MINUTES
OF THE MONETARY COUNCIL MEETING
25 OCTOBER 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.

The risk of recession in the global economy had increased further due to the prolonged Russia-Ukraine war, the European energy crisis and the generally rising interest rate environment. The effects of the exceptional drought in Europe were expected to push inflation rates up further over the short term; however, signs of an impending turnaround in commodity markets had clearly appeared. Growing recession risks, alongside falling global energy and commodity prices and international freight costs, pointed to a moderation in global inflation from 2023.

International investor sentiment remained unfavourable. Expectations for interest rate hikes by the world's leading central banks, fears of recession, the European energy crisis and concerns about the Russian-Ukrainian war had generally led to an increase in risk aversion. Global prices of most commodities had fallen in recent months but remained at high levels. Global oil prices had risen slightly. Gas futures prices in European markets had declined significantly following summer peaks.

As for the Federal Reserve and the European Central Bank, market pricing and decision makers' communications also suggested further interest rate increases. In the CEE region, the Czech and the Polish central banks had not continued to raise their policy rates. The Romanian central bank had raised its policy rate by 75 basis points, exceeding expectations.

High-frequency data showed that the Hungarian economic growth had been clearly slowing since early June. Industrial production had increased in August, with construction output remaining unchanged on a year-on-year basis. A slowdown had been seen in the annual growth rate of retail sales since the spring. The labour market continued to be tight, and the unemployment rate was low. The economic slowdown and the effects of high energy prices were increasingly reflected in a general deterioration in sentiment indicators.

The components of domestic demand were expected to be the main contributors to growth throughout this year. In 2023, growing precaution and a higher level of energy prices than before would cause household consumption to decrease. Rising costs and more uncertain demand prospects induced companies to postpone investments, while the rescheduling of public development projects would also restrain investment activity. Net exports were expected to make a positive contribution to GDP growth again from the end of 2023 as external markets and supply chains recovered. Hungary's GDP was expected to grow by 3.0–4.0 percent in 2022, by 0.5–1.5 percent in 2023, and by 3.5–4.5 percent in 2024.

In September 2022, annual inflation had been 20.1 percent and core inflation had stood at 20.7 percent. Nearly 85 percent of the 4.5 percentage point increase in inflation had been due to rises in the prices of regulated products and services and of food. The monthly change in demand-sensitive inflation, which better reflected developments in the demand environment, had slowed down. Inflation expectations remained elevated, while expectations of increases in retail prices had fallen as demand had weakened.

In the autumn months, inflation in Hungary had mainly been fuelled by items outside the scope of monetary policy. As a result of the exceptional drought and the pass-through of high energy prices, inflation would rise further at a declining pace in the coming months. The easing of external inflationary pressures, the slowdown in global economic growth and the downward pressure on prices, resulting from shrinking domestic demand, were expected to become more pronounced in domestic inflation from early 2023, leading to a gradual turnaround in price growth. Tight monetary conditions contributed to avoiding second-round inflationary effects and anchoring inflation expectations. There were symmetric risks to the outlook for inflation. The consumer price index might average between 13.5–14.5 percent in 2022. Domestic inflation would 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 the first half of 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 76 percent of GDP by the end of 2022. The current account deficit was expected to continue rising temporarily in 2022 due to the import-increasing effect of high energy prices. Nevertheless, the increasing surplus in items of the current account excluding the energy balance, falling energy prices and growing adjustment in the energy market might lead to a rapid improvement. By 2024, with the normalisation of the global economic environment and the pick-up of the production of significant new export capacities built in recent years, the external balance position was expected to improve significantly.

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 prolonged Russia-Ukraine war, the European energy crisis and the generally rising interest rate environment pointed to a further increase in global recession risks. Several decision makers underlined that the exceptional drought in Europe was expected to increase inflation in the coming months. Falling global energy prices, easing frictions in value chains and the decline in international freight costs suggested an approaching turnaround in global inflation. With regards to investor sentiment, members stressed that expectations for interest rate hikes by the world's leading central banks, fears of recession, the European energy crisis and concerns about the Russia-Ukraine war had contributed to an increase in risk aversion.

Several decision makers pointed out that the rise in domestic inflation had been driven mainly by increases in food and energy prices in recent months. Council members agreed that volatile food prices would contribute substantially to the slowing but continued increase in inflation in the coming months. Several members concluded that in parallel with the slowdown in the Hungarian economy perceivable since the beginning of the summer, domestic demand had begun to decline. This, alongside falling global commodity prices indicated a turnaround in domestic inflation as well.

Members agreed that after reaching the trough in September, the current account balance was expected to show a gradual improvement. It was highlighted that the continuous surplus in items excluding the energy balance and the unfolding adjustment in the energy market in terms of consumption and prices suggested that the pace of improvement might be faster than earlier expected.

Decision makers concluded that the 13 percent base rate, decided in September, adequately managed fundamental inflation risks. According to several members, in addition to slowing domestic demand, the emerging real interest rate also indicated moderation in inflation. Several decision makers stressed that, in order to strengthen monetary policy transmission further, the Bank was draining interbank forint liquidity from 1 October, over half of which was currently held in permanently sterilised assets.

Several Council members noted that in the turbulent financial market environment in mid-October, due to tighter liquidity, the Bank had been able to respond flexibly to significant, rapidly increasing market risks while managing factors sensitive and non-sensitive to changes in interest rate environment simultaneously. Capital flows sensitive to interest rate changes were affected by two targeted and temporary instruments: the one-day swap facility providing foreign currency liquidity and the announcement of overnight quick deposit tenders. As a result of the use of these instruments, short-term rates had risen significantly. However, some decision makers pointed out that the adjustment of swap market yields was not yet complete, and that further strengthening of monetary policy transmission could be achieved by eliminating technical barriers in financial market in the period ahead. Developments non-sensitive to changes in interest rates were managed in a way that preserved balance in the foreign exchange market through the Bank's commitment to directly meeting major foreign exchange liquidity needs arising from covering net energy imports while continuously treating the adequacy of foreign exchange reserves with high priority. At the meeting, the formal framework for granting of foreign currency liquidity was also discussed and accepted by the Council. Several decision makers stressed that balance in the foreign exchange market might also be preserved even by providing less foreign currency liquidity than earlier expected, resulting from the significant fall in European energy prices and the increasing adjustment of domestic demand for energy.

Council members agreed that maintaining the current level of the base rate for a prolonged period was warranted, while continuing to drain interbank liquidity was likely to further strengthen monetary policy transmission. Several decision makers emphasised that the instruments introduced in mid-October should be used as long as warranted by the maintenance of market stability and developments in risk perceptions. Additionally, it was also highlighted that maintaining market stability in the current turbulent environment was crucial to achieving price stability.

In line with its previous communication, the Monetary Council kept the base rate at 13.00 percent at its meeting on 25 October. 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 current 13 percent level of the base rate, resulting from the Bank’s cycle of base rate hikes, was adequate to manage fundamental inflation risks. With the real interest rate turning positive, slowing domestic demand in 2023 was expected to reduce inflation. By raising the required reserve ratio, holding central bank discount bond auctions and launching a longer-term deposit instrument from 1 October, the MNB had significantly reduced interbank forint liquidity in order to further increase the effectiveness of monetary policy transmission. Over half of this liquidity was now tied up in permanently sterilised assets.

In the current turbulent environment in financial markets, ensuring market stability was key to achieving the primary objective of price stability. The targeted and temporary measures taken by the Bank in mid-October supported the management of market risks and promoted a balance between supply and demand in the foreign exchange market. By raising the upper bound of the interest rate corridor by 950 basis points, the tighter interest rate conditions on overnight quick deposit tenders and foreign exchange swaps were raising short-term rates and properly influencing interest-sensitive capital flows. The impact of non-interest-sensitive market developments was offset by the Bank’s commitment to directly meeting major foreign currency liquidity needs arising from covering net energy imports in the coming months. The MNB continued to take into account considerations regarding the adequacy of foreign currency reserves. In recent months, domestic economic agents had begun to adjust in the energy market through a decline in energy consumption. This, along with a fall in energy prices, allowed to maintain balance in the foreign exchange market by providing less foreign currency liquidity than earlier expected.

In the Monetary Council's assessment, maintaining the current level of the base rate for a prolonged period was consistent with the achievement of the price stability objective over the monetary policy horizon. The instruments applied over the past month, designed to drain interbank liquidity, were effective in strengthening monetary policy transmission. Additionally, maintaining market stability in a rapidly changing risk environment was also crucial to achieve price stability. The MNB continuously assessed economic and financial market developments and would continue to use the instruments introduced in mid-October as long as it was warranted by the maintenance of market stability and developments in risk perceptions. Tight monetary conditions would be maintained 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, 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 22 November 2022. The minutes of that meeting will be published at 2 p.m. on 7 December 2022.