MINUTES
OF THE MONETARY COUNCIL MEETING
22 MARCH 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:
https://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 that had broken out at the end of February had fundamentally changed the global economic outlook. Due to the geographical proximity and a larger share of trade with the two parties involved, the events were expected to have a greater effect on the European economy, especially in the Central and Eastern European region. Reaching decade highs, inflation had continued to rise in a number of countries. The war was causing additional inflationary effects through rises in commodity and energy prices, which were aggravated by a repeated increase in supply disruptions.

Global investor sentiment had deteriorated sharply due to the war. Risk appetite had been driven by news on the war, rising commodity and energy prices, an increase in inflation risks, central banks' monetary policy responses, and the consequences of the coronavirus pandemic. As a result of the war and the sanctions imposed on Russia, commodity prices had been exceptionally volatile since the previous interest rate decision: global oil prices had first risen to an eight-year peak of nearly USD 130 before adjusting, accompanied by high volatility. Gas prices in Europe had risen to their historic peak in the period.

The world's leading central banks had adopted a tighter monetary policy stance even amid increasing risks to economic growth and inflation. The Federal Reserve had started raising the policy rate in March. Decision makers pointed out that they might begin to reduce the stocks of government securities and mortgage-backed securities at their forthcoming meetings. Consistent with its earlier communication, the European Central Bank would discontinue its Pandemic Emergency Purchase Programme (PEPP) until the end of the first quarter of 2022. In addition, in March, the Governing Council had decided to withdraw its asset purchase programme (APP) at a faster pace than planned earlier. In the CEE region, the Polish central bank had held a policy meeting last month, and it had raised further its key policy rate. The central banks in the region had taken measures aimed at stabilising the market to offset the adverse effects of the Russia-Ukraine war on the financial market.

The recovery of the Hungarian economy had been strong throughout 2021. Hungarian GDP had risen by 7.1 percent in 2021, representing a significant expansion which was at the forefront in

Europe. Strong economic growth had continued at the beginning of 2022, in the period leading up to the outbreak of the Russia-Ukraine war. In January, industrial production and construction output had exceeded their pre-pandemic levels. The unemployment rate had remained low in international comparison.

The Hungarian economy continued to have a strong ability to grow. However, a high level of uncertainty surrounded the short-term economic outlook. In the coming quarters, economic activity would be strongly influenced by the war, the policy of sanctions implemented and the governments' responses to this extraordinary situation. The repercussions of the war had their strongest restraining effect on economic growth directly through trade channels and disruptions in international production chains. In addition, rises in commodity prices and companies' costs as well as a generally high level of uncertainty also restrained growth. The dual nature of economic growth was expected to persist in the coming period. Strong domestic demand might partly offset the adverse effects of the Russia-Ukraine war on growth. Exports were expected to make a smaller-than-expected contribution to GDP growth in 2022 because of the fragmentation of supply chains. From the end of 2022, Hungarian exports might grow again as external markets and supply chains recovered, which would be supported by the utilisation of new export capacities built up in recent years. Household consumption would be bolstered by an increase in wages and by the government measures aimed at boosting household income. Investment growth was likely to slow; however, the investment rate remained high. Depending on the duration of the war and the policy of sanctions, GDP was likely to expand at a slower rate than expected, by 2.5-4.5 percent in 2022, then by 4.0–5.0 percent in 2023, and by 3.0–4.0 percent in 2024.

In February 2022, annual inflation had 8.3 percent and core inflation had stood at 8.1 percent. Headline inflation and core inflation had risen by 0.4 percentage points and 0.7 percentage point, respectively, from the previous month. After January, a wide range of products and services had been repriced to a greater-than-usual extent in February, too. Food prices had continued to exhibit a double-digit increase in February relative to the period a year earlier. The price indices of core inflation sub-items had generally risen. Government measures affecting fuel, certain essential food product and residential energy prices cushioned the spillover of the increase in global commodity prices into domestic inflation. However, inflation expectations were high.

In the coming quarter, strong negative supply effects were likely to raise inflation. The short-term path of inflation would depend on the duration of the war, the extent and persistence of sanctions, as well as the governments' responses. Rises in energy and commodity prices were expected to raise inflation further on the expenditure side. As a result, inflation was likely to begin to decline later, in the second half of the year. Annual inflation was expected to be between 7.5 and 9.8 percent in 2022. Core inflation would rise further in the coming months. With the fading of the first-round effects of the war and the sanctions, the decrease in external inflationary effects and as a result of the central bank's proactive measures, inflation was expected to return to the central bank tolerance band in the second half of 2023, before reaching the central bank target of 3 percent in the first half of 2024. The consumer price index was expected to be 3.3–5.0 percent in 2023, before falling in line with the inflation target from 2024.

The government deficit and the government debt-to-GDP ratio had shifted to a declining path in 2021. The government debt-to-GDP ratio had decreased to 77.3 percent at the end of 2021 from a level of 80.0 percent at the end of 2020. The Russia-Ukraine war had increased budgetary risks through several channels, but following a gradual decline mainly due to economic growth, the debt ratio might fall to 70 percent towards the end of the forecast period. Weak external demand on the export side and high energy prices on the import side both pointed to a deterioration in the trade balance. Overall, the current account balance was expected to deteriorate this year. The external balance might start to improve rapidly from 2023, as a result of which the current account balance might turn positive by the end of the forecast period.

The Russia-Ukraine war posed a much higher risk than usual to the outlook for inflation. The increase in inflation risks warranted a further tightening of monetary conditions. Consequently, the Monetary Council deemed it necessary to continue the general tightening of monetary conditions and to continue the base rate tightening cycle by a larger increment than before. The base rate would gradually catch up to the level of the one-week deposit rate evolving in the coming months. Maintaining tighter monetary conditions for a longer period was warranted to manage increasing second-round inflation risks resulting from persistently negative supply effects. 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 short-term risks in financial and commodity markets.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. As regards domestic inflation developments, the decision makers concluded that inflation was raised by a series of significant global cost shocks (due to increases in energy and food prices as well as the rise in commodity prices in the wake of the war) since the reopening of the economy following the coronavirus pandemic. In the context of the latest domestic macroeconomic data, members emphasised that, similarly to January, there had been a greater-than-usual repricing again in February. Some decision makers pointed out that the components of core inflation had generally become more expensive. Council members agreed that the ceiling on food prices and the cap introduced for fuel prices partly offset external inflationary effects; nevertheless, inflation expectations remained high.

Some decision makers noted that the expected inflation path in the coming quarters was also influenced by the Russia-Ukraine war, the sanctions imposed as repercussions of the war, and governments' responses to the extraordinary movements in prices. Council members agreed that the inflation trajectory had shifted significantly upwards, and therefore the indicator was expected to start declining only from the second half of this year, and could return to the tolerance band in the second half of 2023 in response to the decisive central bank actions, and as the effects of external shocks unwound.

The Council concluded that the Russia-Ukraine war had increased further the risks to the outlook for inflation through growing difficulties in supply and the continued rise in commodity prices. Some members highlighted that, with the outbreak of the war, inflation developments would once again be mostly dominated by negative supply effects.

The decision makers were unanimous in arguing that the markedly higher new inflation projection relative to the December outlook justified the continuation of the tightening of monetary conditions by a larger increment than previously. The rate of increase in prices, expected to exceed the central bank target for an extended period, might lead to a sustained rise in expectations, and therefore the objective of monetary policy continued to be preventing second-round inflationary effects. Accordingly, members agreed that they would raise the base rate by a larger increment than previously while maintaining tighter monetary conditions for a longer period was warranted. Looking ahead, the base rate would converge gradually to the one-week deposit rate evolving in the coming months. At the meeting, the Council considered several options for the size of interest rate increase, of which the Council unanimously opted for the greatest (100 basis point) hike.

In the uniform opinion of members, it was particularly important that conditions in the swap market should develop in line with the monetary policy objectives. The swap facility providing foreign currency liquidity was an appropriate instrument for this purpose, which the MNB was using actively again since early March. The Council still found it crucial to ensure stability in the government securities market. Accordingly, it stood ready to intervene with occasional and targeted government securities purchases if necessary, which did not imply a change in the monetary policy stance.

In addition to tightening policy by raising the base rate, the Council considered it important that the MNB continued to stand ready to respond quickly and flexibly by setting the one-week deposit rate if risks in financial and commodity markets were to increase.

In the Council's assessment, continuing the cycle of interest rate hikes was warranted until the outlook for inflation stabilised around the central bank target in a sustainable manner and inflation risks became evenly balanced again on the horizon of monetary policy.

In order to anchor inflation expectations and mitigate second-round inflation risks, according to the Monetary Council's decision on 22 March 2022, the central bank base rate was raised by 100 basis points to 4.40 percent. The overnight deposit rate was increased by 100 basis points to 4.40 percent, and the overnight and the one-week collateralised lending rates were increased by 100 basis points to 7.40 percent. The MNB would continue to set the one-week deposit rate at weekly tenders.

The Bank placed even greater emphasis than previously on ensuring 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, the MNB was actively using its swap instrument providing foreign currency liquidity from the beginning of March.

The Monetary Council attached great importance to ensuring that every element of the Bank's monetary policy toolkit supported the return to price stability. 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 outbreak of the Russia-Ukraine war had led to a further increase in upside risks to inflation: continued rises in commodity and energy prices pointed to a persistently high external inflation environment. In addition, elevated inflation might persist for longer as a domestic inflationary effect if strong price dynamics were built into economic agents' expectations, resulting in second-round inflationary effects.

Mitigating increased fundamental inflation risks and driving expectations appropriately had necessitated the continuation of the tightening of monetary conditions, and the base rate tightening cycle by a larger increment than before. The base rate would gradually catch up to the level of the one-week deposit rate evolving in the coming months. Maintaining tighter monetary conditions for a longer period was warranted to manage increasing second-round inflation risks resulting from persistently negative supply effects. In the current turbulent period in financial markets, a key task for the MNB was to ensure market stability, in addition to meeting its primary objective of price stability. Over the past month, the Council had increased the room for manoeuvre in monetary policy by widening the interest rate corridor, which was crucial in the current situation. If necessary, the MNB stood ready to intervene using every element in its monetary policy toolkit to ensure financial market stability. The Monetary Council would continue the cycle of interest rate hikes until the outlook for inflation stabilised 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 4.40 percent, the overnight collateralised lending rate and the one-week collateralised lending rate to 7.40 percent and increasing the interest rate on the overnight central bank deposit to 4.40 percent:	8	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:

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 26 April 2022. The minutes of that meeting will be published at 2 p.m. on 11 May 2022.