MINUTES
OF THE MONETARY COUNCIL MEETING
27 JULY 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) was to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserved financial stability and supported the Government's economic policy, as well as its policy on environmental sustainability under the Bank's extended mandate effective from 2 August 2021.

Over the past months, the reopening of economies had begun, the pace of which had been driven by developments in the pandemic and the population's vaccination level. World trade and global industrial production were already above the levels seen before the pandemic. In June, forward-looking confidence indicators of the manufacturing and services sectors had suggested a positive outlook. However, a repeated pick-up in case numbers in recent weeks indicated that the fourth wave of coronavirus was approaching.

International risk appetite had deteriorated due to the impending next wave of the pandemic, global supply problems and reflation concerns. Consistent with this, the US dollar had appreciated against developed and emerging market currencies. Commodity prices had risen significantly since the beginning of 2021. Global oil prices had eased back from USD 77 at the beginning of July to around USD 70 by the middle of the month.

At its policy meeting in July, the European Central Bank (ECB) had confirmed that it would maintain the higher pace of purchases under the Pandemic Emergency Purchase Programme (PEPP) in the third quarter. According to ECB's forward guidance, interest rates would remain durably at or below current levels until inflation reached the 2 percent target. The ECB had released the results of the review of its monetary policy strategy at the beginning of July, in which it had set a 2 percent symmetric inflation target. In addition, the ECB had also accepted an action plan regarding climate change. As part of this, the ECB would review how to include climate protection considerations in its monetary policy framework in the future.

A number of central banks in the region had indicated recently that they would stand ready to tighten monetary conditions when necessary due to the increase in the outlook for inflation. In the second half of June, the Czech central bank had raised its policy rate by 25 basis points, while the central banks of Poland and Romania had left policy rates unchanged.

Hungarian economic growth had continued in the third wave of the coronavirus pandemic. In May, the performance of industry and construction had improved compared with the previous month and a year earlier. The volume of retail sales had risen year on year, but it had been unchanged relative to the previous month. Real earnings, affecting mostly household consumption, had risen further, while wage growth had picked up compared with the previous month. The unemployment rate had fallen and remained at a level considered low by international standards.

The Hungarian economy had been restarted in the second quarter, and as a result of the earlier opening than the European average the pace of economic recovery had picked up significantly. Real-time data pointed to double-digit economic growth in the second quarter. Hungarian economic output was expected to recover to pre-crisis levels in the third quarter. The rapid recovery in industry had been followed by construction and retail trade, while the recovery in the service sector, which was most exposed to the pandemic, would take longer.

The historically high investment rate was expected to continue rising on the forecast horizon. Hungarian export performance was expected to improve markedly in 2021 as external markets recover. The increase in the production of new export capacities built in previous years caused a dynamic expansion of exports over the entire forecast horizon. Household demand was likely to pick up gradually. The Hungarian economy was expected to rise by around 6 percent in 2021, by 5.5 percent in 2022 and by 3.5 percent in 2023. According to expectations the economic recovery in Hungary could prove to be one of the fastest compared with other European countries as well.

In June 2021, annual inflation had been 5.3 percent, and core inflation had stood at 3.8 percent. The consumer price index and core inflation had risen by 0.2 percentage points and 0.4 percentage points, respectively, relative to the previous month. Incoming inflation data had exceeded the Bank's projection and market expectations. Since May, the pace of increase in the prices of services and industrial goods had accelerated further. Underlying measures of inflation had also increased. Inflation data confirmed that inflationary effects, arising from the reopening of the economy, had already been strong in June.

Inflation was expected to decline gradually in the coming months, but to stay above the central bank tolerance band until the end of 2021. Inflation was then projected to fall back to the central bank tolerance band again at the beginning of 2022 and to stabilise around the bank target from mid-2022 as a result of the monetary policy tightening cycle.

Upside risks to the outlook for inflation had generally increased. Inflation in the euro area and the US had risen since the beginning of the year. Sustained rises in commodity prices and international freight costs pointed to a higher external inflation environment. Demand-supply frictions, emerging temporarily due to the rapid restart of the domestic economy, and the renewed tightening of labour market capacities expected in certain sectors, combined with dynamic wage growth, had increased inflation risks.

Following 8.1 percent in 2020, from 2021 the government deficit was expected to decline and, in parallel, the debt-to-GDP ratio to shift to a downward path. The current account surplus and the economy's net lending were expected to continue rising over the forecast horizon. The decline in Hungary's net external debt would continue.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. Council members underlined that Hungary's economy had been restarted in the second quarter of 2021 and that the recovery was characterised by strong dynamics. Real-time data indicated robust, double-digit economic growth in the second quarter. Some members pointed out that, due to the rapid restart of the domestic economy, labour shortages might emerge in certain sectors once again. As a sign of this, the proportion of companies for which the shortage of available labour force set a potential production limit would rise.

Council members agreed that the rise in inflation was a global phenomenon, which was related to the timing and speed of the reopening of economies. Hungary's economy had been reopened earlier than the European average; therefore, inflationary effects had also appeared earlier. Decision-makers pointed out that effects arising from the reopening had been strong in June. This could also be seen in the acceleration of price increases for market services and industrial goods. In addition to higher fuel prices, a two-step increase in excise duty on tobacco products in 2021 had been a significant factor contributing to a pick-up in the domestic price index. Several Council members highlighted that the June inflation data had exceeded the central bank projection and market expectations as well. Decision-makers agreed that inflation was expected to decline gradually in the coming months, but to stay above the central bank tolerance band until the end of 2021. In the Council's expectation, inflation would fall back to the central bank tolerance band again at the beginning of 2022 and would then stabilise around the bank target from mid-2022 as a result of the monetary policy tightening cycle.

The Monetary Council was unanimous in arguing that risks to the inflation outlook remained on the upside. Therefore, in order to ensure price stability, prevent second-round inflationary effects and anchor inflation expectations, a continuation of the cycle of interest rate hikes with a firm step was warranted. Council members unanimously underlined that the cycle of interest rate hikes should be executed on a monthly basis. They added that the July step size could be a guide regarding the August decision. The Monetary Council unanimously argued that the cycle of interest rate hikes would need 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. Decision-makers emphasised that the Monetary Council would carry out a comprehensive evaluation regarding the effects of the cycle of interest rate hikes based on the projection in the September Inflation Report.

Council members were unanimous in their view that in the period ahead the effective tightening of monetary conditions should be supported by a continued gradual phasing out of the crisis management instruments having an effect at longer maturities by the Bank, in addition to the cycle of interest rate hikes. The next step to achieve this was to discontinue the use of the long-term collateralised lending facility from the date of the July interest rate decision. Some members underlined that the facility would remain part of the set of central bank instruments and might be used if warranted. Members agreed that the government securities purchase programme was of key importance; therefore, the MNB would still continue to use it by maintaining a lasting presence in the market. Some members highlighted that the next revision of the programme would be performed when the stock reached HUF 3,000 billion, at the August interest rate decision meeting.

In terms of financial market stability, Council members considered the Bank's active presence in the market to be crucial. In the Council assessment, it was a key priority 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. The Council argued that the MNB would continue to provide the foreign currency liquidity required for the stability of the swap market in the future as well.

In order to ensure price stability, prevent second-round inflationary effects and anchor inflation expectations, the Monetary Council had tightened monetary conditions further by several steps in its decision in July. According to the July decision, the cycle of interest rate hike continued by 30 basis points. The central bank base rate rose to 1.20 percent. The Monetary Council also considered a 30 basis point increase in the interest rate corridor to be justified. The overnight deposit rate changed to 0.25 percent, and the overnight and one-week collateralised lending rates changed to 2.15 percent. The MNB would continue to set the one-week deposit rate at weekly tenders. According to the Monetary Council's assessment, it was warranted to increase the interest rate on the one-week deposit instrument by the same amount as in the base rate.

In parallel with the tightening of interest rate conditions, the Monetary Council continued to phase out the instruments having an effect at longer maturities. With the exhaustion of the available amount, the MNB had announced the termination of the FGS Go! in June. As a next step, from the July interest rate decision the Bank would discontinue the use of the long-term collateralised lending facility.

The Monetary Council continued to consider the government securities purchase programme to be crucial in its set of monetary policy instruments, which it assessed to be successful during the third wave of the pandemic and in a volatile international financial market environment. Purchases by the Bank had contributed to maintaining a stable liquidity position in the government securities market and improved the effectiveness of monetary policy transmission. The MNB would continue to use the programme by maintaining a lasting presence in the market, taking a flexible approach to changing the quantity and structure of weekly securities purchases, to the extent and for the time necessary.

Through an active market presence, the MNB had cushioned the spillover of end-of-quarter tensions in international swap markets to the domestic market, thereby contributing to preserving the stability of monetary conditions and through this to maintaining price stability. It was a key priority for the Bank 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.

The Monetary Council was committed to maintaining price stability. In the decision-makers' assessment, risks to the inflation outlook remained on the upside. The Council considered it justified to continue the cycle of interest rate hikes by taking firm steps on a monthly basis to ensure price stability, avoid second-round inflationary effects and to anchor inflation expectations. The Monetary Council would continue the cycle of interest rate hikes until the outlook for inflation stabilised around the central bank target 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 1.20 percent, **increasing the overnight collateralised lending rate, the one-week collateralised lending rate at 2.15 percent** **and** **increasing the interest rate on the overnight central bank deposit at 0.25 percent:**	9	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, Bianka Parragh, 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

György Matolcsy

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 24 August 2021. The minutes of that meeting will be published at 2 p.m. on 8 September 2021.