MINUTES
OF THE MONETARY COUNCIL MEETING
14 DECEMBER 2021

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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:
http://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.

The global economic recovery had slowed in recent months, while the fourth wave of the coronavirus pandemic and the emergence of the new variant of the virus had led to a renewed increase in risks surrounding the recovery. Inflation had risen to levels not seen for several decades in a number of countries, which had been further aggravated by disruptions in supply across a growing range of markets, in addition to persistent rises in commodity and energy prices.

Global investor sentiment had deteriorated since the Council's previous policy decision. Risk appetite had been driven by rising inflation, the related monetary policy messages, and the spread of the Delta and Omicron variants of coronavirus. In commodity markets, a significant wave of price increases had occurred in the autumn months. In the case of energy sources, the rise in prices had been extraordinarily high; the prices of natural gas and electricity had multiplied since the beginning of the year. The global market price of crude oil had fallen, but it was significantly above its level a year earlier. Movements in the US dollar had been mixed against developed market currencies, while it had tended to strengthen against emerging market currencies. At the same time, a withdrawal of capital had begun from emerging markets.

The policy stances of the world's leading central banks had become tighter. In line with its November decision, the Federal Reserve had started phasing out its asset purchase programme. Based on the Bank's communication at the end of November, the phasing out of asset purchases might proceed at a faster pace than earlier announced, which was expected to be discussed at the December policy meeting. According to its communication, the European Central Bank would take a decision in December on the future use of the asset purchase programme. In the CEE region, the Polish central bank had continued to raise its policy rate in December.

Hungarian economic growth had continued, but its dynamics had slowed. GDP had grown by 6.1 percent in annual terms in the third quarter of 2021, thus exceeding its pre-crisis level by 0.7 percent. A wide range of sectors had contributed to growth, but there had been differences in dynamics across sectors. In October, industrial output had continued to decline, reflecting subdued production due to the global shortage of semiconductors. Construction output had continued to grow, supported by government investment activity and the strong housing market. The volume of retail sales had continued to rise in October, slightly exceeding its pre-pandemic level. The unemployment rate remained steadily low even in international comparison.

The Hungarian economy had a strong ability to recover. Economic growth was expected to continue at a slower pace, while the structure of growth showed a dichotomy. Disruptions in international production chains, as well as rising commodity and energy prices, had led to a slowdown in the economic recovery, while the further strengthening in domestic demand

cushioned the effects of external factors. Household consumption growth continued, supported by the increase in the minimum wage next year and the government measures aimed at boosting household income. In addition to the increase in the minimum wage, the tight labour market also helped to maintain rapid wage growth. Higher commodity and energy prices, and weaker external demand were likely to hold back corporate investment activity in 2022. However, the investment rate was expected to stabilise at a high level even compared to the EU. As a result of the temporary slowdown in exports, reflecting the effects of external factors, and stronger domestic demand, net exports were likely to have a nearly neutral impact on GDP growth in 2022. In the second half of next year, exports were expected to rebound quickly as external markets and supply chains recover, which would also be supported by new export capacities. Hungarian GDP was expected to grow by 6.3–6.5 percent in 2021 and by 4.0–5.0 percent in 2022.

In November 2021, annual inflation had been 7.4 percent, and core inflation had stood at 5.3 percent. Headline inflation had risen by 0.9 percentage points and core inflation by 0.6 percentage points on the previous month. The rise in inflation had affected a wide range of goods and services. The global pick-up in commodity prices was appearing in consumer prices for a growing range of goods. Consumer prices were expected to rise by 5.1 percent in 2021 as a whole.

Inflation had reached its peak in November, and it was expected to fall gradually from December. Short-term developments in inflation were determined by the fading impact of base and tax effects, the introduction of a cap on fuel prices and the extent of repricing at the beginning of the year. Core inflation would rise in the coming months and would be close to 6 percent by mid-2022, reflecting the rise in commodity and energy prices, increases in freight costs, and increasingly wider supply disruptions. Over the medium term, anchoring inflation expectations at a level consistent with the inflation target would play a crucial role in the achievement of price stability.

Core inflation excluding the effects of tax changes was expected to follow a downward path from the second half of next year as a result of the Bank's proactive measures and as the effects of the pandemic and the external inflation environment faded gradually. Inflation was expected to return to the central bank tolerance band in the fourth quarter of 2022, before reaching the 3 percent central bank target in the first half of 2023. The consumer price index was projected to be 4.7–5.1 percent in 2022 and to be consistent with the inflation target from 2023.

The government deficit and the government debt-to-GDP ratio were expected to shift to a declining path from this year. The current account balance was likely to worsen due to the temporary effects of the pandemic, but to increase as external markets and supply chains recovered, which would be supported by new export capacities built up in recent years. As a result, the current account balance was expected to show a deficit of three percent of GDP this year and next, and then to improve gradually toward the end of the forecast horizon. At the same time, the economy's net lending was likely to increase following a temporary decline in 2021 and 2022 and would be around 1 percent of GDP at the end of the forecast horizon.

Following the review of macroeconomic and financial market developments as well as the Inflation Report projection, the Monetary Council discussed the details of its monetary policy decision. The

decision-makers noted that based on incoming data, the Hungarian economic recovery had remained strong, but economic growth showed a strong dichotomy. The newest wave of coronavirus was expected to slow down economic growth and hold back corporate investment activity at the end of 2021 and in the first half of 2022. However, decision-makers signalled that exports were expected to rebound quickly as supply chains recovered in the second half of 2022. Council members highlighted that the further strengthening in domestic demand cushioned the effects of external factors. In parallel with wage growth further increasing, the pick-up in household consumption was likely to continue.

Turning to inflation developments, Council members noted that the rise in inflation had affected a wide range of goods and services. Members were of the view that the increase in consumer prices may have peaked in November and inflation was expected to decline gradually from December. Nevertheless, Council members agreed that underlying inflation was expected to remain persistently high and core inflation was likely to be close to 6 percent until the middle of 2022. Core inflation excluding tax effects was likely to fall from the second half of 2022 as a result of the Bank's proactive measures and as external effects faded. Decision-makers underlined that inflation might return to the central bank tolerance band in the fourth quarter of 2022 before approaching 3 percent again in the first half of 2023.

Members unanimously argued that over the medium term, anchoring inflation expectations at a level consistent with the inflation target would be decisive in the achievement of price stability. Council members emphasized that inflation expectations had risen in recent months. More persistent external inflationary effects, the tight labour market coupled with rising wage growth, and the generally high inflation environment might lead to an increase in second-round inflation risks. Decision-makers were of the view that in addition to longer-term macroeconomic effects, short-term inflationary effects driven by an increase in risks in financial and commodity markets, were of key importance as well.

In the Monetary Council's unanimous assessment, in order to ensure price stability, a monetary policy was required which was capable of responding to a quickly changing financial and commodity market environment while appropriately anchoring inflation expectations over the long-term. Monetary policy had to be predictable and sufficiently flexible at the same time. Furthermore, Council members emphasized that all elements of the Bank's set of policy instruments had to support the return to price stability as soon as possible through all transmission channels.

In the decision-makers' view, the continuation of the base rate hike cycle – by 30 basis points, the same as in November – ensured predictability, and the Bank would be able to respond to short-term inflationary effects quickly, flexibly and to the extent necessary in the exceptionally rapidly changing financial and commodity market environment by using the one-week central bank deposit. The asymmetrical interest rate corridor provided the Bank more room for manoeuvre and ensured sufficient flexibility. Members underlined that it was key for the measures affecting the one-week deposit rate to be implemented persistently in the Bank's cycle of base rate hikes. In

order to ensure this, the base rate would converge with and reach again the level of the one-week deposit rate in 2022.

In the decision-makers' view, a predictable and credible cycle of base rate hikes was the most effective instrument to anchor inflation expectations in line with the central bank target. In the Council's assessment, the cycle of base rate hikes had to be continued until the outlook for inflation stabilised around the central bank target in a sustainable manner and inflation risks became evenly balanced on the horizon of monetary policy.

Members pointed out that in the event of unexpected liquidity shocks in periods between one-week deposit tenders, the overnight deposit rate, available without restriction, might become effective temporarily. As a result, raising the overnight deposit rate to the level of the base rate might drive all relevant domestic markets towards interest rate conditions corresponding to the base rate.

The Monetary Council wished to achieve price stability as soon as possible, which was supported by all elements of the Bank's monetary policy toolkit. Consistent with this, the Monetary Council had closed its government securities purchase programme and stopped purchasing bonds with immediate effect. Accordingly, the Bank would make purchases neither at auctions nor in the secondary market. At the same time, the Council agreed that stable liquidity in the government securities market was crucial for the effectiveness of monetary policy transmission looking ahead. For this reason, the MNB would continue to closely monitor liquidity developments in the government securities market, and it would be ready to intervene in order to maintain the stability of the market with occasional and targeted purchases if necessary. However, decision-makers noted that this did not indicate a change in the Council's monetary policy stance. Purchases were aimed at maintaining market stability.

In addition, Council members decided to close the Bond Funding for Growth Scheme. The Bank would realise the negotiations with issuers currently underway up to the maximum amount allocated under the programme and subsequently it would not purchase additional corporate bonds. Decision-makers highlighted that the BGS had contributed to the improvement in domestic corporate bond market conditions and the development of the market in recent years. The measures taken in December were designed to finish the phasing out of crisis management instruments.

Several members pointed out that in the current rapidly changing environment short-term rates in every sub-market and at all times should develop consistently with the level of short-term rates deemed optimal by the Monetary Council. The foreign currency swap market was a crucially important sub-market for monetary policy transmission. Council members agreed that at the end of the year the Bank should use its swap instrument providing foreign currency liquidity actively again, without setting a quantitative limit, to reduce swap market volatility. In addition, Council members pointed out that the central bank discount bill auction held at the end of December also helped mitigate increased volatility of liquidity conditions at the end of the quarter and thereby to improve swap market stability. Some members indicated that raising the interest rate on the O/N

central bank deposit to the same level as the base rate also facilitated the stability of swap market rates.

In order to avoid second-round inflationary effects and to properly anchor expectations, the Monetary Council continued to tighten monetary conditions. According to today's decision, the central bank base rate rose by 30 basis points to 2.40 percent. The overnight deposit rate was increased by 80 basis points to 2.40 percent which was equal to the base rate, while the overnight and the one-week collateralised lending rates were increased by 30 basis points to 4.40 percent.

The Monetary Council considered it a key priority to anchor inflation expectations properly and thereby continuously to mitigate second-round inflation risks. In the persistently changed inflation environment, the Monetary Council intended to drive expectations appropriately by continuing the cycle of base rate hikes at a monthly frequency and in a predictable manner. Rising yields as a result of the interest rate hikes and the expected gradual fall in inflation were expected to lead to an increase in real interest rates in the coming months.

The Bank continued to intend to respond to the increase in short-term risks in financial and commodity markets quickly, flexibly and to the extent necessary. The interest rate on the one-week central bank deposit had risen above the level of the base rate in recent weeks. The Monetary Council had increased the Bank's room for manoeuvre by making the interest rate corridor asymmetrical. As long as financial and commodity market risks persisted, the Bank would be ready to set the one-week deposit rate persistently above the base rate. The MNB would continue to set the one-week deposit rate at weekly tenders. In the Monetary Council's assessment, raising the interest rate on the one-week central bank deposit at least by as much as the base rate was raised was warranted.

It remained a key priority for the MNB that short-term rates in every sub-market and at all times should develop consistently with the level of short-term rates deemed optimal by the Monetary Council. To this end, the MNB would actively use its swap facility providing foreign currency liquidity again, without a quantitative limit. In this context, the Bank would conduct a total of four tenders in December 2021. In addition, auctions of short-term discount bills would further contribute to the efficient sterilisation of financial system liquidity. The Monetary Council also supported the stability of swap market rates by raising the interest rate on the O/N central bank deposit to the same level as the base rate.

The Monetary Council attached great importance to ensuring that all elements of the Bank's monetary policy toolkit supported the return to price stability as soon as possible. In line with this, at its December meeting the Monetary Council decided to close the Bond Funding for Growth Scheme. Following the realisation of negotiations with issuers currently underway up to the maximum amount allocated under the programme, the Bank would not purchase additional corporate bonds. Ample liquidity and strong capital position of the banking sector, as well as the improvement in bond market conditions in recent years and the effects of market development, made it possible to satisfy the corporate sector's funding needs on a market basis.

The Monetary Council also took a decision on closing the government securities purchase programme. Accordingly, the Bank would stop purchasing bonds. In the Monetary Council's view, the stable liquidity position of the government securities market was crucial for the effectiveness of monetary policy transmission looking ahead. The MNB would continue to closely monitor liquidity developments in the government securities market, and it would be ready to intervene in order to maintain the stability of the government securities market with occasional and targeted government securities purchases if necessary. Occasional government securities purchases would not indicate a change in the stance of monetary policy. The Bank would hold securities purchased until maturity.

In the Council's assessment, the risks to inflation continued to be on the upside. Inflation expectations had risen in recent months. Persistently high commodity and energy prices, the increase in international freight costs and increasingly wider supply disruptions continued to point to more sustained external inflationary pressures. At the same time, the tight labour market, coupled with rising wage growth and a higher inflation environment, might lead to a further rise in inflation expectations and an increase in second-round inflation risks.

Mitigating second-round inflation risks and driving expectations appropriately had necessitated longer lasting, predictable monetary policy tightening. The Council still considered it necessary to continue the base rate tightening cycle on a monthly basis. Changes to the one-week central bank deposit rate would feed into the MNB's tightening cycle for a sustained period. By raising the one-week deposit rate, the MNB continued to stand ready to respond to short-term risks in financial and commodity markets quickly and flexibly. The Monetary Council would continue the cycle of interest rate hikes until the outlook for inflation stabilised around the central bank target in a sustainable manner and inflation risks became evenly balanced on the horizon of monetary policy.

Votes cast by individual members of the Council:

In favour of increasing the base rate to 2.40 percent, raising the overnight collateralised lending rate, the one-week collateralised lending rate to 4.40 percent and increasing the interest rate on the overnight central bank deposit to 2.40 percent:	9	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, Mihály Patai, Bianka Parragh, 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

György Matolcsy

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 25 January 2022. The minutes of that meeting will be published at 2 p.m. on 9 February 2022.