MINUTES
OF THE MONETARY COUNCIL MEETING
21 SEPTEMBER 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.

Global economic recovery had continued in the summer months, and in parallel, inflation had risen. Where the reopening had taken place earlier an increase in consumer prices had occurred faster as well. The fourth wave of the coronavirus pandemic had led to a renewed increase in risks surrounding the economic recovery. Consequently, international confidence indicators in manufacturing and services had deteriorated in August.

International risk appetite had been driven by the spread of the Delta variant of coronavirus, monetary policy messages of the world's leading central banks, and incoming macroeconomic data. Prices of several important commodities had risen in the past month, and as a result they remained significantly above pre-pandemic levels. Global oil prices had risen overall in the period.

The world's leading central banks had maintained loose monetary conditions and continued their asset purchase programmes in the past month. The Federal Reserve had maintained its monetary policy stance; however, based on communication by some decision-makers the possibility of modifying its crisis management programmes was approaching. Following its decision in September, the ECB had announced that purchases under the Pandemic Emergency Purchase Programme (PEPP) would be made at a slower pace than in the previous two quarters. Several developed country central banks had started to phase out their asset purchase programmes in the past months. In the region, central bank decision-makers had generally indicated that they would stand ready to tighten monetary conditions, when necessary, due to an increase in the outlook for inflation.

The Hungarian economy had restarted successfully. GDP had reached its pre-pandemic level in the second quarter. Hungary was among the economies in Europe showing the fastest recovery. Based on monthly data, strong economic recovery had continued in the third quarter. A wide range of sectors had contributed to growth, but there had been differences in the pace of recovery. In July, construction and industrial production had already exceeded pre-pandemic levels. The recovery in the domestic automobile industry had been held back by a global shortage in microchips; however, robust growth in battery manufacturing was becoming increasingly dominant in industrial production. The volume of retail sales had continued to rise in July but had still fallen short of levels seen before the pandemic. Demand for market services had increased significantly, which had also been reflected in a strong expansion in household consumption. The unemployment rate had fallen further in July, and its level had remained low in international comparison.

Hungary's GDP would rise by between 6.5 and 7 percent in 2021 and by between 5 and 6 percent in 2022. In the favourable labour market environment, growth in household consumption was expected to continue, while a general pick-up in investment was likely to make a positive contribution to GDP growth from 2021 again. The investment rate would continue to rise before stabilising around 29 percent in the second half of the forecast horizon. Hungarian export performance had rebounded strongly in 2021, and with the utilisation of new export capacities built in previous years, it was expected to grow strongly over the entire forecast horizon. With the end of the year approaching, the fourth wave of the coronavirus pandemic was increasing risks to the economic outlook.

In August 2021, annual inflation had been 4.9 percent, and core inflation had stood at 3.6 percent. Headline inflation had risen by 0.3 percentage points and core inflation by 0.1 percentage point compared with the previous month. The rise in inflation had been driven mainly by an increase in the inflation of fuel, industrial goods and unprocessed food. The effect of a global pick-up in commodity prices was causing inflation to accelerate in an increasingly wide range of industrial goods. In the summer, the significant monthly rise in market services had stopped, suggesting that the vast majority of repricings related to the reopening might had already materialised.

Inflation was expected to rise further in the autumn months and to stay above 5 percent during the remainder of the year. The gradual pass-through of increased commodity prices and freight costs into industrial goods prices was expected to be decisive in case of underlying inflation. Core inflation was expected to rise to close to 4 percent during the remainder of the year. The effects of the Bank's tightening cycle would be clearly felt in 2022. According to the Inflation Report projection, inflation would start to fall from the beginning of 2022 before returning to the central bank tolerance band in the second quarter. The consumer price index was expected to stabilise around the 3 percent central bank target in the second half of 2022.

Some of the inflation risks, indicated in June, had materialised in the summer months; however, risks to the outlook remained on the upside. The increase in commodity prices and freight costs had continued; therefore, these factors continued to point to a higher external inflationary environment. Demand-supply frictions emerging temporarily, and the renewed tightening of labour market capacities in certain sectors, combined with dynamic wage growth carried upside risks to inflation. A more serious fourth wave of the coronavirus pandemic than expected in the baseline projection and a stronger slowdown in the global economy indicated a lower inflation path.

The government deficit, even with the September issuance of foreign currency denominated bonds, was expected to decline from 2021 and the debt-to-GDP ratio to shift to a declining path. The current account balance was expected to improve over the forecast horizon, with a growing contribution from net exports due to new export capacities built up. The economy's net lending was likely to increase further and to stabilise around 3 percent of the GDP, and therefore Hungary's net external debt would continue to fall.

At its September meeting the Monetary Council decided to continue to tighten monetary conditions by applying several instruments. In the Monetary Council's assessment, the inflation outlook and the risks surrounding it clearly warranted the continuation of the ongoing, monthly interest rate tightening cycle. In addition to the tightening of interest rate conditions, the Monetary

Council reduced further the target amount of weekly government securities purchases. Furthermore, the Council considered it necessary to gradually phase out the foreign-exchange swap facility providing forint liquidity and to tighten the liquidity provided by the instrument.

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 the Hungarian economy had restarted successfully and based on incoming data, this robust growth would continue in the third quarter. Several Council members pointed out that as a result, the Hungarian economy would grow faster in 2021 than previously expected; therefore, Hungary might be one of the economies in the EU showing the quickest recovery. Some members highlighted that rises in investment and net exports made a positive contribution to economic performance from 2021, in addition to household consumption. Regarding net exports, the utilisation of new export capacities built in recent years were of key significance, which helped maintain the country's persistently positive net lending through an improvement in the current account balance. However, several members also underlined that the fourth wave of coronavirus might temporarily restrain economic growth again from the fourth quarter.

Moving on to inflation developments, Council members agreed that based on data received in the summer months, the vast majority of repricings related to the reopening might have already materialised. Nevertheless, several decision-makers pointed out that the effect of a rise in global oil prices led to a more persistent pick-up in inflation in an increasingly wide range of industrial goods. This was also confirmed by the September Inflation Report projection, according to which core inflation would rise to nearly 4 percent by the end of the year. Furthermore, the decision-makers noted that inflation was expected to rise sharply again in the autumn months, with the consumer price index staying above 5 percent during the remainder of the year. The Council agreed that due to continued growth in commodity prices and freight costs, factors that pushing inflation upwards were expected to persist further than earlier expected. Based on the assessment of the inflation outlook, Council members noted that the sustainable achievement of the inflation target had shifted to a later time compared to the June projection. However, they indicated that the consumer price index was expected to start to fall again in the next year before stabilising around the central bank target in the second half of 2022.

Council members were unanimous in arguing that due to a shift in achieving the inflation target and the persistence of upside risks surrounding the outlook, it was necessary to continue the cycle of interest rate hikes and to tighten monetary conditions by using several instruments. Several decision-makers underlined that the fourth wave of coronavirus would increase the uncertainty surrounding the macroeconomic outlook from the fourth quarter.

Against this backdrop, Council members agreed that the cycle of interest rate hikes started in July in a proactive and determined manner had to be continued unaltered on a monthly basis, but at a slower pace. In the decision-makers' assessment, the extent of the tightening of interest rate conditions in September would be indicative of decision-making in the coming months. Council members collectively argued in favour of maintaining a tight monetary policy stance and highlighted that the cycle of interest rate hikes would need to be continued until the outlook for inflation stabilised around the central bank target and inflation risks became evenly balanced again on the horizon of monetary policy.

Inflation risks continued to lie to the upside. Consequently, the Monetary Council decided to raise the base rate and to tighten monetary conditions by applying several instruments. Accordingly, in addition to raising the base rate and the interest rate corridor by 15 basis points, Council members continued to reduce the amount of weekly purchases under the government securities purchase programme, while announcing that the swap facility providing forint liquidity would be phased out gradually in order to effectively tighten monetary conditions.

Several decision-makers noted that swap market volatility had increased recently, which the MNB successfully mitigated by using its swap facility providing euro liquidity at the end of the quarter. Members concluded that it remained 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. In order to ensure this, in the decision-makers' assessment it remained necessary to use the swap facility providing euro liquidity at the end of the quarter and it was warranted to tighten excess liquidity, currently amounting to around HUF 1,100 billion, by gradually phasing out the swap facility providing forint liquidity.

In the Monetary Council's view, the tightening of interest rate conditions was also supported by the reduction in the target amount of weekly purchases under the government securities programme from HUF 50 billion to HUF 40 billion. Decision-makers agreed that the programme should be phased out without posing risk to market stability. Therefore, the Bank might deviate from the target amount of weekly purchases upwards or downwards in a flexible manner depending on supply and other market conditions. Members reiterated that the Monetary Council would take the next decision on the target amount of weekly purchases under the government securities purchase programme at its December meeting.

According to the September decision, the central bank base rate rose by 15 basis points to 1.65 percent. The Monetary Council also considered a 15 basis point increase in the interest rate corridor to be justified: the overnight deposit rate increased to 0.70 percent, while the overnight and the one-week collateralised lending rates increased to 2.60 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 measure as in the base rate.

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. The MNB continued to actively use its swap facility providing euro liquidity at the end of the quarters. Accordingly, the Bank would hold a total of five tenders until the end of September. To the same end, the MNB gradually phased out its FX swap facility providing forint liquidity taking into account developments in the swap market.

The Monetary Council continued to gradually withdraw the government securities purchase programme while considering aspects of maintaining market stability. Accordingly, the target amount of the MNB's weekly purchases would decrease from HUF 50 billion to HUF 40 billion from the week starting on 27 September 2021. The Bank might depart from this arrangement in a flexible manner, depending on supply and other market conditions. Next time the Monetary Council would set the target amount of weekly purchases for the following quarter in December.

In the Council's assessment, a stable liquidity position in the government securities market remained crucial from the perspective of monetary policy transmission. 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. If warranted by the maintenance of market stability, the MNB would stand ready to temporarily raise the volume of weekly purchases at any given time. 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 was committed to maintaining price stability. In the decision-makers' assessment, the inflation outlook was surrounded by upside risks. According to the Inflation Report projection, inflation would follow a declining path from the beginning of 2022, while the fourth wave of the coronavirus pandemic pointed to an increase in the risks to economic recovery. These warranted a continuation of the monthly interest rate tightening cycle at a slower pace. 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 1.65 percent, **raising the overnight collateralised lending rate, the one-week collateralised lending rate to 2.60 percent** **and** **increasing the interest rate on the overnight central bank deposit to 0.70 percent:**	8	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, Bianka Parragh, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

<u>The following members of the Council were present at the meeting:</u>

Péter Gottfried

Csaba Kandrács

Kolos Kardkovács

György Kocziszky

György Matolcsy

Bianka Parragh

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 19 October 2021. The minutes of that meeting will be published at 2 p.m. on 3 November 2021.