# MINUTES
# OF THE MONETARY COUNCIL MEETING
# 23 MAY 2023

Time of publication: 2 p.m. on 7 June 2023

*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 global economic outlook continued to be characterised by duality. In 2023, output growth was expected to slow in developed countries. In emerging countries, growth was likely to be similar to last year. In most countries, labour markets were tight. The Russia-Ukraine war and the persistently high inflation environment were posing downside risks to growth. The reversal of energy prices and the high level of gas storage facilities were mitigating the adverse effects of the energy crisis in Europe, which pointed to an improvement in the outlook for economic activity on the Continent.

The turnaround in inflation had been emerging in an increasing number of countries in the world. The slowdown in global economic activity, the correction in energy and commodity prices and the fall in international freight costs pointed to continued global disinflation. However, the slow change in the trend of core inflation suggested that the normalisation of inflation might take longer than earlier expected.

Investor sentiment had improved since the Monetary Council's last policy decision. As a result of a US bank failure in early May, concerns about certain participants of the global banking system had increased again; however, market turbulence had proved to be temporary. Market participants' attention had been focused on expectations for interest rate policies of the world's leading central banks, the US debt ceiling, and macroeconomic data releases, in addition to the events relating to the bank failure.

Both the Federal Reserve (Fed) and the European Central Bank (ECB) had raised their policy rates by 25 basis points. Based on market expectations, the Fed was nearing the end of its tightening cycle while the ECB might raise its policy rate further in a few more steps. In line with expectations, central banks in the CEE region had not changed monetary conditions.

Hungary's GDP had fallen in the first quarter of 2023. Based on preliminary data, Hungary's GDP had declined by 0.9 percent year on year, with the weakness in industrial output being the main contributing factor, as the decline had been partly offset by the performance of agriculture and services. The household confidence indicator remained at a low level. 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 duality this year. Output growth would be weighed down mainly by domestic demand factors, while export sales would continue to grow steadily. Economic growth was expected to pick up again from the second half of the year as inflation declined markedly and investment recovered. Both internal and external factors might make a positive contribution to growth in 2024. 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.

In April, inflation had continued to decline at a faster rate than previously. Annual inflation had been 24.0 percent and core inflation had stood at 24.8 percent. The consumer price index had fallen by 1.2 percentage points compared to the previous month. A slowdown in inflation had been seen across a wide range of products. The fall in core inflation had primarily reflected a fall in processed food price inflation. Market services were still characterised by significant monthly price increases. Inflation expectations of both households and companies had fallen.

Tight monetary conditions had broader disinflationary effects. The consumer price index was expected to continue to decrease at an accelerating pace in the next months, which would also be strongly supported by the growing impact of base effects from the middle of the year. The consumer price index would return to the central bank tolerance band in 2024. Inflation was projected to be 15.0–19.5 percent in 2023, 3.0–5.0 percent in 2024 and 2.5–3.5 percent in 2025.

The fiscal deficit would continue to decline this year. The deficit was projected to be 3.9 percent in 2023. The government debt ratio might fall to 69 percent in 2023 and to close to 65 percent by the end of 2025.

The external balance had continued to improve. After two years, the current account balance had turned positive again in March 2023. The trend-like improvement in the external balance had been driven by a decrease in the energy balance, more favourable terms of trade, the adjustment of domestic demand and the dynamic growth of exports. The current account deficit was expected to decline to a level between 3 percent and 4 percent this year. In parallel with a normalising global economic environment and the utilisation of new export capacities built recently, 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 May monetary policy decision. In the Council's assessment, the outlook for global growth continued to be characterised by duality. The turnaround in inflation had continued in several countries; however, some members pointed out that based on core inflation indicators, the decline in the consumer price index in most countries might be slower than earlier expected.

Discussing domestic real economic developments, the Monetary Council concluded that in the first quarter of 2023, a duality had emerged in the structure of domestic GDP. Some decision makers noted that industrial and construction output had fallen; however, the decline in economic output was partly offset by growth in agriculture and services. Some members highlighted that incoming data suggested that export sales continued to grow. The decision makers agreed that the trend-like improvement in the external balance and current account data in the beginning of the year suggested that the indicator might evolve more favourably in 2023 even compared to the forecast in the March Inflation Report.

Monetary Council members stressed that disinflation had changed pace in April. The decline in inflation and core inflation indicators primarily reflected a slowdown in food and industrial goods price inflation. Some decision makers pointed out that the moderation in inflation was seen across a wide range of products, as the rate of price increases had slowed in more than half of the consumer basket in annual terms. Other Council members concluded that market services were still characterised by significant monthly repricing, which might result in a slower decline in core inflation compared to that expected in headline inflation. The Council was unanimous in its view that the cycle of rate hikes, which had been started in Hungary in June 2021, first in the European Union, and had been accelerated in 2022, was having an increasingly broad disinflationary effect. Decision makers pointed out again the expected strengthening impact of base effects from the middle of the year, and underlined that as a result of these effects inflation was likely to fall into the single-digit range until the end of 2023.

The Monetary Council was in agreement that, looking ahead, maintaining tight monetary conditions was necessary to achieve price stability; therefore, there was a strong consensus in favour of leaving the base rate at its current level. Several decision makers stressed that the process of disinflation should continue in 2024. Some members highlighted that through the slowdown in inflation and the maintenance of a tight monetary policy, the real interest rate might turn positive at the end of 2023, which was necessary to a persistent decline in inflation. The

Council was unanimous in its view that the Bank should continue to do everything to anchor inflation expectations and rapidly achieve the inflation target.

In the members' assessment, by introducing the overnight instruments in mid-October 2022, the MNB had succeeded in ensuring financial market stability and the risk environment had improved persistently and significantly since then. Decision makers indicated that although concerns about certain participants of the global banking system had increased temporarily at the beginning of May, market turbulence had not proved lasting and there had been a general improvement in investor sentiment towards emerging economies. In addition, some members noted that the world's leading central banks might discontinue their tightening cycles in the foreseeable future. Decision makers also highlighted that in parallel with external developments Hungary's risk perception had improved as well. Domestic foreign exchange market had stabilised, the government securities market and the capital and liquidity positions of domestic banks were stable, and there had been a strong and trend-like improvement in Hungary's external balance position. Some members underlined that the current account balance had been in surplus in March for the first time in two years, with the adjustment of domestic demand and export growth playing a significant role, in addition to the fall in energy prices.

The consensus among decision makers was that the improvement in risk perceptions had been persistent, which enabled the Bank to take additional steps towards the normalisation of its monetary policy. Regarding this, Council members agreed that it was warranted to reduce the interest rate on overnight quick deposit tenders and foreign exchange swap tenders by 100 basis points. Accordingly, the Council decided to reduce the upper bound of the interest rate corridor and the interest remunerated on optional reserves by 100 basis points.

Monetary Council members were unanimous in their view that as the current level of the base rate was adequate to manage fundamental inflation risks, there was no reason to apply changes at the May meeting or at the upcoming months' meetings. Decision makers also emphasised that in order to maintain market stability, interest rates on the overnight instruments introduced on 14 October 2022 should be aligned with the base rate gradually, carefully, step by step. However, Council members noted that if the improvement in risk perceptions persisted, continuing with normalisation would be warranted. 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. The Council left the base rate unchanged at 13 percent at its meeting on 23 May 2023. The current level of the base rate was adequate to manage fundamental inflation risks.

There had been a sustained and significant improvement in domestic financial market stability recently, driven by external and internal factors. The turmoil in developed economies' banking systems observed in recent months had had no global spillover effects. Investor sentiment towards emerging economies had widely improved. The risk of a European energy crisis had decreased, while there had been a strong and trend-like improvement in Hungary's current account balance. The capital and liquidity positions of domestic banks was stable.

In the Monetary Council's assessment, the persistent improvement in risk perceptions had enabled the Bank to take additional steps towards the normalisation of the interest rate environment. In accordance, the Council decided to reduce the interest paid on optional reserves by 100 basis points, from 18 to 17 percent at its meeting in May, with effect from 24 May. In addition, the O/N collateralised lending rate serving as the top of the interest rate corridor was lowered by 100 basis points to 19.5 percent. According to the Council's assessment, a reduction in the interest rate on the one-day quick deposit tenders and foreign exchange swap tenders by 100 basis points was warranted.

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, 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. 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 incoming data and developments in the outlook for inflation and was closely monitoring the effects of international financial market developments on the domestic risk environment. 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.

**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 19.50 percent** **and** **maintaining the interest rate on the overnight central bank deposit at 12.50 percent:** | 8 | Éva Búza, Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, Zoltán Kovács, György Matolcsy, Mihály Patai, Barnabás Virág |
| **Vote against:** | 0 | |

**<u>The following members of the Council were present at the meeting:</u>**

Éva Búza

Péter Gottfried

Csaba Kandrács

Kolos Kardkovács

Zoltán Kovács

György Matolcsy

Mihály Patai

Barnabás Virág

**The Council will hold its next policy meeting on 20 June 2023. The minutes of that meeting will be published at 2 p.m. on 5 July 2023.**