MINUTES
OF THE MONETARY COUNCIL MEETING
24 OCTOBER 2023

Time of publication: 2 p.m. on 8 November 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:
https://www.mnb.hu/en/monetary-policy/the-monetary-council/minutesminutes

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.

Geopolitical tensions had intensified recently, which had led to a general increase in risks surrounding the outlook for economic growth and investor sentiment. In 2023 Q2, economic growth in the European Union had slowed while growth had accelerated in the US. Economic growth in China had slowed in the third quarter, but it had exceeded expectations. However, the short-term economic outlook was exposed to downside risks. The persistently high inflationary environment and the ongoing Russia-Ukraine war continued to be a source of significant uncertainty to the outlook for economic activity globally, and particularly in Europe. The escalation of the Gaza-Israel conflict in early October had added to uncertainty, contributing to the general increase in geopolitical tensions.

Global trends pointed to continued disinflation. Weakening global economic demand, lower commodity prices compared to the previous year and the correction in international freight costs suggested a continued decline in inflation rates. However, renewed and significant rises in oil and gas prices might stall disinflation. This, combined with core inflation indicators decreasing more slowly, suggested that achieving price stability again was expected to be a protracted process in general.

Global risk appetite had deteriorated since the September policy decision in response to elevated geopolitical risks and rises in developed market yields. Based on market expectations, the Fed was nearing the end of its tightening cycle and the ECB's interest rates may have peaked; however, monetary conditions would remain tight for a prolonged period, according to communication from both central banks. In the CEE region, the Polish central bank had lowered its policy rate by 25 basis points to 5.75 percent in October, and the Czech and Romanian central banks had left their interest rates unchanged.

Based on high-frequency data, the gradual increase in domestic economic activity had begun in the third quarter. The household confidence indicator had improved slightly in August, but had remained at a low level. In August, industrial production, construction output and retail sales had fallen in annual terms. By contrast, vehicle production, accounting for the largest share of industrial production, had increased. The labour market remained tight, and the unemployment rate was low.

In 2023, subdued economic performance had mainly reflected high inflation and declining government investment. Falling real wages in the first eight months of the year due to price rises, coupled with consumer and investment decisions becoming cautious, had led to a decline in domestic demand. However, this year’s economic performance was expected to be improved significantly by the correction in agricultural growth after last year’s drought. The real wage index, increasing since September, was also expected to contribute to a slow pick-up in performance towards the end of the year. Hungarian exports might also rise in 2023, and imports were expected to fall due to the decline in domestic demand items and lower energy prices. Net exports were expected to make a positive contribution to economic growth in 2023. Declining inflation and the recovery in domestic demand components were likely to support GDP growth in 2024 and 2025. With the pick-up in the production of new export capacities built recently, Hungary’s export market share was expected to increase further. In our projection, Hungary’s economic performance was expected to be in the range of (-0.5)–0.5 percent in 2023. In 2024 and 2025, Hungary’s GDP was expected to expand by 3.0–4.0 percent.

The widespread and general decline in domestic inflation had continued in September. Consumer prices had risen by 12.2 percent in annual terms and core inflation had stood at 13.1 percent. The consumer price index had been significantly, 4.2 percentage points lower than the August value, primarily reflecting the slowdown in the price dynamics of regulated products and services as well as processed food, although fuel price inflation had risen. Core inflation had slowed across a wide range of products and services, so the indicator had declined by 2.1 percentage points from the previous month. The three-month annualised change in core inflation, an indicator better capturing underlying inflation in the current situation, had fallen below 4 percent, a level last seen before Covid-19. Recent monthly repricings reflected in inflation and core inflation had corresponded to the historical average for September.

In the coming months, domestic CPI inflation and core inflation would continue to decrease. Tight monetary policy, lower commodity prices compared to last year, subdued domestic consumption and the Government’s measures to strengthen market competition were expected to have an increasingly broad-based strong disinflationary effect. Annual inflation was expected to reach the

7–8 percent territory towards the end of the year. The consumer price index was expected to return to the central bank tolerance band in 2025. Annual inflation might fluctuate between 17.6–18.1 percent in 2023, 4.0–6.0 percent in 2024 and 2.5–3.5 percent in 2025.

Due to the high fiscal deficit in the first half of the year, less favourable macroeconomic developments than expected and the increase in expenditures, the Government had raised the ESA deficit target for 2023 from 3.9 percent to 5.2 percent in early October. The government debt ratio was expected to fall from 73.9 percent at the end of 2022 to nearly 71 percent by the end of 2023, to be followed by annual declines of around 2.5 percentage points.

There had been a rapid and substantial improvement in the external balance. The current account had been in surplus again in August 2023. The significant improvement in the external balance position had been driven mainly by lower energy prices compared to the previous year, the adjustment of energy consumption, shrinking import intensity due to subdued domestic demand, and growing vehicle and battery industry exports. From 2024, the favourable external balance position was expected to persist, reflecting the utilisation of new export capacities built recently and a normalising global economic environment. Overall, the current account deficit was expected to fall below 1 percent of GDP in 2023, with the balance expected to improve further over the forecast horizon.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its October monetary policy decision. In the Council's assessment, the risks to the global economic outlook were being exacerbated by a further rise in geopolitical tensions. Several Council members noted that the Gaza-Israel conflict could cause a renewed, significant international financial market uncertainty. The decision-makers pointed out that although global trends pointed to the continuation of disinflation, renewed and significant rises in oil and gas prices could stall the process. Some members drew attention to the fact that international core inflation indicators typically continued to fall slowly, so the world's leading central banks might maintain tight monetary conditions over a longer term.

The significant and widely perceptible decline in domestic inflation continued. Members concluded that domestic inflation data for September also confirmed that tight monetary policy and the Government's measures to strengthen competition played a key role in the increasingly broader disinflationary process, which was supported by lower commodity prices compared to last year and subdued consumption. Some members noted that the level of prices in the basket excluding fuel and regulated prices had fallen in September, while that the narrowing in the margin on fuel prices had restrained inflation. The Monetary Council concluded that inflation had been in line with the June Inflation Report projection, while core inflation had been somewhat more favourable than expected. Several members noted that the short-run measure of core inflation, an indicator better capturing underlying inflation in the current situation, had fallen below 4 percent, a level last seen before Covid-19.

The Council was in agreement that despite the favourable trends, inflation continued to be unacceptably high. Some members noted that real interest rates had risen to positive territory in a number of developed and emerging economies. Several members pointed out that with the acceleration in disinflation, the domestic real interest rate had moved into positive territory in September and, with inflation falling dynamically, it was expected to rise gradually until the end of the year. Members noted that inflation would reach the 7–8 percent range towards the end of this year. This, however, continued to be significantly above the central bank target of 3 percent necessary to achieve a sustainable growth path; therefore, the Council was unanimously of the view that the disinflation process should continue in 2024.

Some decision-makers stressed that based on high-frequency data, domestic economic activity had begun to pick up gradually in the third quarter as inflation had fallen noticeably, and, as a result, the economy may have recovered from recession. With the moderation in inflation, real wages would rise in the autumn, which also contributed to the improvement in economic performance and the recovery in consumption towards the end of the year. In the Council's unanimous view, the decline in inflation and the strengthening in domestic demand items would support GDP growth in 2024 and 2025, and therefore balanced economic growth of 3-4 percent was expected from next year. The Council was in agreement that Hungary's external balance showed a significant improvement in a European comparison: the current account deficit might fall below 1 percent in 2023 and was expected to improve further over the forecast horizon.

The decision-makers noted that global risk appetite had fallen since the September policy decision due to the increase in geopolitical risks and rises in yields in developed markets, while the key domestic financial markets had remained stable. The Council was in agreement that the existing risks, i.e. persistently high interest rate conditions of the world's leading central banks, the Russia-Ukraine war and the renewed Gaza-Israel conflict, warranted a cautious and careful approach to monetary policy.

Monetary Council members were unanimous in their view that strong disinflation and the reduction in the country’s vulnerability made it possible to lower the base rate. The decision-makers discussed alternatives of reducing the base rate by 100, 75 or 50 basis points, and considered it appropriate to maintain a cautious approach and to continue the series of interest rate reductions at a slower pace than previously, due to increasing external risks. Of the three options discussed, Council members unanimously voted to reduce the base rate and the interest rate corridor by 75 basis points. The decision-makers pointed out that it was still necessary to maintain tight monetary conditions in order to achieve price stability in a sustainable manner.

With the October decision, monetary policy entered a new phase, where the Monetary Council took its decisions step-by-step, carefully and in a data-driven manner, paying particular attention to incoming data, factors influencing the inflation path and developments in the risk environment.

Strong disinflation and a reduction in the country’s vulnerability allowed the MNB to continue shaping monetary conditions by lowering the base rate. At the same time, a cautious approach and a slower pace of interest rate cuts were warranted in view of the increasing external risks. In line with this, at its meeting on 24 October 2023 the Monetary Council cut the base rate by 75 basis points to 12.25 percent. Accordingly, the lower bound of the interest rate corridor, the O/N deposit rate, was reduced to 11.25 percent, while the upper bound, the O/N loan rate, would be reduced to 13.25 percent. With disinflation accelerating, the domestic real interest rate had moved into positive territory in September and, with inflation falling dynamically, it was expected to rise gradually until the end of the year.

Risks surrounding global disinflation and volatility in international investor sentiment warranted a careful approach to monetary policy. The Council was constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment, and it would take decisions on additional changes in monetary conditions based on these factors in the coming months.

Votes cast by individual members of the Council:

In favour of reducing the base rate to 12.25 percent, reducing the overnight collateralised lending rate to 13.25 percent and reducing the interest rate on the overnight central bank deposit to 11.25 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 21 November 2023. The minutes of that meeting will be published at 2 p.m. on 6 December 2023.