MINUTES
OF THE MONETARY COUNCIL MEETING
25 JANUARY 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 global economic recovery had slowed in recent months. Meanwhile, additional waves of the coronavirus pandemic had led to a renewed increase in risks surrounding the recovery. Inflation had risen to levels not seen for several decades in a number of countries, which had been further aggravated by disruptions in supply across a growing range of markets, in addition to persistent rises in commodity, crop and energy prices.

Global investor sentiment had been mixed since the Council's previous policy decision. Risk appetite had been driven by rising inflation, movements in commodity and energy prices, and the spread of the Omicron variant of coronavirus. Global gas and electricity prices had fallen significantly from their peak reached at the end of the year. After a temporary reversal in December, the global market price of crude oil had risen sharply in January, and it remained significantly above its level a year earlier. The US dollar had shown a mixed performance against developed market currencies and had mostly depreciated against emerging market currencies.

The monetary policy stances of the world's leading central banks had become tighter. At its December meeting, the Federal Reserve had decided to phase out its asset purchase programme at a faster pace, which therefore might be entirely discontinued already in March 2022. Based on market expectations, the base rate would be raised four times this year. In December, the European Central Bank had decided to slow the pace of its asset purchases. In the CEE region, the Czech, Polish and Romanian central banks had raised their policy rates, and further interest rate hikes were expected by the market.

The Hungarian economy had grown strongly throughout 2021. High frequency data suggested strong economic activity in the fourth quarter of 2021. In November, industrial output had picked up, again exceeding its pre-pandemic levels; however, the global shortage of semiconductors continued to pose a risk. Based on business surveys, industrial production had remained strong in December. In addition, the sectors linked to domestic demand (construction, retail sales) had also grown at a fast rate. Annual GDP growth in 2021 might have exceeded the 6.3–6.5 percent level projected in the December Inflation Report. The unemployment rate remained low in international comparison.

The Hungarian economy had a strong ability to recover. GDP were expected to rise by 4.0–5.0 percent in 2022, which was at the forefront in the EU. The structure of economic growth showed a dual nature, which was likely to persist in the coming period. The further strengthening in domestic demand was offsetting the negative growth effects resulting from disruptions in international production chains and rising commodity, crop and energy prices. Household consumption growth continued, supported by the increase in the minimum wage and the government measures aimed at boosting household income. In addition to the increase in the minimum wage, the tight labour market also helped to maintain rapid wage growth. Higher commodity and energy prices, coupled with weaker external demand, were likely to hold back corporate investment activity in 2022. However, the investment rate was expected to stabilise at a high level in EU comparison. As a result of the temporary slowdown in exports, reflecting the effects of external factors, and stronger domestic demand, net exports were likely to have a nearly neutral impact on GDP growth in 2022. In the second half of 2022, Hungarian exports were expected to rebound quickly as external markets and supply chains recovered, which would also be supported by new export capacities.

In December 2021, annual inflation had been 7.4 percent and core inflation had stood at 6.4 percent. Headline inflation had remained unchanged and core inflation had risen by 1.1 percentage point compared with the previous month. A highly unusual repricing pattern had been observable in December, which had appeared in a wide range of goods and services. Inflationary pressures had strengthened, and inflation expectations had risen in previous months. The rate of increase in food prices had accelerated significantly, while the inflation of goods and services had risen to a lesser degree. The contribution of fuel prices to annual inflation had continued to be strong. Overall, consumer prices had risen by 5.1 percent and average core inflation had stood at 3.9 percent in 2021.

Inflation and core inflation were expected to follow divergent paths in the coming months. Inflation might have approached its peak in December; however, it might begin to decline later than previously expected. Core inflation was expected to pick up further in the coming months. Companies were repricing their goods and services at short notice amid strong domestic demand in order to reflect rises in commodity prices and wage costs. The degree to which repricings took place during the beginning of the year would determine the yearly dynamics of both inflation and core inflation.

According to available data, the government deficit and the government debt-to-GDP ratio had shifted to a declining path in 2021. The Government had lowered its 2022 budget deficit target from 5.9 percent to 4.9 percent by rolling over certain government investments, which, along with stronger-than-expected GDP growth, enabled a faster decline in the government debt ratio. In November, the trade balance had turned into a surplus, reducing the current account deficit, which had been around 3 percent in 2021. The balance was likely to deteriorate due to the temporary effects of the pandemic, but to increase from the second half of 2022 as external markets and supply chains recover, which would be supported by new export capacities built up in recent years. At the same time, the economy's net lending was likely to increase following a temporary decline in 2021 and 2022 and was expected to be around 1 percent of GDP at the end of the forecast horizon.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. Decision-makers concluded that the Hungarian economy may have grown strongly in the fourth quarter of 2021; however, growth continued to show a dual nature. Disruptions in international production chains and high commodity prices slowed the supply side recovery of the global economy. Nevertheless, Council members pointed out that domestic exports were expected to rebound quickly in the second half of 2022 as supply chains recovered. Several members highlighted that domestic demand was strong and was able to cushion the negative effects of external market factors in the following quarters. In the beginning of the year, domestic demand was also strongly supported by the increase in the minimum wage and the government measures aimed at boosting household incomes. With the pick-up in wage growth, Council members expected household consumption to rise.

Turning to domestic inflation developments, Monetary Council members noted that the repricing patterns that took place at the end of 2021 differed substantially from those observed in the previous years. Larger rise of prices had been observable across a wide range of goods and services. In addition to industrial goods and services, food prices had also risen at a faster rate, while fuel prices, having exceeded their 2020 levels, had continued to make a significant contribution to annual inflation. Council members agreed that the substantial increase in core inflation signalled stronger inflationary pressure in the economy. Decision-makers expected inflation and core inflation to follow divergent paths in the first half of 2022. The projected decline in inflation is expected to begin later, while core inflation is expected to rise further at the beginning of the year. Council members underlined that the degree to which repricing took place at the beginning of the year would determine the evaluation of the medium-term developments in inflation.

Members unanimously argued that over the medium term, anchoring inflation expectations at a level consistent with the inflation target would be key in the achievement of price stability. Council members emphasized that inflation expectations had risen in recent months. More persistent external inflationary effects and the tight labour market, coupled with a rising wage growth, might lead to an increase in second-round inflation risks. Decision-makers were of the view that in addition to longer-term macroeconomic effects, short-term inflationary effects driven by an increase in risks in financial and commodity markets continued to be of key importance as well.

In the Monetary Council's unanimous assessment, in order to ensure price stability, a monetary policy was required which was reliable and capable of responding to a quickly changing financial and commodity market environment while appropriately anchoring inflation expectations over the longer term. Decision-makers pointed out that risks in financial and commodity markets had decreased slightly since December; however, volatility was persistently high.

Judging by the sharp increase in core inflation, Council members expected persistent inflationary effects to strengthen. In order to reach the inflation target in a sustainable manner, a further general tightening of monetary conditions was clearly warranted. Reacting to the persistent increase in inflationary risks, Monetary Council members unanimously favoured increasing the increments of base rate hikes to 50 basis points and beginning the catch-up process of the base rate to the level of the one-week deposit rate. In the Council's assessment, it was necessary to raise the base rate in a larger increment than in December in order to appropriately anchor longer-term inflation expectations. Members unanimously argued that the tightening of monetary conditions had to be continued by raising the one-week deposit rate as well, while the base rate would catch up to the one-week deposit rate evolving in the coming quarters. Several members noted that the current level of short-term risks in financial and commodity markets necessitated raising the one-week deposit rate on a monthly basis. However, decision-makers signalled that if an increase in short-term risks in financial and commodity markets required action, the Council was ready to change the one-week deposit rate in a quick and flexible manner.

The Monetary Council attached great importance to achieving price stability again as soon as possible by utilising all elements of the Bank's monetary policy toolkit. Council members agreed that looking ahead, the withdrawal of the Bank's crisis management programmes in December 2021 helped to improve the central bank balance sheet and drain surplus liquidity in the banking sector.

In the Council's assessment, the cycle of base rate hikes had 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.

Inflation risks warranted a further tightening of monetary conditions. By setting the one-week deposit rate, the MNB had responded quickly and firmly to risks in financial and commodity markets of recent months. These risks had abated since December, while the sharp increase in core inflation signalled an increase in persistent inflationary pressures. In the Monetary Council's assessment, the catching up of the base rate to the level of the one-week deposit rate was warranted. Accordingly, the Council would continue the cycle of base rate hikes at a monthly frequency and in larger increments than in December. Meanwhile, the Bank would further tighten monetary conditions by raising also the one-week deposit rate. The MNB remained ready to respond quickly and flexibly by changing the one-week deposit rate, if warranted by an increase in short-term risks in financial and commodity markets.

In order to anchor inflation expectations and mitigate second-round inflation risks, the Monetary Council started the catching up of the base rate to the one-week deposit rate at its January 25 meeting. According to the January decision, the central bank base rate was raised by 50 basis points to 2.90 percent. The overnight deposit rate was increased by 50 basis points to 2.90 percent, and the overnight and the one-week collateralised lending rates was increased by 50 basis points to 4.90 percent. The MNB would continue to set the one-week deposit rate at weekly tenders and would stand ready to raise it further if necessary.

In the Monetary Council's assessment, the MNB, through an active market presence, had cushioned the spillover of tensions in international swap markets to the domestic market at end of 2021 and had facilitated the efficient sterilisation of financial system liquidity, thereby contributing to the tightening of monetary conditions. 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. Rising yields as a result of the interest rate hikes and the expected gradual fall in inflation were likely to lead to a continuous increase in real interest rates this year.

The Monetary Council attached great importance to ensuring that all elements of the Bank's monetary policy toolkit supported the return to price stability as soon as possible. The Bank had completed the withdrawal of its crisis management programmes in December 2021. Consistent with this, the MNB had not purchased government securities since December. The Monetary

Council still found it crucial to maintain stability in the government securities market. Accordingly, the Council was ready to intervene with occasional and targeted government securities purchases, if necessary, which did not imply a change in the monetary policy stance.

In the Council's assessment, the risks to inflation continued to be on the upside. Based on incoming data, the risk of the alternative scenario related to a higher external inflation environment had increased. Persistently high commodity, crop, food and energy prices and elevated international freight costs continued to point to sustained external inflationary pressures. At the same time, the tight labour market, coupled with accelerating wage growth and a higher inflation environment, might lead to a further rise in inflation expectations and an increase in second-round inflation risks.

Mitigating second-round inflation risks and driving expectations appropriately necessitated the continuation of the base rate tightening cycle on a monthly basis and in larger increments than in December. As a result, the base rate would catch up gradually to the one-week deposit rate evolving in the coming months. However, by setting the one-week deposit rate, the MNB continued to stand ready to respond quickly and flexibly to short-term risks in financial and commodity markets if necessary. The Monetary Council would continue the cycle of interest rate hikes until the outlook for inflation stabilises 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 raising the base rate to 2.90 percent the overnight collateralised lending rate, the one-week collateralised lending rate to 4.90 percent **and** **increasing the interest rate on the overnight central bank deposit to 2.90 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 22 February 2022. The minutes of that meeting will be published at 2 p.m. on 9 March 2022.