MINUTES
OF THE MONETARY COUNCIL MEETING
25 JULY 2023

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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 outlook continued to be characterised by duality. Output growth was expected to slow in developed countries. Meanwhile, growth in emerging countries was likely to be similar to last year. In most countries, labour markets were tight. Among the major economies, annual economic growth in China had been below expectations in 2023 Q2. The easing of the energy crisis in Europe pointed to an improvement in the outlook for economic activity on the Continent. However, the ongoing Russia-Ukraine war and the persistently high inflationary environment were posing downside risks to growth.

Global inflation rates had continued to fall. The slowdown in global economic activity, the correction in energy and commodity prices and the fall in international freight costs pointed to a further decline in inflation rates. However, core inflation indicators, generally falling at a slow pace, suggested that achieving price stability again might take longer than earlier expected.

Risk appetite had been volatile since the June policy decision. The temporary deterioration in global investor sentiment in the first week of July had been followed by a quick reversal. In terms of international data, domestic financial markets had showed a stronger reaction than regional ones to US labour market and inflation data as well as movements in the dollar exchange rate. Oil prices had risen slightly, while European gas prices had fallen over the past month. The uncertainty due to the Russia–Ukraine war continued to have a negative impact on investor sentiment.

Communications by the Federal Reserve's (Fed) and the European Central Bank's (ECB) decision makers had suggested that interest rate hikes were likely to continue. Nevertheless, based on market expectations, both central banks were nearing the end of their tightening cycle. Central banks in the CEE region had not changed their monetary conditions; however, a professional debate on the timing of interest rate cuts had recently begun in the region.

In 2023 Q1, Hungary's GDP had declined by 0.9 percent. Industrial and construction output as well as the volume of retail sales had continued to fall in May. Monthly production indicators and high-frequency data also suggested that the decline in Hungary's economic performance had continued in the second quarter. The household confidence indicator remained at a low level. The labour market remained tight, and the unemployment rate was low.

In 2023, declining annual average real wages, rising corporate costs and cautious consumer and investment decisions all contributed to a decline in domestic demand, while net exports supported output growth. In parallel with declining inflation, rising real wages were expected to support a pick-up in GDP growth from the second half of the year. This year's economic performance was also expected to be improved by the correction in agricultural growth after last year's drought. Hungary's GDP was expected to grow by 0.0–1.5 percent in 2023, by 3.5–4.5 percent in 2024 and by 3.0–4.0 percent in 2025.

The rapid decline in inflation had continued in June. Consumer prices had risen by 20.1 percent in annual terms and core inflation had stood at 20.8 percent. The consumer price index had fallen by 1.4 percentage points compared to May, primarily reflecting a slowdown in the rate of increase in food and tradables prices. Core inflation had slowed across a wide range of products. As a result, this indicator had declined by 2.0 percentage points from the previous month. Services inflation had eased for the first time since July 2021. Inflation expectations of both households and companies had fallen.

In the coming months, domestic inflation and core inflation would continue to decrease at a rapid pace. During 2023, the disinflationary effect of tight monetary policy, falling global commodity prices, declining domestic consumption and the Government's measures to strengthen market competition would become increasingly apparent. Disinflation was likely to continue to accelerate. As a result, inflation was expected to reach single digits by the end of the year, while core inflation might fall at a slightly slower pace. The consumer price index might return to the central bank tolerance band in early 2025. Annual inflation might fluctuate between 16.5–18.5 percent in 2023, 3.5–5.5 percent in 2024 and 2.5–3.5 percent in 2025.

The fiscal deficit would continue to decline this year. The budget appropriation for the 2023 deficit was 3.9 percent. Based on the 2024 Budget Act, the accrual-based deficit target was 2.9 percent in 2024 and 1.9 percent in 2025. The government debt ratio was expected to fall from 73.3 percent at the end of 2022 below 70 percent by the end of 2023, and then below 65 percent by the end of the forecast horizon, driven by nominal GDP growth and a declining deficit.

The external balance had continued to improve further. The current account balance had registered a significant surplus in May 2023, primarily due to a trade surplus of EUR 1.3 billion, a historic high. The trend-like improvement in the external balance had been driven by the more favourable energy balance and terms of trade, the adjustment of domestic demand and strong export growth. This year, the current account deficit was expected to be more favourable than projected in June, being below 2 percent of GDP as the trade balance improved. In parallel with the utilisation of new export capacities built recently and a normalising global economic environment, the trade balance and net lending would continue to improve in 2024.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its July monetary policy decision. In assessing the global outlook for growth, several Council members pointed to a deterioration in the outlook for economic activity in major economies. Other decision makers pointed out that inflation was declining globally; however, core inflation rates were falling only at a slow pace.

In assessing inflation data for June, Monetary Council members noted that domestic inflation had continued to fall rapidly. Decision makers highlighted that there had been a broad-based slowdown in inflation, with prices falling in nearly a third of the consumer basket on a monthly basis. High-frequency data indicated that, following June, food prices had also moderated in July. Some members noted that services inflation had slowed for the first time since July 2021. Decision makers reiterated that, looking ahead, disinflation was likely to continue to accelerate, and as a result, inflation was expected to clearly decline to single-digit levels by the end of the year. However, Council members also pointed out that core inflation might fall at a slightly slower pace. Several members highlighted that the consumer price index should decline further in 2024 in order to achieve price stability.

Discussing real economic developments, the Monetary Council concluded that the decline in Hungary's economic performance may have continued in the second quarter. However, in the unanimous view of members, high-frequency data suggested that economic activity would pick up again from the second half of the year, which was supported by rising real wages in parallel with declining inflation and the correction in agricultural production. Some decision makers noted that the trade surplus had been at a record high in May. In this regard, some members indicated that there was a good chance that the current account deficit in 2023 would be below 2 percent of GDP, more favourable than projected in the June Inflation Report.

In members' view, the MNB had succeeded in ensuring financial market stability using its instruments introduced in mid-October 2022, and the risk environment had improved persistently and significantly since then. However, decision makers underlined that domestic financial markets had recently been more sensitive to international macroeconomic developments compared to other countries of the region. In the Council's unanimous view, continued risks, i.e. expectations regarding the interest rate paths of the Fed and the ECB and the uncertainties caused by the Russia-Ukraine war, had warranted a cautious and gradual approach in monetary policy. The persistence of improvements in risk perceptions had to be assessed carefully.

The Monetary Council was in full agreement that it was necessary to maintain tight monetary conditions in order to achieve price stability; therefore, members unanimously argued in favour of leaving the base rate at its current level and saw no reason to change it in the coming months. Council members agreed that, at 13 percent, the level of the base rate would ensure that inflation expectations were anchored and the inflation target was met in a sustainable manner. Several decision makers stressed that with inflation falling rapidly, ex-post real interest rates might turn positive as early as the autumn.

In the Council's assessment, the risk environment remained favourable but showed greater volatility compared to the previous months, which warranted the maintenance of a cautious approach. Council members agreed that the Bank might continue the normalisation of the interest rate environment at the previous pace at its July 2023 policy decision. Accordingly, the Monetary Council unanimously decided to reduce the upper bound of the interest rate corridor and the interest remunerated on optional reserves by 100 basis points to 17.5 percent and 15 percent, respectively. The decision makers were in consensus that it was warranted to reduce the interest rate on one-day quick deposit tenders and foreign exchange swap tenders by 100 basis points. It was necessary to implement the normalisation of interest rate conditions depending on the improvement of the risk environment, which the Monetary Council would continuously consider at the next policy meetings. The decision makers indicated that if the improvement in risk perceptions persisted, the Bank would continue the gradual convergence of the interest rate conditions of one-day tenders to the base rate. The Monetary Council agreed unanimously that maintaining financial market stability was key to achieving price stability.

In the Monetary Council's assessment, it was necessary to maintain tight monetary conditions in order to achieve price stability. At its meeting on 25 July 2023, the Council left the base rate unchanged at 13 percent. The current level of the base rate was adequate to manage fundamental inflation risks.

In the Monetary Council's assessment, the still favourable risk environment enabled the Bank to continue the normalisation of the interest rate environment at the previous pace. Accordingly, the Council decided to reduce the interest paid on optional reserves by 100 basis points, from 16 to 15 percent at the July meeting, with effect from 26 July. In addition, the O/N collateralised lending rate serving as the upper bound of the interest rate corridor was lowered by 100 basis points to 17.5 percent. According to the Council's assessment, it was also warranted to reduce the interest rate on one-day quick deposit tenders and foreign exchange swap tenders by 100 basis points.

In the Monetary Council's assessment, looking ahead, strengthening monetary policy transmission was also an important factor of achieving price stability. For this reason, the Bank would use the instruments to absorb interbank forint liquidity on a long-term basis in the coming period.

In the Monetary Council's assessment, maintaining the current level of the base rate would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. Looking ahead, financial market stability was also key to achieving price stability. In the current environment, a cautious and gradual approach was warranted. The MNB was constantly assessing the effects of international financial market developments on the domestic risk environment, incoming macroeconomic data and developments in the outlook for inflation. If the improvement in risk perceptions persisted, the Bank would continue the gradual convergence of the interest rate conditions of one-day tenders to the base rate at the previous pace.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 13.00 percent, reducing the overnight collateralised lending rate to 17.50 percent and maintaining the interest rate on the overnight central bank deposit at 12.50 percent:	9	Éva Búza, Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, Zoltán Kovács, György Matolcsy, Mihály Patai, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

The following members of the Council were present at the meeting:

Éva Búza

Péter Gottfried

Csaba Kandrács

Kolos Kardkovács

Zoltán Kovács

György Matolcsy

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 29 August 2023. The minutes of that meeting will be published at 2 p.m. on 13 September 2023.