MINUTES
OF THE MONETARY COUNCIL MEETING
30 AUGUST 2022

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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 Russia-Ukraine war, a possible new wave of Covid-19, high commodity prices and ongoing disruptions in supply chains were increasing recession risks in the global economy which were also exacerbated by a deterioration in confidence indicators. The effects of persistently high commodity and energy prices and the drought in Europe were increasing external inflationary effects further in the coming months; however, from 2023 onwards, global inflation was expected to fall alongside commodity and energy prices as economic growth declined.

Investor sentiment had been volatile. Risk appetite had been driven by news on the war, expectations for interest rate increases by the world’s leading central banks, concerns caused by persistently high inflation, fears of recession and developments related to the coronavirus pandemic. In the first half of 2022, global prices of several commodities had reached historic highs and then started to decline recently. However, they had remained at high levels. Gas and electricity prices had continued to rise significantly in European markets.

The Federal Reserve had raised interest rates by 75 basis points at the end of July. In the CEE region, the Czech central bank had not raised its base rate any further in August, while the National Bank of Romania had increased its key policy rate by 75 basis points.

In the first half of 2022, the Hungarian economy had grown strongly: GDP had risen by 6.5 percent in the second quarter of 2022 relative to a year earlier. All sectors of the national economy had contributed to economic growth, except for the agricultural sector. In June, industrial output had continued to grow on an annual basis, while the volume of construction activity had decreased. Following strong growth at the beginning of the year, the turnover of retail stores had been gradually declining since April. The labour market continued to be tight, and the unemployment rate remained low. High-frequency data indicated a clear slowdown in economic growth since the beginning of June. The global economic slowdown and the effects of high energy prices were increasingly reflected in the general deterioration of sentiment indicators.

The time profile and structure of domestic GDP growth had been characterised by strong duality in 2022. The rate of annual economic growth was likely to slow significantly in the second half of the year. Components of domestic demand, particularly household consumption, were expected to contribute to growth throughout this year. By contrast, net exports were likely to hold down the expansion. Looking forward, consumption and investment dynamics were expected to slow considerably, while net exports were expected to make a positive contribution to GDP growth again as external markets and supply chains recovered.

In July 2022, annual inflation had been 13.7 percent and core inflation had stood at 16.7 percent. Inflation had risen by 2.0 percentage points mainly due to an increase in the prices of food, manufactured goods and alcohol and tobacco products. Almost half of the monthly price change had been caused by the rise in food prices. Producer prices continued to rise rapidly and fed through to a broad range of consumer prices. Inflation expectations were at a high level.

In the autumn months, similarly to the developments in the global inflation environment, inflation was expected to rise further in Hungary. The exceptional drought, the price explosion in the energy market and changes in official energy price regulations had all contributed to the rise in consumer prices. However, increasing fears of global recession and the resulting fall in commodity prices were expected to reduce external inflationary effects from the end of the year. In terms of achieving the inflation target, it was still crucial to avoid second-round effects and to anchor inflation expectations in the medium term.

The significant cash-based surplus of the central sub-sector of general government had amounted to more than HUF 250 billion in July 2022. The measures announced by the Government and their implementation were expected to ensure that the fiscal objectives would be met this year and next. As a result of economic growth and the declining deficit, the government debt-to-GDP ratio might fall from 76.7 percent at the end of the previous year to below 75 percent in 2022, followed by further declines of around 2.5 percentage points each year. The current account deficit was expected to rise further temporarily in 2022. The deterioration in the trade balance this year was likely to reflect a worsening in the terms of trade due to high energy prices, the slowdown in external markets, and imports in connection with buoyant domestic demand. However, significant new export capacities had been built in recent years, and as their production picked up, the external balance was expected to improve quickly.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. Council members agreed that the Russia-Ukraine war, high commodity prices and disruptions in supply chains increased the risk of recession in the global economy. In addition, the energy price explosion in Europe and the extraordinary situation caused by the drought strengthened inflationary effects. The prices of most commodities had fallen relative to the peak in the first half of the year but continued to be high. Several members pointed out that domestic inflation was expected to remain on an upward path in the autumn months, increasingly driven by factors outside the scope of monetary policy. However, members pointed out that as a result of a slowdown in global economic activity a reversal in commodity prices and base effects linked to high inflation this year, external inflation was likely to decline from 2023. Some members highlighted that although the Hungarian economy had grown strongly in the first half of 2022, high-frequency data had indicated a clear slowdown in economic growth since the beginning of June.

Decision makers agreed that preventing second-round effects and anchoring inflation expectations were crucial in terms of achieving the inflation target. Monetary Council members highlighted that the further rise in inflation and persistent inflation risks warranted the decisive continuation of the tightening cycle in August. Several Council members underlined that the projections for the macroeconomy in September would offer additional information on the future of the cycle of interest rate hikes.

Several members noted that the MNB's swap tenders providing foreign currency liquidity, held on a daily basis since the beginning of July, had improved the effectiveness of monetary transmission through an increase in swap rates, thereby supporting the achievement and maintenance of price stability. Council members agreed that in the current environment, the effective functioning of monetary transmission had a key role. To that end, the Monetary Council introduced measures in order to drain interbank liquidity available over the short term. The instruments aimed to persistently absorb increased liquidity in the banking system, and to facilitate the effectiveness of monetary transmission. The interest rate on the new instruments was linked to the central bank base rate. It was of key importance that short-term financial market interest rates developed consistently with the Bank's policy stance in a turbulent financial market environment, as well.

Finally, the Monetary Council formulated its forward guidance with no changes, stating that it 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.

In the Monetary Council's assessment, it was warranted to tighten the base rate further in a decisive manner in order to anchor inflation expectations and mitigate second-round inflation risks. The MNB continued to stand ready to respond quickly and flexibly by setting the interest rate on the one-week deposit instrument if warranted by the rise in short-term risks in financial and commodity markets.

According to the decision of the Monetary Council on 30 August, the central bank base rate was raised by 100 basis points to 11.75 percent. The overnight deposit rate was increased by 100 basis points to 11.25 percent, and the overnight and the one-week collateralised lending rates were increased by 100 basis points to 14.25 percent. 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 the base rate.

The Bank considered it crucial that short-term rates in every sub-market, particularly in the swap market, and at all times developed consistently with the level of interest rates deemed optimal by the Monetary Council. Therefore, the MNB had held swap tenders providing foreign currency liquidity since the beginning of July on a daily basis. With an active presence in the market, swap tenders had improved the effectiveness of monetary policy transmission through an increase in swap rates, thereby supporting the achievement and maintenance of price stability.

To enhance monetary transmission further, the Monetary Council had decided to introduce three measures which would support the development of short-term financial market interest rates consistently with the Bank's policy stance in a turbulent period in financial markets by draining interbank liquidity from this autumn. The Bank would raise the required reserve ratio set for the banking system. Additionally, central bank discount bill auctions would be announced and held regularly. The Bank would also introduce a long-term deposit instrument in order to sterilise liquidity in the banking system at longer maturities than currently.

The further rise in inflation and persistent inflation risks warranted the decisive continuation of the tightening cycle. The MNB continuously monitored developments in financial market risks as well and stood ready to intervene in a decisive manner using every instrument in its monetary policy toolkit, if necessary. Maintaining tighter monetary conditions for a longer period was warranted to manage increasing second-round inflation risks resulting from persistently negative supply effects. 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 raising the base rate to 11.75 percent, the overnight collateralised lending rate and the one-week collateralised lending rate to 14.25 percent **and** **increasing the interest rate on the overnight central bank deposit to 11.25 percent:**	7	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Matolcsy, 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 Matolcsy

Bianka Parragh

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 27 September 2022. The minutes of that meeting will be published at 2 p.m. on 12 October 2022.