MINUTES
OF THE MONETARY COUNCIL MEETING
26 SEPTEMBER 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:
https://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.

In 2023 Q2, economic growth in the European Union had slowed to 0.4 percent in annual terms, while growth had accelerated in the US and China. The short-term economic outlook was surrounded by downside risks. The persistently high inflationary environment, the ongoing Russia-Ukraine war and generally increasing geopolitical tensions continued to be a source of significant uncertainty to the outlook for economic activity globally, and particularly in Europe.

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. Renewed and significant rises in oil prices might stall disinflation. This, combined with the effects of core inflation indicators generally decreasing more slowly suggested that achieving price stability again was expected to be a protracted process.

Global risk appetite had deteriorated since the August policy decision. Investor sentiment had been driven by incoming macroeconomic data releases and expectations for interest rate policies of the world's leading central banks. At its rate-setting meeting in September, the Federal Reserve (Fed) had left monetary conditions unchanged. By contrast, the European Central Bank had raised its policy rate by 25 basis points. Based on market expectations, the Fed was nearing the end of its tightening cycle, while the ECB had reached it. In the CEE region, the Polish central bank had lowered its policy rate by 75 basis points to 6.00 percent in September, while based on market expectations, the Czech and Romanian central banks might begin cutting their interest rates later.

Hungary's GDP had declined by 2.4 percent year-on-year in 2023 Q2. The main contributor to the downturn in economic performance had been the decline in industrial and construction output and market services, while agricultural performance and that of the health and social care sector had moderated the decline. On the expenditure side of GDP, net exports and government final consumption had made positive contributions to growth, while household consumption and gross fixed capital formation had declined sharply. In July, the volume of industrial output and retail sales had fallen further, while construction output had risen. Of the manufacturing sub-sectors, production volumes had increased in vehicle production and in the manufacture of electrical equipment. Based on high-frequency data, the gradual increase in domestic economic activity had begun in the third quarter. The household confidence indicator remained at a low level. The labour market remained tight, the unemployment rate was low.

In 2023, low economic performance had mainly reflected high inflation and the stalling of government investments. Falling real wages due to price rises and 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, turning positive, 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. As a result, 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 current projection, Hungary's economic performance was expected to be in the range of (-0.5)–0.5 percent. 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 August. Consumer prices had risen by 16.4 percent in annual terms and core inflation had stood at 15.2 percent. The consumer price index had been 1.2 percentage points lower than the level in July, primarily reflecting the slowdown in the rate of growth of processed food and tradables prices, although fuel price inflation had risen. Core inflation had slowed across a wide range of products and services, so the indicator had declined by 3.3 percentage points from the previous month. The recent repricing had reflected in inflation and core inflation had matched the historical average usually seen in August.

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 disinflationary effect. Annual inflation was expected to reach the 7–8 percent territory towards the end of the year. The inflation path expected for next year had shifted upwards slightly compared to the June forecast due to the carry-over effect of higher fuel prices.

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.

The fiscal deficit would continue to decline this year. With the macroeconomic path, and particularly the path of consumption, being substantially weaker than expected, the deficit was likely to be above this year's target of 3.9 percent. The exact level of the deficit would be largely influenced by developments in expenditures around the end of the year. The government debt ratio was expected to fall from 73.3 percent at the end of 2022 to nearly 70 percent by the end of 2023, to be followed by annual declines of 2.5 percentage points.

There had been a rapid and substantial improvement in the external balance. In July 2023, the current account had been close to balance. 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 and shrinking import intensity due to subdued domestic demand. In parallel, with a pick-up in vehicle and battery production, buoyant exports had also supported the improvement in the trade balance. 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.

The Monetary Council had highlighted three alternative scenarios around the baseline projection in the September Inflation Report. In the Council's risk assessment, the inflation outlook was surrounded by upside risks, while the outlook for growth was characterised by downside risks. The risk scenario featuring decelerating global economic activity was consistent with a lower growth and inflation path compared to the baseline scenario. In the alternative scenario assuming a withdrawal of capital from emerging markets, the inflation path was higher and the growth path was lower. The risk scenario featuring a faster recovery in consumption was consistent with higher growth and inflation paths compared to the baseline scenario.

Following the review of macroeconomic and financial market developments as well as the latest Inflation Report projection, the Monetary Council discussed the details of its monetary policy decision in September. In the Council's assessment, the outlook for global economic growth was exposed to several downside risks over the short term. Decision makers noted that although global trends pointed to continued disinflation, this process might be stalled by recent rises in oil prices. Some members underlined that core inflation indicators generally continued to fall only slowly.

The Hungarian economy showed clear signs of rapid, favourable shifts in terms of inflation and the external balance while GDP growth had fallen short of expectations. In assessing inflation data for August, Monetary Council members concluded that tight monetary policy and the Government's measures to strengthen competition had a key role in strong disinflation started in Hungary. The decline in inflation was most noticeable in the case of tradables and processed food. However, the Council unanimously agreed that inflation remained unacceptably high; therefore, tight monetary conditions were still warranted in order to achieve price stability in a sustainable manner. Several members pointed out that recent rises in fuel prices and increasing retrospective pricing might lead to upside inflationary effects. There was a consensus that the inflation path expected for next year had shifted slightly upwards compared to June due to the carry-over effect of higher fuel prices. Members highlighted that according to the latest Inflation Report projection, inflation was likely to fall to the 7–8 percent range towards the end of the year. However, this still significantly exceeded the 3 percent central bank target necessary for a sustainable growth path. In order for inflation to return to the central bank tolerance band in 2025, disinflation needed to continue. Based on the alternative scenarios highlighted by the Council, upside risks to inflation had increased around the baseline scenario.

Discussing domestic real economic developments, the Monetary Council concluded that subdued economic performance mainly reflected high inflation and the decline in government investments. However, some decision makers pointed out that high-frequency data suggested that growth had picked up gradually in the third quarter, as a result of the noticeable decline in inflation. Others underlined that as inflation fell, positive changes were expected to occur in real wages in autumn, which was also going to be a factor contributing to a pick-up in economic performance at the end of the year. In the Council's unanimous view, falling inflation and the recovery in domestic demand components were likely to support GDP growth in 2024 and 2025; therefore, economic growth was expected to be balanced at 3–4 percent from 2024. The Council mainly identified downside risks to growth against the baseline scenario. The consensus view among decision makers was that the external position of the Hungarian economy had also improved significantly even in European comparison, with the current account deficit expected to decline below 1 percent of GDP in 2023 and to improve further over the forecast horizon. However, the government deficit was expected to be above this year's target of 3.9 percent.

Decision makers noted that despite the global deterioration in investor sentiment, major domestic financial markets had been stable in the past quarter. Nevertheless, in the Council's unanimous view the continued risks, i.e. the persistently high interest rate conditions of the world's leading central banks and the uncertainty caused by the Russia-Ukraine war, warranted a cautious, careful approach to monetary policy.

Monetary Council members agreed that it was necessary to maintain tight monetary conditions in order to achieve price stability. Accordingly, decision makers left the base rate unchanged at 13 percent. The Council was unanimous in its view that taking a cautious approach to setting the base rate was warranted in order to address fundamental inflation risks. Decision makers pointed out that with the acceleration in disinflation, the domestic real interest rate would turn positive in September.

Monetary Council members were unanimously of the view that the favourable risk environment enabled the Bank to reduce the effective interest rate by 100 basis points and to conclude the normalisation of the extraordinary interest rate environment introduced in mid-October 2022. Decision makers stressed that this meant that the gap between the base rate and the interest rate on one-day deposit quick tenders had been closed. According to the Council's decision, the interest rate corridor became narrower and symmetric. Consequently, the Council set the interest rate corridor as a band of +/- 100 basis points around the base rate. Several members emphasised the technical character of narrowing the interest rate corridor, noting that the instruments defining the interest rate corridor were utilised to a small degree.

Council members agreed that it was time to change and simplify the Bank's set of monetary policy instruments. Decision makers pointed out that the Bank guaranteed unlimited amounts of deposits on reserve accounts at the prevailing base rate from 1 October. The consensus among decision makers was that longer-term instruments to absorb interbank forint liquidity should also be announced at the base rate. The Council still considered it important to apply one-day FX-swap tenders; therefore, the Bank would continue to use this instrument. Several decision makers noted that the lower bound of the interest rate corridor should be treated as indicative of the interest rate on FX swap tenders. Council members highlighted that since the reserve account was to become the Bank's main sterilisation instrument, the termination of one-day quick deposit tenders was warranted.

Decision makers underlined that with the September decision, monetary policy entered a new phase. The Council agreed that tight monetary conditions and financial market stability remained necessary in order to achieve price stability in a sustainable manner. Council members argued that in the new phase, decisions about interest rates should be taken applying a step-by-step, cautious and careful approach and not in 'autopilot' mode. Decision makers focused their attention on incoming data, factors influencing the inflation path and developments in the risk environment. Some Council members noted that clear communication was key to the coherence between the Bank's decisions and interest rate expectations; one of the important elements of which was the regular publication of the Bank's flash analyses of key macroeconomic indicators.

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 26 September 2023. Taking a cautious approach to changing the base rate was warranted in order to address fundamental inflation risks. With the acceleration in disinflation, the domestic real interest rate would move to positive territory in September, then it would continue to rise gradually.

With a reduction of 100 basis points in the effective interest rate, the Monetary Council concluded the normalisation of the extraordinary interest rate environment. Following the September decision, the base rate became the effective central bank interest rate. In addition, according to the Council's decision, the interest rate corridor had become symmetric, with a band of +/- 100 basis points around the base rate.

In line with the Monetary Council's decision on 26 September, the Bank's set of monetary policy instruments would be changed and simplified. From 1 October, the reserve account would be available to banks without an upper limit and the Bank would remunerate the part bearing interest at the base rate. The Bank would announce its longer-term instruments to absorb interbank forint liquidity, i.e. the long-term deposit facility and the central bank discount bill, at the base rate in the coming period. In the Council's assessment, one-day FX-swap quick tenders remained an important element of strengthening the monetary transmission; therefore, the Bank would continue to use this instrument. The lower bound of the interest rate corridor served as a guidance regarding the interest paid on FX-swap quick tenders. The Bank published a separate information release on the technical details of the changes on its website.

Following the decision taken on 26 September 2023, the gap between the interest conditions of one-day deposit tenders and the base rate had closed. Therefore, the normalisation of the extraordinary interest rate environment introduced in October 2022 had been concluded and thus monetary policy entered a new phase. In order to achieve price stability in a sustainable manner, monetary conditions needed to remain tight. With the appearance of risks surrounding global disinflation and volatility in international investor sentiment, a cautious approach to monetary policy was warranted. The Council was constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment, and it would take decisions on changes in monetary conditions based on these factors, if warranted.

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 14.00 percent** **and** **decreasing the interest rate on the overnight central bank deposit to 12.00 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 24 October 2023. The minutes of that meeting will be published at 2 p.m. on 8 November 2023.