MINUTES
OF THE MONETARY COUNCIL MEETING
26 JULY 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 increased recession risks in global economy. The recent effects of financial market developments and persistently high commodity and energy prices as well as the worsening European drought, pointed to a prolonged period of high external inflation.

There had been a general deterioration in investor sentiment since the end of June. 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. Global prices of most of major commodities remained at high levels. By contrast, certain metals and oil prices had declined since the June interest rate decision.

In response to persistently high inflation, monetary conditions had been tightened further by the world's leading central banks as well as the region's central banks. At its policy meeting in July, the European Central Bank had raised its policy rate by 50 basis points and had ceased its asset purchase programme (APP) on 1 July. In the CEE region, the Polish central bank had raised its key policy rate by 50 basis points and the Romanian central bank by 100 basis points.

Hungarian economic growth had been slowing; however, annual dynamics remained buoyant. In May, industrial production and construction output had continued to expand on an annual basis. The turnover of retail stores had also risen at a double-digit rate in May relative to a year earlier. The labour market continued to be tight, and the unemployment rate remained low. Following strong growth in the first half of 2022, real time data suggested a considerable slowdown in growth, which reflected the phase-out of single income support, restrained government investment and companies' rising costs in addition to the deterioration in external economic activity.

The time profile and structure of domestic GDP growth had strongly shown a dual nature in 2022. The rate of economic growth was likely to slow in the second half of the year. Components of domestic demand, particularly household consumption, were expected to contribute to growth this year. By contrast, net exports were likely to hold down the expansion. Looking forward, however, consumption and investment dynamics were also 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. Despite the temporary slowdown, the investment rate was expected to stabilise at a high level of above 27 percent on the forecast horizon. Hungary's GDP was expected to grow by 4.5–5.5 percent in 2022, by 2.0–3.0 percent in 2023, and by 3.0–4.0 percent in 2024.

In June 2022, annual inflation had been 11.7 percent and core inflation had stood at 13.8 percent. Food prices had risen at a rate above 20 percent relative to the same period a year earlier. Repricings in June had continued to be much greater than the level in recent years. Generally rising costs continued to quickly feed through to consumer prices. The Government's measures affecting fuel and household energy prices were providing a cushion against the spillover of the increase in global commodity prices into domestic inflation. However, inflation expectations remained elevated.

The rise in energy, commodity and food prices continued to quickly feed through to consumer prices. Price dynamics were expected to peak during the autumn months and then to decline at a modest pace. The future course of price cap measures and the Government's announcements regarding the household prices of electricity and natural gas were expected to have a significant effect on the timing of the peak and the subsequent inflation path. Preventing second-round effects and anchoring inflation expectations were crucial in terms of achieving the inflation target. Inflation was expected to return to the central bank tolerance band at the end of 2023, as the first-round effects of war tensions abated, external inflationary effects moderated, the inflationary effects of the tax measures announced in June faded and as a result of the proactive central bank measures, and then to meet the 3 percent central bank target in the first half of 2024.

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 declining deficit, the government debt-to-GDP ratio might fall from 76.6 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 temporarily rise further in 2022. The deterioration in the trade balance this year was likely to reflect the deterioration 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 a result, the external balance was expected to improve quickly as the global economic environment normalises. The economy's net lending position might return to positive territory at the end of the forecast horizon.

Upside risks to inflation had strengthened further since the June interest rate decision, while the risk of second-round inflationary effects had increased. The situation in financial markets had recently increased the risk of persistent inflationary effects, posing a clear threat to price stability. In order to avoid the above risks, it had become necessary to tighten monetary conditions further; therefore, the Monetary Council had decided to raise central bank interest rates by 200 basis points on 12 July. A combination of the central bank measures and the Government's expenditure-side budget measures had together mitigated financial market risks.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. Decision makers highlighted that the Russia-Ukraine war, high commodity prices and continued disruptions in supply chains increased the risk of global recession and a persistently high external inflationary environment. The measures taken by the world's leading central banks to reduce inflation also pointed to more subdued economic activity. Several members noted that based on real time data, the Hungarian economy had grown strongly in the second quarter of 2022; however, in June and in the first weeks of July, definite signs of a slowdown had appeared.

Monetary Council members agreed that in the current environment, the MNB's key task was to continue the fight against inflation and underlined that the Bank remained committed to price stability. Council members stressed that the prolonged period of high inflation was strengthened by the recent financial market developments and the effects of persistently elevated commodity and energy prices. Some members pointed out that risk aversion in emerging markets had increased, and the risk indicators of emerging markets had risen further. As for domestic factors, it was noted that although the Government's decisions relating to regulated energy prices would raise the consumer price index from August for one year, its effect was not expected to change the longer-term outlook for inflation. However, several members emphasised that the Government's measures improved the position of the fiscal budget and the current account.

A key task for monetary policy was still to take firmest possible action in order to prevent second-round inflationary effects. Several members stressed that second-round effects could be prevented from emerging by applying a decisive tightening cycle which progressed step by step, and as a result, price stability could be achieved again after the reduction in global risks. Council members agreed that the tightening of monetary conditions should be continued in July as well by taking a decisive step in order to restore price stability, as a result of which the base rate would rise into double-digits. Consistent with its earlier communication, the MNB had closed the gap between the base rate and the one-week deposit rate at the end of June. Monetary Council members agreed that in line with the strategy developed in June, after increasing the base rate the one-week deposit rate should be raised to the same extent, so that the gap between the two rates closed again.

Several members pointed out that 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 short-term rates deemed optimal by the Monetary Council. To that end, on 8 July 2022, the MNB had started to use swap tenders providing foreign currency liquidity within quarters, which it held on a daily basis. Monetary Council members agreed that the use of swap tenders was a success; FX swap yields, decisive for money markets, had risen significantly, thereby enhancing the effectiveness of monetary policy transmission.

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, raising the base rate in a decisive manner was warranted 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 an increase in short-term risks in financial and commodity markets.

According to the Monetary Council's decision on 26 July 2022, the central bank base rate was raised by 100 basis points to 10.75 percent. The overnight deposit rate was increased by 100 basis points to 10.25 percent, and the overnight and the one-week collateralised lending rates were increased by 100 basis points to 13.25 percent. According to the Monetary Council's assessment, raising the interest rate on the one-week deposit instrument by the same measure as the base rate was warranted.

The Bank considered it crucial that short-term rates in every sub-market, particularly in the swap market, and at all times develop consistently with the level of short-term rates deemed optimal by the Monetary Council. To that end, on 8 July 2022, the MNB had started the use of swap tenders providing foreign currency liquidity within quarters and held tenders on a daily basis. By maintaining an active presence in the market, the MNB enhanced the effectiveness of monetary policy transmission, thereby supporting the achievement and maintenance of price stability.

The Magyar Nemzeti Bank had started the cycle of interest rate hikes one year ago, first among the central banks in the European Union. 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 10.75 percent, the overnight collateralised lending rate and the one-week collateralised lending rate to 13.25 percent **and** **increasing the interest rate on the overnight central bank deposit to 10.25 percent:**	8	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, 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

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 30 August 2022. The minutes of that meeting will be published at 2 p.m. on 14 September 2022.