN LAST YEAR, BUT REAL WAGES CONTINUE TO RISE SIGNIFICANTLY

Average earnings in the national economy as a whole have increased by 14.7 percent, above analysts' expectations at 14 percent.

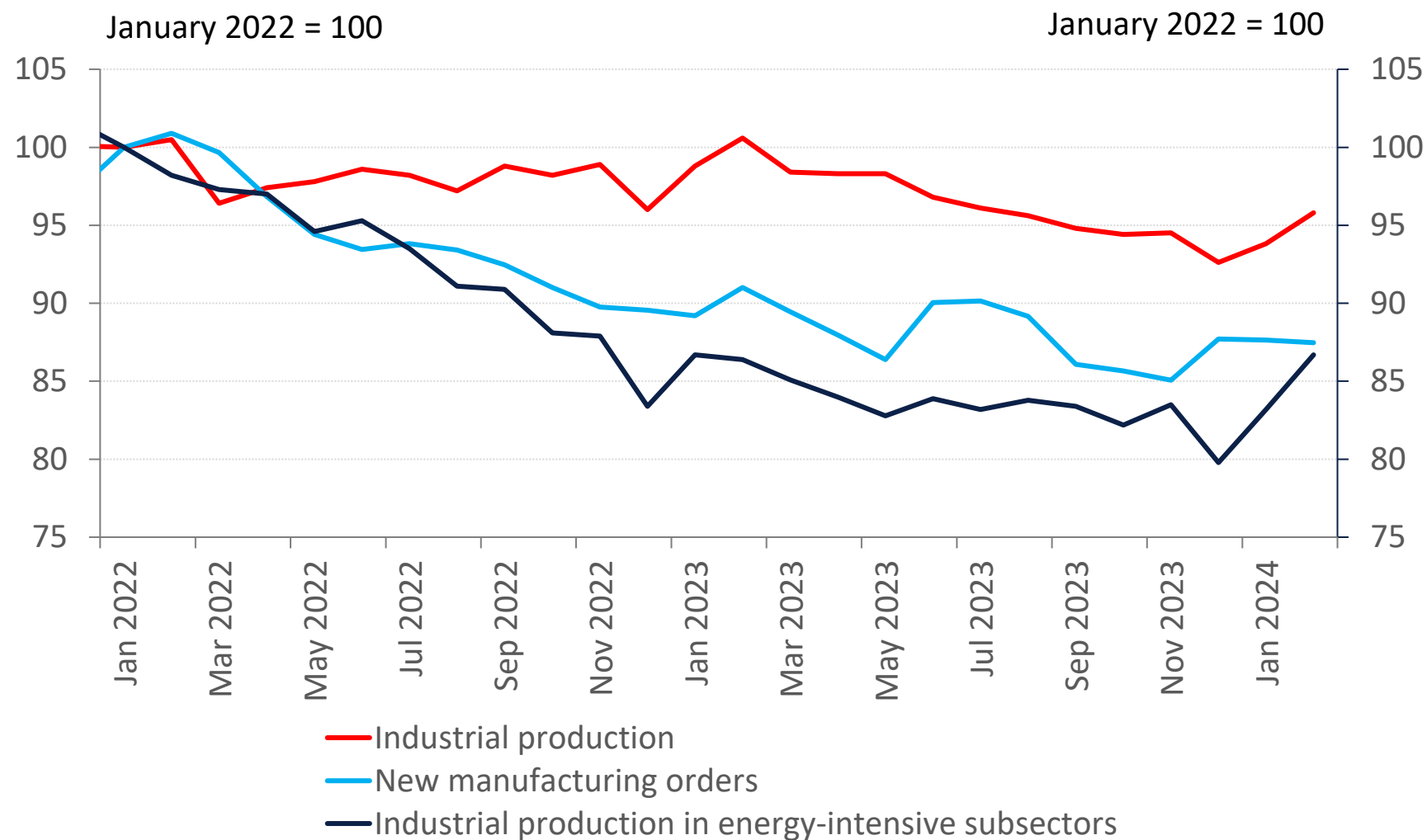


EVOLUTION AND PROJECTION OF YOY CHANGES IN GROSS AVERAGE EARNINGS IN THE PRIVATE SECTOR

Source | HCSO, MNB



KEY INDUSTRIAL INDICATORS SIGNAL THE PERSISTENCE OF WEAK DEMAND FROM MAIN TRADING PARTNERS



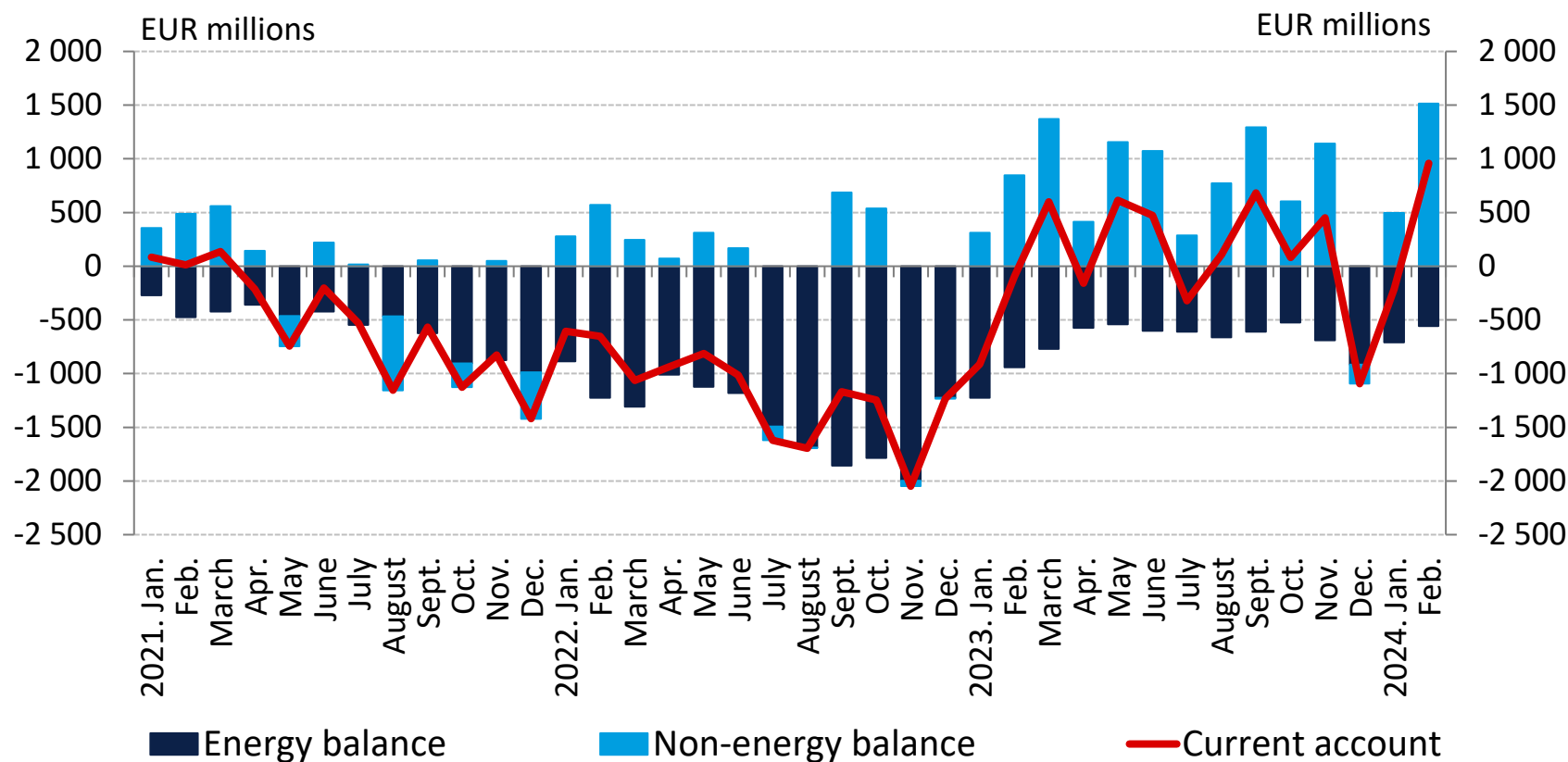
KEY INDICATORS OF THE GERMAN INDUSTRIAL BUSINESS CYCLE

Source | Destatis, European Commission, HCSO



THE CURRENT ACCOUNT SURPLUS HAS REACHED A NEW HISTORICAL PEAK AND IS EXPECTED TO GROW AS A PERCENTAGE OF GDP

In February, the current account surplus has reached 958 million euros, driven by a record high trade balance of goods.



DEVELOPMENTS IN THE CURRENT ACCOUNT AND THE ENERGY BALANCE

Note | Energy trade balance for the latest month is an estimate.

Source | HCSO, MNB



MONETARY POLICY

DOMESTIC DISINFLATION IS STRONG AND BROAD-BASED, HOWEVER THE DEVELOPMENT IN THE RISK ENVIRONMENT WARRANTS CAUTION

INTERNATIONAL FACTORS



In the world economy, disinflation has been strong, but at the same time, persistently high services inflation restrains it.



The risk perception of emerging markets is volatile.



The MNB is closely monitoring geopolitical tensions in the Middle East and their potential inflationary risks.



The Federal Reserve's expected interest rate path, based on market pricings, shifted further upwards relative to March, while market expectations for the ECB's policy rate path remained broadly unchanged. Long-term yields in developed markets continued to rise.

DOMESTIC DEVELOPMENTS



Domestic disinflation is strong and broad-based.

Inflation is in line with analysts' expectations.

Short-base inflation indicators already show patterns before mid-2021.

Market services inflation is slowly decreasing from a high level.



In February, the current account surplus rose to historically high levels. After last year's improvement, the surplus will continue to increase over the forecast horizon.



The risk premium on Hungarian assets has also risen recently.



The level of foreign exchange reserves remains close to its historical peak.



THE MONETARY COUNCIL'S APRIL INTEREST RATE DECISION

Central bank instrument	Interest rate	Previous interest rate (percent)	New interest rate (percent)
Central bank base rate		8.25	7.75
O/N deposit rate	Central bank base rate minus 1.00 percentage point	7.25	6.75
O/N collateralised lending rate	Central bank base rate plus 1.00 percentage point	9.25	8.75



THE MNB PAYS SPECIAL ATTENTION TO A NUMBER OF FACTORS WHEN SHAPING THE INTEREST RATE POLICY

INFLATION

Inflation **will temporarily increase in the middle of this year** due to the retrospective pricing of market services, and base effects.

Maintaining tight monetary conditions is necessary to **achieve the inflation target in a sustainable manner in 2025.**

INTERNATIONAL MONETARY POLICY ENVIRONMENT

In the case of the Fed, the expected date of the first interest rate cut was postponed again. Divergence with the ECB also affects emerging markets through the global interest rate environment.



The outlook for inflation warrants further reduction in the base rate at a slower pace than before.

The volatile risk environment warrants a careful and patient approach to monetary policy.

RISK PERCEPTION

From the point of view of the country's risk assessment, the **credible fulfillment of budget deficit targets** and the **improvement of the primary balance to near equilibrium levels** are of particular importance.

Another key factor in risk assessment is this year's evolution of **external balance developments.**

FINANCIAL MARKET STABILITY

In a volatile international sentiment, a key question is **whether risks will appear that could threaten the evolution of the forint exchange rate or domestic yields.**





THE MONETARY COUNCIL'S FORWARD GUIDANCE

*„Risks surrounding global disinflation, volatility in international investor sentiment and the sustainable continuation of domestic disinflation warrant a **careful and patient approach to monetary policy in the coming months**. The Council is constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment. In the new phase which started in April, the Monetary Council is proceeding at a slower pace than before, and will **take decisions on any further reductions in the base rate in a data-driven manner.**”*

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