MINUTES
OF THE MONETARY COUNCIL MEETING
20 DECEMBER 2022

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Article 3 (1) of the Central Bank Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines the achievement and maintenance of price stability as the Magyar Nemzeti Bank's primary objective. 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.

Over the past quarter, global economic growth had slowed, and GDP had already declined in several countries. Looking ahead, the prolonged Russia-Ukraine war, the energy crisis in Europe and the generally rising interest rate environment continued to present significant uncertainty. Commodity and energy prices had fallen significantly in the past months but remained high relative to previous years.

Global inflation had started to moderate slowly in an increasing number of countries. The slowdown in the global economy, weakening demand, falling global energy and commodity prices, as well as lower international freight costs and the easing of difficulties in production chains, pointed to a continued deceleration in global price increases from 2023.

Investor sentiment had been mixed since the previous interest rate decision. Monetary policy decisions by the world’s leading central banks and developments in the economic outlook had been the main factors influencing risk appetite. Developments in the Russia-Ukraine war continued to create significant uncertainties in the CEE region.

The Federal Reserve and the European Central Bank had raised interest rates by 50 basis points in December, to a smaller extent than previously. In addition, the ECB had announced that it would start reducing the portfolio built under its asset purchase programme from March 2023. In the CEE region, the Polish central bank had left interest rate conditions unchanged.

Hungarian economic growth had slowed in the third quarter of 2022. In October, industrial production had increased on an annual basis, while construction output declined. Retail sales had been growing at a declining pace since March, while sales excluding fuels had already been decreasing. The labour market continued to be tight, and the unemployment rate was low. Overall, annual growth in 2022 was more favourable than earlier expected, while the high-frequency data pointed to a further slowdown in GDP growth towards the end of the year.

Growth next year was likely to be slowed by both domestic and external demand factors. The decline in real incomes, rising corporate costs, restrained public investment and the stricter interest rate environment all had a restraining impact on domestic demand. The difficulties affecting international production chains had eased further in recent months; however, the war and the related sanctions continued to create considerable uncertainty. Despite subdued global economic activity, an increase in Hungary’s foreign market share and an improvement in net exports were expected, due to growing domestic export capacities, which was also supported by the dynamic expansion of battery production. Hungary’s GDP was expected to grow by 4.5–5.0 percent in 2022, by 0.5–1.5 percent in 2023, by 3.5–4.5 percent in 2024, and by 3.0–4.0 percent in 2025.

In November 2022, annual inflation had been 22.5 percent and core inflation had stood at 23.9 percent. The increase in inflation had mainly been explained by a pick-up in food price inflation. Inflation expectations continued to be elevated; however, companies’ expectations for retail and services prices remained below their peak levels seen in the summer.

The termination of the price cap on fuels and higher-than-expected food prices had pushed the inflation path significantly higher than expected in September. From the beginning of 2023, the slowdown in inflation would be supported by both external and domestic factors. The expected moderation in global energy and commodity prices, as well as international freight costs, easing tensions in value chains, and the slowdown in global economic activity were likely to moderate external inflation further. Regarding internal factors, the fading of the base effects of tax measures and the moderating effect on pricing arising from the fall in domestic demand would support a decline in domestic inflation as well. Tight monetary conditions contributed to avoiding second-round inflationary effects and anchoring inflation expectations. Domestic inflation was expected to decrease slowly in the first half of 2023, and then more significantly from the middle of the year. The consumer price index would return to the central bank tolerance band in 2024.

The measures announced by the Government and their implementation were expected to ensure the achievement of this year’s budget deficit target indicated by the Ministry of Finance. Thus, the government debt-to-GDP ratio would decrease to close to 74 percent of GDP by the end of 2022. In the autumn months, the current account deficit had started to decrease as gas prices had fallen and domestic demand had adjusted. From 2023, the increasing surplus in items of the current account excluding the energy balance and growing adjustment in the energy market might lead to a rapid improvement. With the normalising global economic environment and terms of trade, as well as with the utilisation of new export capacities built recently, the trade balance would improve significantly, resulting in a further reduction in the current account deficit. The agreement on the Hungarian Recovery and Resilience Facility had significantly reduced uncertainties related to EU funds.

Following the review of macroeconomic and financial market developments as well as the December Inflation Report projection, the Monetary Council discussed the details of its monetary policy decision. In the context of real economic developments, several decision makers pointed out that high-frequency data pointed to a further slowdown in GDP growth. Based on incoming industrial data and favourable developments in new export orders, several decision makers agreed that the performance of the domestic export sector remained strong despite a weakening external activity. Council members were of the view that the continuation of the favourable performance of the export sector was also supported by export capacities built up in recent years, which led to an increase in net exports through moderating imports as domestic demand declined. Some decision makers noted that the balance of the items excluding the energy balance was in the positive range, while a decrease in energy prices, adjustment in the energy market and rising net exports also indicated an improvement in the current account balance.

Regarding the outlook for inflation, Monetary Council members agreed that the inflation path had shifted upwards compared to the September projection due to the termination of the price cap on fuels and strong food price increases. However, Council members underlined that a turnaround in inflation was expected still in the first half of 2023. Decision makers agreed that international developments suggested that global inflation might already have been past its peak. Several council members highlighted that the expected slowdown in global economic growth from 2023 onwards would cause disinflation in itself, while indirectly restraining the pace of price increases through lower energy and commodity prices. Decision makers noted that, in addition to external factors, base effects and declining domestic demand also pointed to a turnaround in domestic inflation. Due to the increase in fuel prices, inflation will rise further in December and will remain at a high level in the coming months. Based on these factors, the Council was unanimous in its view that the decline in inflation was expected to accelerate in the second quarter of 2023, returning to the single-digit range by the end of next year before declining into the tolerance band in 2024. Council members also agreed that the risks to the outlook for inflation were symmetric.

There was a broad consensus in the Monetary Council that tight monetary conditions should be maintained for a prolonged period. Several decision makers pointed out that monetary tightening of the world's leading central banks remained a risk for central banks in the CEE region. In the Council members' assessment, the current level of interest rate conditions ensured the achievement of the inflation target in a sustainable manner, while avoiding second-round effects and anchoring expectations remained a priority due to the upward shift in the inflation path. In addition to this, the Council was constantly assessing incoming data and developments in the inflation outlook and was ready to take the appropriate actions if risks increased. Members also pointed out that developments in risk perceptions continued to be of great significance, and that the agreement with the European Union was a positive development in this respect. However, decision makers argued that a patient approach was warranted, and that it was necessary to maintain the MNB's targeted measures and the interest rate on the one-day deposit quick tender at 18 percent until a sustained trend improvement in risk perceptions occurred.

Council members concluded that the strengthening of monetary transmission and the preservation of market stability remained priorities, with every element of the Bank's toolkit and all transmission channels playing a key role. In addition to maintaining tight interest rate conditions, liquidity-absorbing measures enhanced the effectiveness of monetary transmission in a targeted manner, which would continue by applying the instruments announced for the end of the year and maintaining the MNB's active market presence. Furthermore, Council members noted that as a result of the reduction in liquidity through deposit and FX swap tenders, the Bank was able to respond effectively and flexibly should a strong risk premium shock occur in the current, rapidly changing war environment. Additionally, in order to maintain stability in the foreign exchange market, the Bank would continue to meet foreign currency liquidity needs to reach market balance related to the energy account in the coming months as well.

The Monetary Council kept the base rate at 13.00 percent at its meeting on 20 December. In addition, the O/N deposit rate and the O/N collateralised borrowing rate were left unchanged at 12.50 percent and 25.00 percent, respectively.

The Monetary Council highlighted two alternative scenarios around the baseline projection in the December Inflation Report. The risk scenario with decelerating global economic activity assumed lower growth and inflation than in the baseline scenario. The scenario that presented the strengthening risk of second-round inflationary effects presumed higher inflation and a slightly higher growth path compared to the baseline scenario.

The current level of the base rate was adequate to manage fundamental inflation risks, while monetary tightening continued with the reduction of interbank liquidity. The MNB had held a two-month deposit tender at the end of November to tie up banking sector liquidity over a longer term. Furthermore, from the beginning of December the Bank again had been conducting FX swap tenders providing euro liquidity and discount bill auctions with maturities extending beyond the end of the year. With its active market presence, the MNB increased the effectiveness of monetary policy transmission.

The targeted measures taken by the Bank in mid-October had led to an improvement in financial market stability in a rapidly changing risk environment. The one-day deposit quick tenders and FX swap transactions resulted in tighter interest rate conditions at the short end of the yield curve. In the coming months, the MNB would continue to meet foreign currency liquidity needs to reach market balance related to the energy account.

In the Monetary Council's assessment, maintaining the current level of the base rate for a prolonged period was required to achieve the price stability objective over the monetary policy horizon. The Council was constantly assessing incoming data and developments in the outlook for inflation and was ready to take appropriate actions if risks increase. The continued use of instruments reducing interbank forint liquidity strengthened the effectiveness of monetary policy transmission in a targeted manner. Looking ahead, maintaining market stability was also key to achieving price stability. In the Monetary Council's view, the agreement on EU funds was a favourable development. However, the MNB still focused on sustained shifts in financial market conditions, and it would use its instruments introduced in mid-October until a trend improvement in risk perceptions occurred. It was necessary to maintain tight monetary conditions over a prolonged period, which would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 13.00 percent, the overnight collateralised lending rate at 25.00 percent and maintaining the interest rate on the overnight central bank deposit at 12.50 percent:	8	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, Bianka Parragh, Mihály Patai, 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

Mihály Patai

Barnabás Virág

The Council will hold its next policy meeting on 24 January 2023. The minutes of that meeting will be published at 2 p.m. on 8 February 2023.