MINUTES
OF THE MONETARY COUNCIL MEETING
28 FEBRUARY 2023

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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 recent period, global economic growth had continued to slow; however, GDP growth had been more favourable than expected in the majority of EU countries. The outlook for global growth was characterised by duality. Looking ahead, the prolonged Russia-Ukraine war and the generally rising interest rate environment continued to pose significant downside risks. By contrast, the mild winter weather and the favourable levels of gas storage facilities were mitigating the adverse effects of the energy crisis in Europe, which pointed to an improvement in the outlook.

Inflation had been moderating slowly but clearly in an increasing number of countries. Weakening demand, the easing of difficulties in production chains, the normalising international freight market and falling energy and commodity prices pointed to a further decline in global inflation.

Risk appetite had been volatile since the beginning of 2023. After an initial, significant improvement, expectations for interest rate hikes by the world’s leading central banks had increased in view of incoming macroeconomic data, in parallel with this investor sentiment had deteriorated. Developments in the Russia-Ukraine war continued to create significant uncertainties.

According to both market pricing and decision makers’ communication, the Federal Reserve and the European Central Bank were expected to continue interest rate hikes further. In addition, the ECB would start reducing the portfolio built under its asset purchase programme at a predictable pace through a reduction in the reinvestment rate from March 2023 onwards. In the CEE region, the Czech, the Polish and the Romanian central banks had left key interest rates unchanged.

In 2022 as a whole, Hungary’s economic performance had increased by 4.6 percent, exceeding the EU average. Hungarian economic growth had slowed further in the last quarter of 2022. Based on preliminary data, the GDP had grown by 0.4 percent relative to a year earlier, with industry and market services being the main contributing sectors. By contrast, the significant decline in agricultural output had acted as a brake on growth. In December, the volume of retail sales and construction output had fallen, while industrial production had risen. Based on surveys, the outlook for production had deteriorated slightly over the past month, while the household

confidence indicator had remained at a low level following a slight improvement. The labour market remained tight, and the unemployment rate was low.

The time profile and structure of domestic GDP was expected to be characterised by strong duality in 2023. Initially subdued growth was expected to be followed by a pick-up in the second half of the year. Decline in real incomes, rising corporate costs, delayed public investments and the stricter interest rate environment all had a restraining impact on domestic demand. Despite subdued global economic activity, Hungary's foreign market share was expected to increase due to growing domestic export capacities, which was supported by the dynamic expansion of battery production. According to the December Inflation Report projection, Hungary's GDP was expected to increase by 0.5–1.5 percent this year, by 3.5–4.5 percent in 2024 and by 3.0–4.0 percent in 2025.

In January 2023, annual inflation had been 25.7 percent and core inflation had stood at 25.4 percent. The increase in inflation had mainly been driven by a rise in fuel prices. Incoming data had been in line with the December Inflation Report projection. The acceleration in food inflation had stopped in January. Within this group of products, the annual price indices for both processed and unprocessed food had fallen slightly. Repricing in market services at the beginning of the year had been significantly greater than previously. However, mainly two sectors, health care and telecommunications services had contributed significantly to this. Inflation expectations continued to be elevated; however, companies' expectations for retail and services prices had remained below their peak levels seen in the summer.

Disinflationary effects were expected to increase in the coming months, causing a turnaround in inflation. Global energy, commodity and food prices had fallen below the levels observed before the Russia-Ukraine war. In addition, the moderating effect on pricing arising from the fall in domestic demand and, from the spring months, the fading of base effects would support the decline in inflation. Tight monetary conditions contributed to avoiding second-round inflationary effects and anchoring inflation expectations. Domestic inflation was expected to decrease gradually 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.

A trend reversal in the current account balance had clearly started in recent months, as exports had expanded, gas prices had moderated, and household consumption had adjusted. In line with this, the current account deficit had declined substantially based on December data. From 2023, the increasing surplus in items of the current account excluding the energy balance, growing adjustment in the energy market and lower gas prices might lead to a rapid improvement. In parallel 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, and as a result, the current account deficit was expected to be reduced further.

Domestic financial market developments had been stable recently. The measures taken by the Bank – in particular the regular use of the discount bill – had restored the balance in the swap market, and its results were undoubtedly reflected in the stabilisation of the forint exchange rate.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its February monetary policy decision. In the Council's assessment, global economic growth had continued to slow; however, incoming GDP data had been more favourable than expected in a considerable number of EU countries. Several decision makers noted that inflation had been moderating slowly but clearly in an increasing number of countries. Some members highlighted that the outlook for inflation in advanced economies had deteriorated slightly in view of incoming data. Global disinflation might continue at a slower pace than anticipated at the beginning of the year. Consequently, expected interest rate paths of the world's leading central banks had shifted upwards, based on market pricing.

In terms of domestic real economic developments, several decision makers pointed out that after the fourth quarter of 2022, economic growth may have slowed further at the beginning of 2023. Several Council members noted that growth was being restrained primarily by declining domestic demand. Decision makers agreed that with a historically high number of employees and improving allocation efficiency, the labour market remained stable. Several members underlined that the current account balance had clearly started to improve based on December data. The adjustment of items excluding the energy balance and falling energy prices in Europe, coupled with stable industrial production, pointed to a further reduction in the current account deficit.

Monetary Council members stressed that incoming January data suggested the peak in inflation and a change in its structure. The acceleration in food inflation had stopped at the beginning of 2023, and the moderation may have continued in February. However, repricing in market services at the beginning of the year had been greater than previously. Decision makers pointed out that looking ahead, disinflationary effects were expected to increase in the coming months. After peaking and then gradually moderating in the first half of 2023, from the middle of the year domestic inflation was expected to decline more markedly, which was also supported by the fading of base effects.

In the unanimous view of members, the measures introduced by the Bank in the autumn to absorb interbank forint liquidity on a long-term basis had managed to stabilise financial markets through

strengthening monetary policy transmission. Based on this positive experience, the MNB would continue to use these instruments in the coming period as well. Council members agreed that the Bank should continue to use one-day deposit quick tenders and FX swap transactions announced in mid-October in the coming period. In addition, decision makers stressed that the Bank would continue to be available in meeting foreign currency liquidity needs to reach market balance related to the energy account.

The January decision to raise the required reserve ratio to 10 percent was complemented by applying a tiered structure to the interest rate on reserve accounts in February. In the decision makers' assessment, the Council had tightened further the impact of the required reserves on liquidity through these measures, thereby continuing to strengthen monetary policy transmission. Some members emphasised that even with the increased required reserve ratio, there would be ample liquidity in the banking system.

Monetary Council members were unanimous in pointing out that the fundamental outlook for inflation warranted maintaining the base rate at its current level for a prolonged period. Decision makers were of the view that maintaining the 18 percent interest rate at one-day deposit quick tenders remained necessary. Council members agreed that the Bank should take into account the persistence of the recent improvement in risk perceptions when setting the conditions of overnight instruments introduced in mid-October, while continuing to focus on trend-like developments.

The Monetary Council kept the base rate at 13 percent at its meeting on 28 February. The current level of the base rate was adequate to manage fundamental inflation risks. The O/N deposit rate and the O/N collateralised borrowing rate were left unchanged at 12.5 percent and 25 percent, respectively.

There had been a general and broad-based increase in yield environment as a result of the MNB's instruments introduced in the autumn to absorb interbank forint liquidity on a long-term basis, i.e. the revised reserve requirement system, the one-week discount bill and the long-term deposit tender. These measures had led to a sustained improvement in monetary policy transmission, which was critical to achieving the price stability objective over the monetary policy horizon. Based on this positive experience, the MNB would use these instruments in the coming period, as well.

By raising the reserve requirement ratio and restructuring interest rates, the Monetary Council had tightened further the impact of the required reserves on liquidity. At its January meeting, the Council had decided to raise the required reserve ratio to 10 percent, effective from 1 April. At its meeting on 28 February, the Council made changes to the interest rate on reserve accounts in

order to increase further the amount of liquidity absorbed on a long-term basis and thereby to improve monetary policy transmission. The MNB would exempt 2.5 percent of the reserve base from bearing interest, while continuing to remunerate the base rate on 7.5 percent of the reserve base, and, in order to encourage greater utilisation, optional reserves would be remunerated at the overnight quick deposit tender rate instead of the base rate.

In addition to strengthening monetary policy transmission, the Bank would use one-day deposit quick tenders and FX swap transactions in the coming period in order to ensure financial market stability, and it would continue to be available in meeting foreign currency liquidity needs to reach market balance related to the energy account.

In the Monetary Council's assessment, it was necessary to maintain the current level of the base rate over a prolonged period, which would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. The MNB was constantly assessing incoming data and developments in the outlook for inflation and was ready to take appropriate actions if risks increased. Looking ahead, maintaining market stability and strengthening monetary policy transmission were also key to achieving price stability. The MNB continued to focus on trend-like developments in financial market conditions. Therefore, the Bank took into account the persistence of the recent improvement in risk perceptions when setting the conditions of overnight instruments introduced in mid-October.

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:	7	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, Bianka Parragh, Gyula Pleschinger, 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

Bianka Parragh

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 28 March 2023. The minutes of that meeting will be published at 2 p.m. on 12 April 2023.