MINUTES
OF THE MONETARY COUNCIL MEETING
16 NOVEMBER 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 continued at a slowing pace in recent months, while the fourth wave of the coronavirus pandemic had led to a renewed increase in risks surrounding the recovery. Inflation had risen to decade highs in several countries, which had been further aggravated by disruptions in supply in a growing number of markets, in addition to persistent rises in commodity and energy prices.

Global investor sentiment had deteriorated since the Council's previous policy decision and the probability of tensions in financial markets had increased. The spread of the Delta variant of coronavirus, difficulties becoming more common in supply and the persistent energy crisis had also had an adverse effect on investor sentiment. In commodity markets, a significant wave of price increases had occurred. 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 world market price of crude oil had remained above USD 80. Overall, the US dollar had appreciated against the euro and most emerging market currencies.

The policy stances of the world's leading central banks had become tighter. At their November policy meeting, the decision-makers of the Federal Reserve had decided to start phasing out the asset purchase programme. The European Central Bank had slowed the pace of purchases under the Pandemic Emergency Programme (PEPP) in September, and based on the ECB's communication, a decision would be taken in December on the further use of the asset purchase programme. In the CEE region, the Polish and Czech central banks had sped up the pace of interest rate hikes, and the Romanian central bank had continued to raise its policy rate at a constant rate in November.

Hungarian economic growth had continued, but its dynamics had slowed. According to the release of preliminary data, GDP had grown by 6.1 percent in annual terms in the third quarter of 2021, leaving it 0.7 percent above its pre-crisis level. A wide range of sectors had contributed to growth, but there had been differences. In September industrial output had declined and construction output had increased. The volume of retail sales had continued to rise in September, approaching pre-pandemic levels. The unemployment rate had remained low in international comparison.

Looking ahead, based on high frequency data economic growth was expected to continue in the fourth quarter, but at a slower pace than before. Hungary's GDP was expected to grow by between 6.5 and 7 percent in 2021 and by between 5 and 6 percent in 2022. Over the short term, the impact of declining industrial production due to weakening external demand and supply disruptions would be dampened by further increases in investment and consumption. Domestic demand had been supported by budgetary measures stimulating economic growth, favourable labour market conditions and higher wage growth resulting from the increase in the minimum wage from 2022. The investment rate was likely to rise further from its current high level. Hungarian export performance was expected to rise again as the fourth wave of the pandemic fades, which would be supported by new export capacities built in previous years.

In October 2021, annual inflation had been 6.5 percent, and core inflation had stood at 4.7 percent. Headline inflation had risen by 1.0 percentage point and core inflation by 0.7 percentage points compared to the previous month. The rise in inflation had been primarily driven by increases in fuel, industrial goods and food prices. The global pick-up in commodity prices was appearing in consumer prices of a growing range of products.

Inflation was expected to rise above 7 percent in November. Higher-than-expected and sustained increases in commodity prices were rapidly being incorporated into consumer prices in a buoyant domestic demand environment, leading to rising inflation in general. In addition to the lasting effects of supply, the pick-up in wage growth next year due to the increase in the minimum wage and strong economic growth, the consumer price index was expected to decline only slowly from the end of this year. As a result, inflation was expected to be substantially higher in 2022 as a whole than projected in the September Inflation Report. The extent of the shift in the inflation path would be quantified in the December Inflation Report projection.

In the Monetary Council's assessment, inflation was clearly on an upward path along the risk scenarios compared to the September projection. Persistently high commodity and energy prices, rises in international freight costs and increasingly wider supply disruptions continued to point to a higher and more persistent external inflation environment. The tight labour market, coupled with strong wage growth and a higher inflation environment, might lead to increases in inflation expectations and strengthen second-round inflation risks.

The government deficit was expected to fall from this year and the debt-to-GDP ratio to shift to a declining path even taking into account the September issuance of foreign currency denominated bonds. Over the short term, the current account balance was likely to worsen due to deteriorating terms of trade and more subdued export growth, but it was expected to improve again over the forecast horizon as a result of new export capacities and rising net exports. The economy's net lending was likely to stabilise around 3 percent of the GDP, and therefore Hungary's net external debt would continue to fall.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. The decision-makers concluded that based on incoming data, economic growth had continued at a slower rate than earlier; however, several members also highlighted the increasing duality of growth. The underlying reasons for this were the sluggish external demand and the adverse impact of subdued industrial production on exports due to the increasingly wider supply disruptions, on the hand, and continued growth in domestic demand, on the other, which in turn was also supported by firm wage growth. Council members noted that the world's leading central banks had recently tightened monetary conditions. Several members pointed out that the Federal Reserve had started to reduce the amount of its asset purchases. By contrast, the European Central Bank might make a decision on the future of its asset purchase programme in December. With regard to policy actions by central banks of the CEE region, a number of decision-makers drew attention to the fact that due to the deteriorating outlook for inflation, the Polish and Czech central banks had raised interest rate more sharply than previously, even exceeding expectations. At the same time, the Romanian central bank had continued to raise its policy rate at a constant rate in November.

Turning to inflation developments, Council members noted that with the repricing of manufactured products, the effects of the global rise in commodity prices was feeding through to a growing range of consumer prices. Members were of the view that the Hungarian consumer prices index was expected to rise above 7 percent in November, which clearly reinforced that inflation was on an upward path along the risk scenarios compared to the September projection. With regard to the outlook for inflation, the decision-makers pointed out that external factors having an upward effect on inflation were likely to be more persistent than previously expected, while inflation was likely to decrease more slowly in 2022, reflecting strengthening domestic demand. Council members agreed that the path for inflation had moved upwards, and the achievement of the inflation target had shifted out recently. Several members pointed out that the tight labour market, coupled with rising wage growth and a higher inflation environment, might lead to a pick-up in inflation expectations and an increase in second-round inflation risks. In conclusion, members of the Monetary Council were unanimous in arguing that, in responding to the longer-term, domestic fundamental changes in the inflation outlook, more extensive and longer lasting monetary policy tightening was necessary. These factors warranted an increase in the pace of the tightening cycle at the November meeting.

In general, Council members stressed that monetary policy had to be conducted in an environment of extremely rapidly changing financial and commodity markets in emerging markets. Those effects might raise domestic inflation as well. Members judged that the Bank must react rapidly to such risks. Decision-makers pointed out that faced with short-term risks arising from financial and commodity markets as well as domestic fundamentals factors, the Bank had to fight inflation on two fronts. The Monetary Council reacted to changes in the longer-term inflation outlook by speeding up the tightening cycle, while the most effective way to manage short-term risks arising from financial and commodity markets was setting the one-ween central bank deposit rate appropriately. Accordingly, the decision-makers agreed that the interest rate on the one-week deposit facility should be raised above the level of the central bank base rate and maintained above the central bank base rate as long as short-term risks existed.

The Monetary Council took several measures to further improve the effectiveness of monetary policy transmission. 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 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. Decision-makers pointed out that the swap instrument providing forint liquidity would be phased out to support the stability of the swap market, thereby tightening forint liquidity in the financial system. Council members were unanimous in arguing that, preparing for increased volatility of liquidity conditions at the end of quarters, the introduction of a discretional short-term central bank discount bill would provide the Bank with a new, efficient instrument which it would use to further improve swap market stability.

In response to the higher inflation path and the risk of increasing second-round effects, the Monetary Council decided to continue tightening monetary conditions at a faster pace. According to the November decision, the central bank base rate rose by 30 basis points to 2.10 percent. The overnight deposit rate was increased to 1.15 percent, while the overnight and the one-week collateralised lending rates were increased to 3.05 percent. The base rate had risen by 150 basis points since the start of the rate tightening cycle in June.

The Monetary Council responded to longer-term internal fundamental changes in the outlook for domestic inflation by applying the interest rate tightening cycle. 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 shape expectations appropriately by continuing the cycle of base rate hikes.

Nevertheless, short-term risks in financial and commodity markets had increased recently, and the Bank must respond to these significant changes quickly and flexibly. The corresponding instrument for this was the one-week central bank deposit. As long as financial and commodity market risks persisted, the Bank must be ready to set the interest rate on one-week deposit above the base rate. The MNB would continue to set the one-week deposit rate at weekly tenders.

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 at the end of the year, in addition to introducing several new measures.

To reduce liquidity in the banking system, the Bank would cease to use the FX swap facility providing forint liquidity. Furthermore, the Bank was also introducing a new, limited, occasional and short-term central bank discount bill that supported the effective sterilisation of liquidity in the financial system. The effectiveness of monetary policy transmission was also facilitated by the modification of the foreign exchange balance ratio (FXBR) regulations by the MNB's Financial Stability Council, which provided more room for banks' activity at the FX swap market. The technical details of the measures would be communicated in a separate press release.

In the Council's assessment, a stable liquidity position in the government securities market remained crucial from the perspective of monetary policy transmission. At its September meeting, the Council had set the target amount of the MNB's weekly purchases at HUF 40 billion. The MNB continued to use the government securities purchase programme taking a flexible approach to changing the quantity and structure of weekly purchases, to the extent and for the time necessary. The Bank would not sell the stock of government securities on its balance sheet, purchased government securities would be held to maturity. The Monetary Council would set the next target amount of weekly purchases for the following quarter in December.

The persistent rise in external inflationary pressures and increasing second-round inflation risks had necessitated more extensive and longer lasting monetary policy tightening. The Council still considered it necessary to continue the interest rate tightening cycle on a monthly basis. The projection in the December Inflation Report would be decisive in determining the further extent of interest rate hikes. 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 2.10 percent, **raising the overnight collateralised lending rate, the one-week collateralised lending rate to 3.05 percent** **and** **increasing the interest rate on the overnight central bank deposit to 1.15 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 14 December 2021. The minutes of that meeting will be published at 2 p.m. on 5 January 2022.