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Analyst background discussion

29 August 2023

# BACKGROUND DISCUSSION AFTER THE MONETARY COUNCIL'S 29 AUGUST 2023 DECISION

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- **Disinflation is widespread. Inflation should be decreased further in 2024.**
  - **In July, the decline in domestic inflation accelerated. Consumer prices rose by 17.6 percent in annual terms and core inflation stood at 17.5 percent.** This year, all vectors of economic policy are strongly disinflationary.
  - **Inflation is expected to decline to a single-digit range during the autumn.**
  - **It calls for caution that in the case of services, disinflation started later and at a slower pace.**
- **Hungary's GDP declined by 2.4 percent year-on-year in 2023 Q2.**
  - **The main reason for the economic slowdown is falling domestic demand due to high inflation.**
  - **The current account balance could turn out significantly more favourable than previously expected.**
- **International investor sentiment deteriorated and became more volatile.**
  - **Permanently high interest rates of the world's leading central banks, developments related to the slowdown in Chinese economic growth, volatility in energy prices and the Russia-Ukraine war pose increased risks in the autumn months.**
  - **Domestic financial markets showed a stronger reaction to the volatility of the external environment.**



- **The disinflationary effect of monetary policy is widespread.**
- **At today's meeting, the Council left the base rate unchanged at 13 percent.** The current level of the base rate is adequate to manage fundamental inflation risks.
- **In August, the MNB continued the convergence of the interest rate conditions of one-day tenders to the base rate.**
  - The Council reduced **the O/N collateralised lending rate** by 100 basis points to 16.5 percent.
  - **The interest paid on optional reserves** was lowered by 100 basis points to 14 percent.
  - It is warranted to reduce the **interest rate on the one-day quick deposit tenders and foreign exchange swap tenders** by 100 basis points.



- With the future closing of the gap between the one-day quick tender rate and the base rate, **monetary policy will enter a new phase.**
- **We can't sit back! Inflation remains public enemy number one!** The focus of monetary policy remains on achieving the inflation target and maintaining financial market stability.
  - **The resumption of GDP growth can be achieved by a rapid decrease in inflation.**
- **It is necessary to maintain tight monetary conditions** in order to achieve price stability.
- After closing the gap, a **simplification of the central bank's toolkit is expected.**
- **Monetary policy does not operate on autopilot! After closing the gap, the central bank will make data-driven, step-by-step decisions on interest rate conditions.**



# MACROECONOMIC ASSESSMENT AND OUTLOOK

# TIGHT MONETARY POLICY IS THE KEY TO ACHIEVE PRICE STABILITY



**In the first half of 2021, the MNB was one of the first to recognise the change in inflation trends and to draw attention to the risk of persistently high inflation, then responded decisively.**

**Cycle of interest rate hikes up to 13 percent of the base rate**

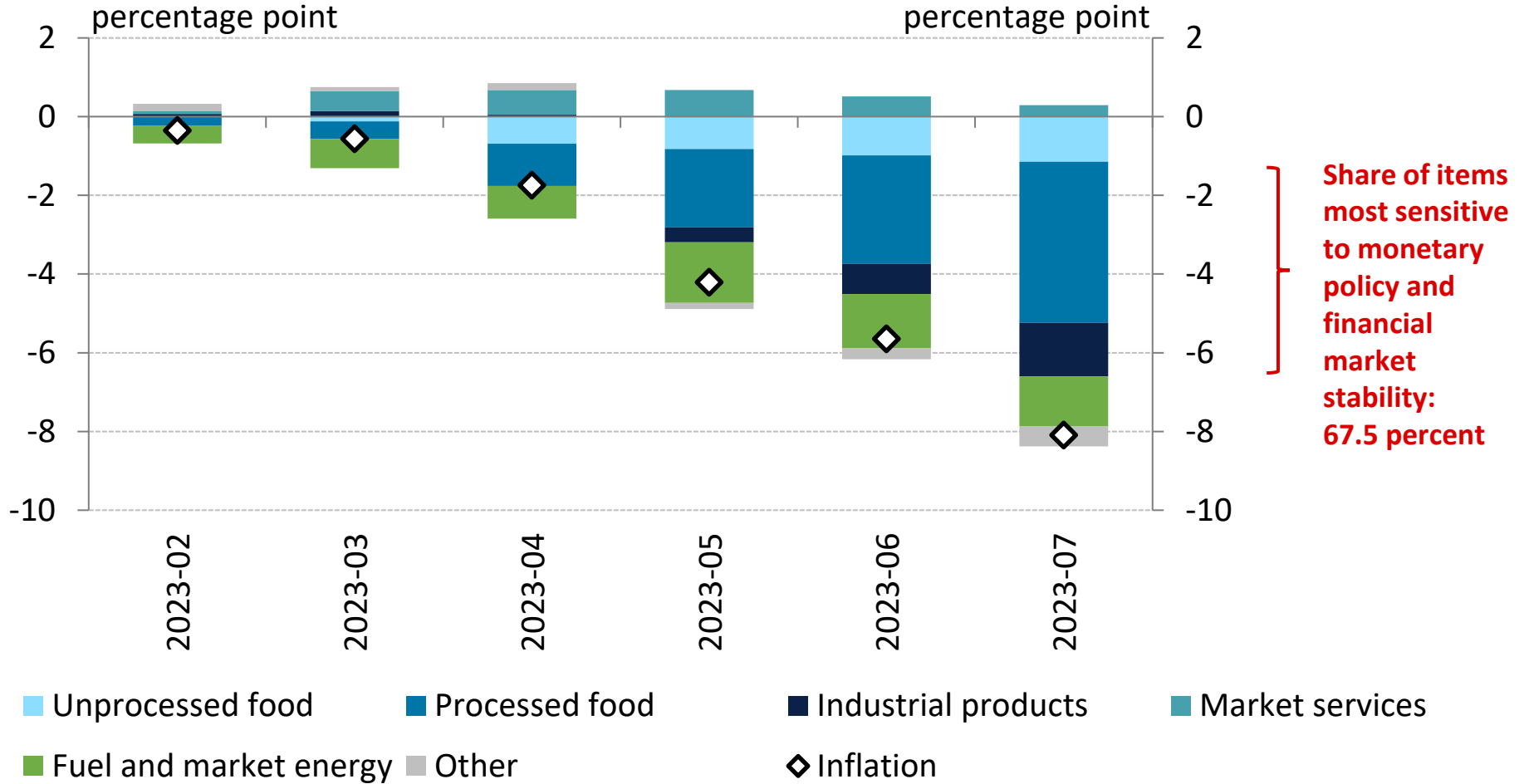
**Phasing-out crisis management instruments**

**In mid-October 2022, the MNB had to deal with extreme financial market instability. From 14 October, the MNB responded with a targeted series of measures to restore and support financial market stability.**

**The instruments have successfully stabilised the financial market.**

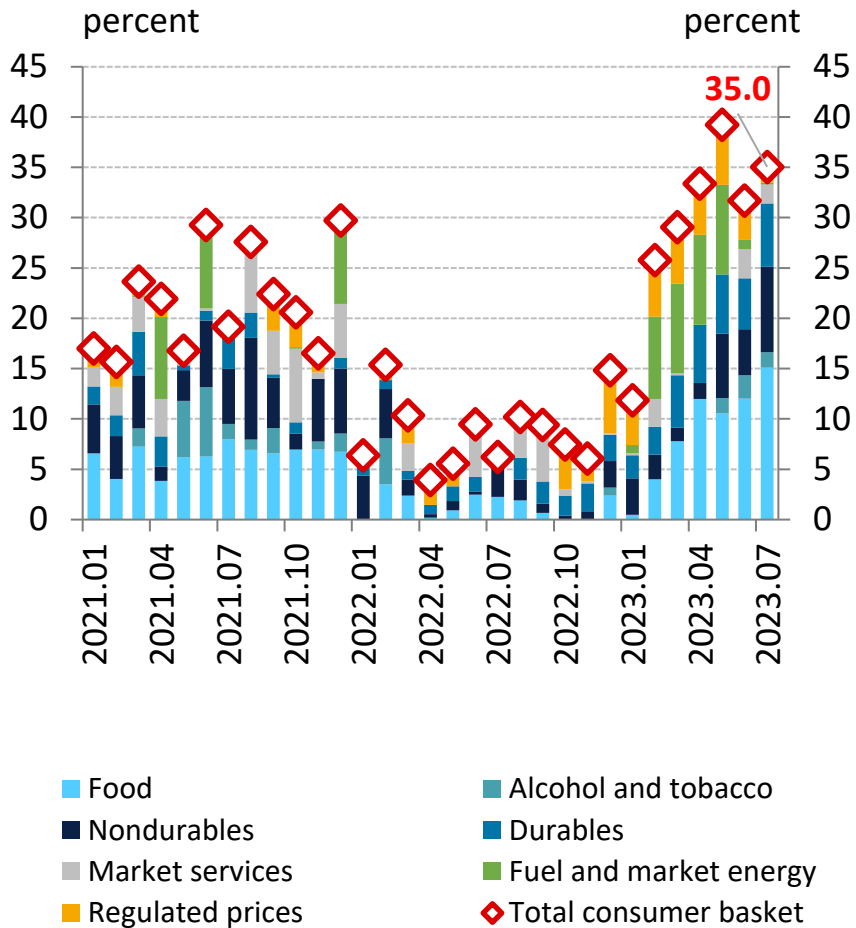
**With the interest rate hike cycle and the measures taken in mid-October, the MNB has supported the achievement of its primary objective of price stability.**

# STRONG DISINFLATION WAS INITIATED BY DECISIVE MONETARY TIGHTENING

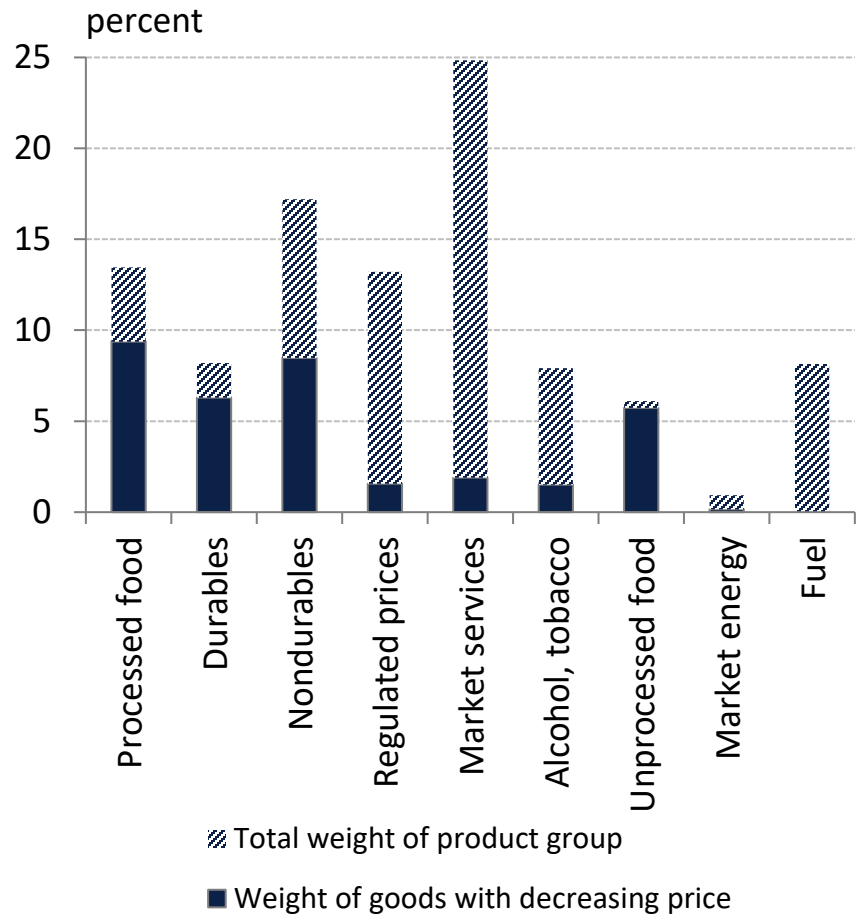


DECOMPOSITION OF THE CHANGE IN INFLATION COMPARED TO ITS PEAK VALUE IN JANUARY 2023

# PRICES DECREASED IN ROUGHLY 35 PERCENT OF THE CONSUMER BASKET



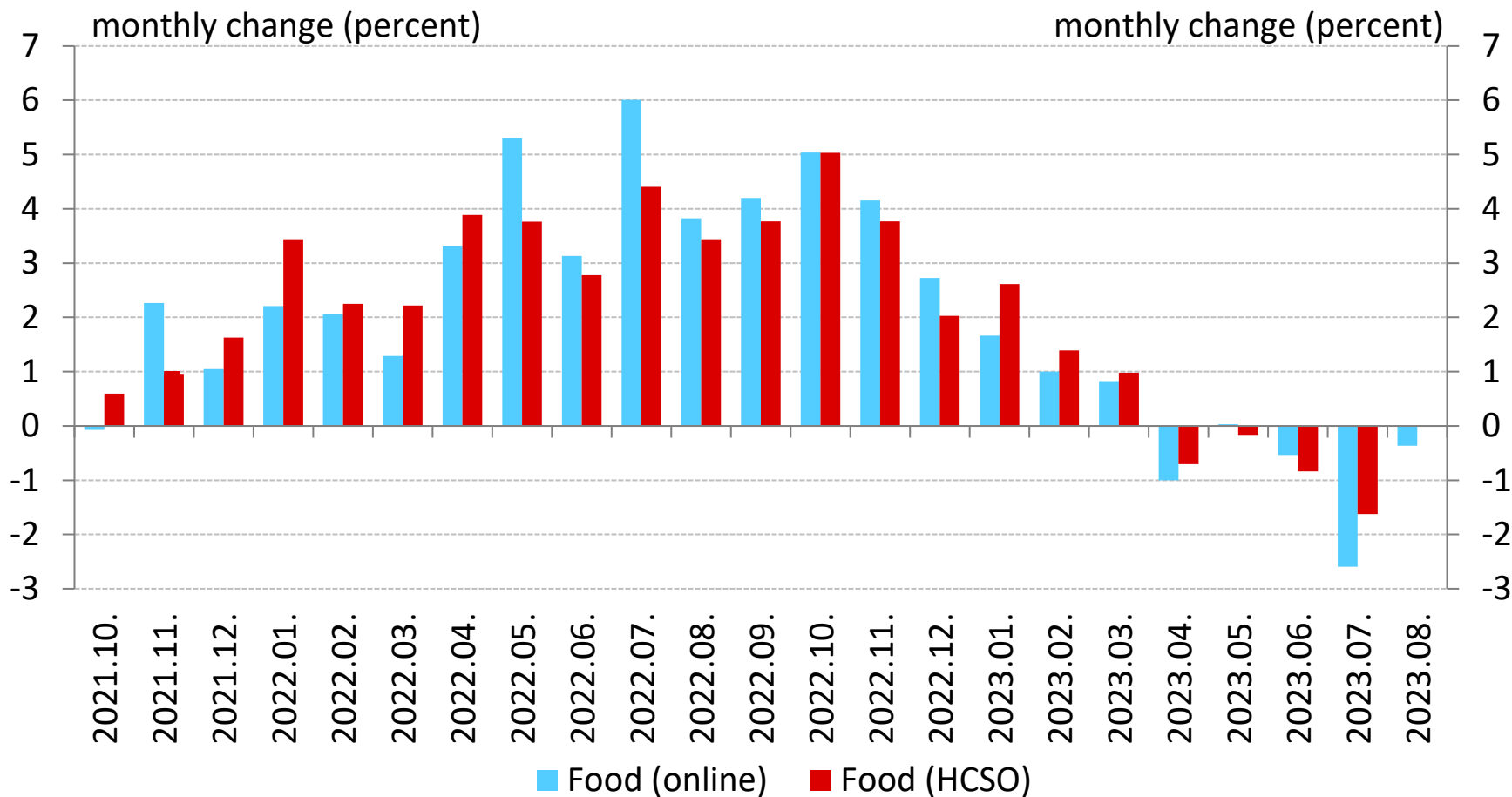
WEIGHTS OF GOODS WITH DECREASING PRICES ON A MONTHLY BASIS



WEIGHTS OF GOOD WITH DECREASING PRICES ON A MONTHLY BASIS (JULY 2023)



# FOOD PRICES CONTINUED TO DECREASE IN AUGUST

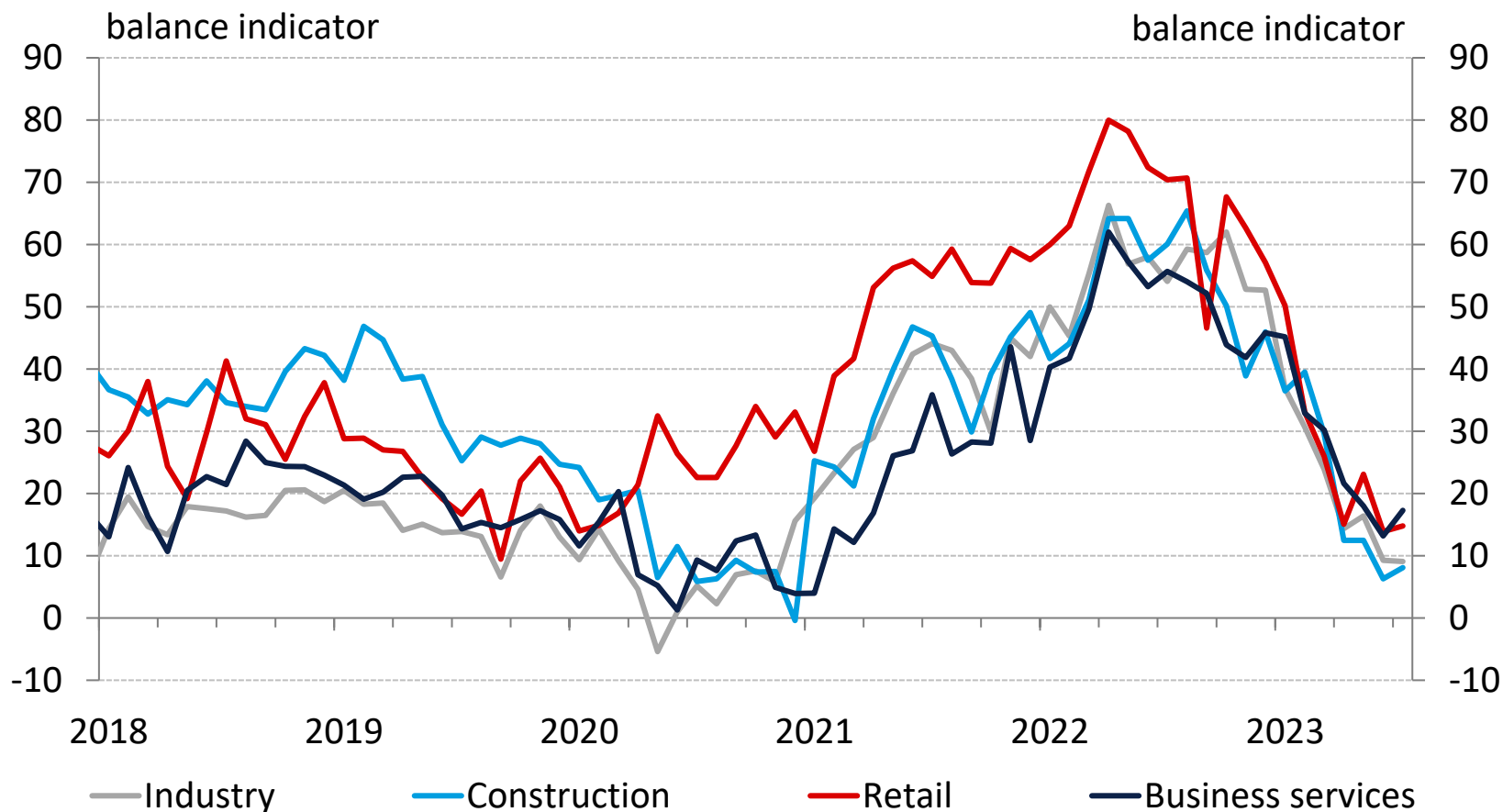


## FOOD PRICE INDEX OF ONLINE COLLECTED DATA AND HCSO

Note | The purpose of online data collection is only to analyse high frequency price developments. The collected data consist of information until 18 August.

Source | HCSO, MNB

# EXPECTATIONS FOR PRICE INCREASES ARE APPROACHING LEVELS BEFORE THE SURGE IN INFLATION

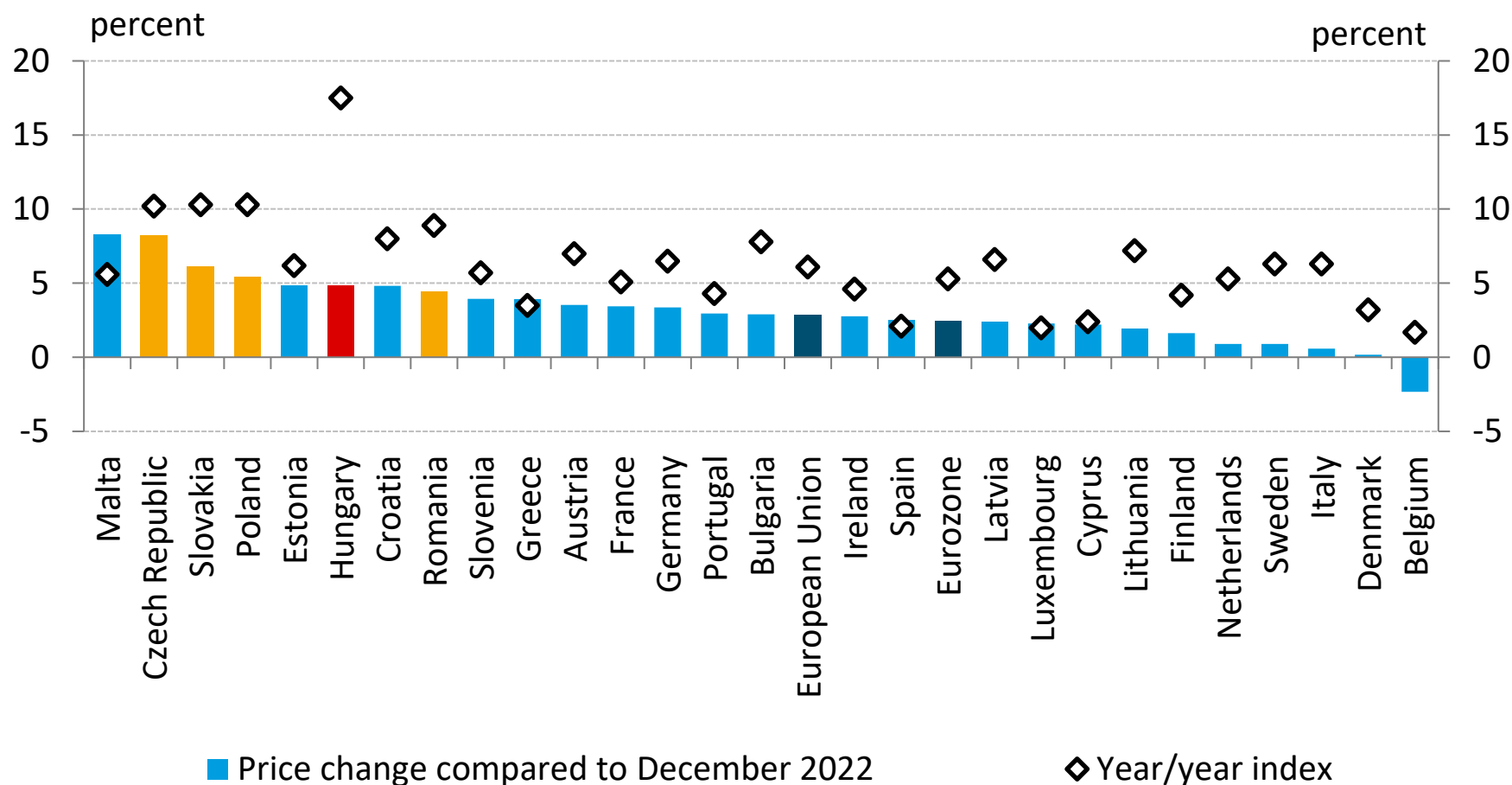


## SALES PRICE EXPECTATIONS FOR THE NEXT THREE MONTHS

Note | Balance indicator, calculated as the difference between the companies which plan to increase their prices and the ones which plan to decrease it. Seasonally adjusted data.

Source | European Commission, MNB

# THE RATE OF REPRICING THROUGHOUT THIS YEAR IN HUNGARY WAS IN LINE WITH THAT IN THE REGION

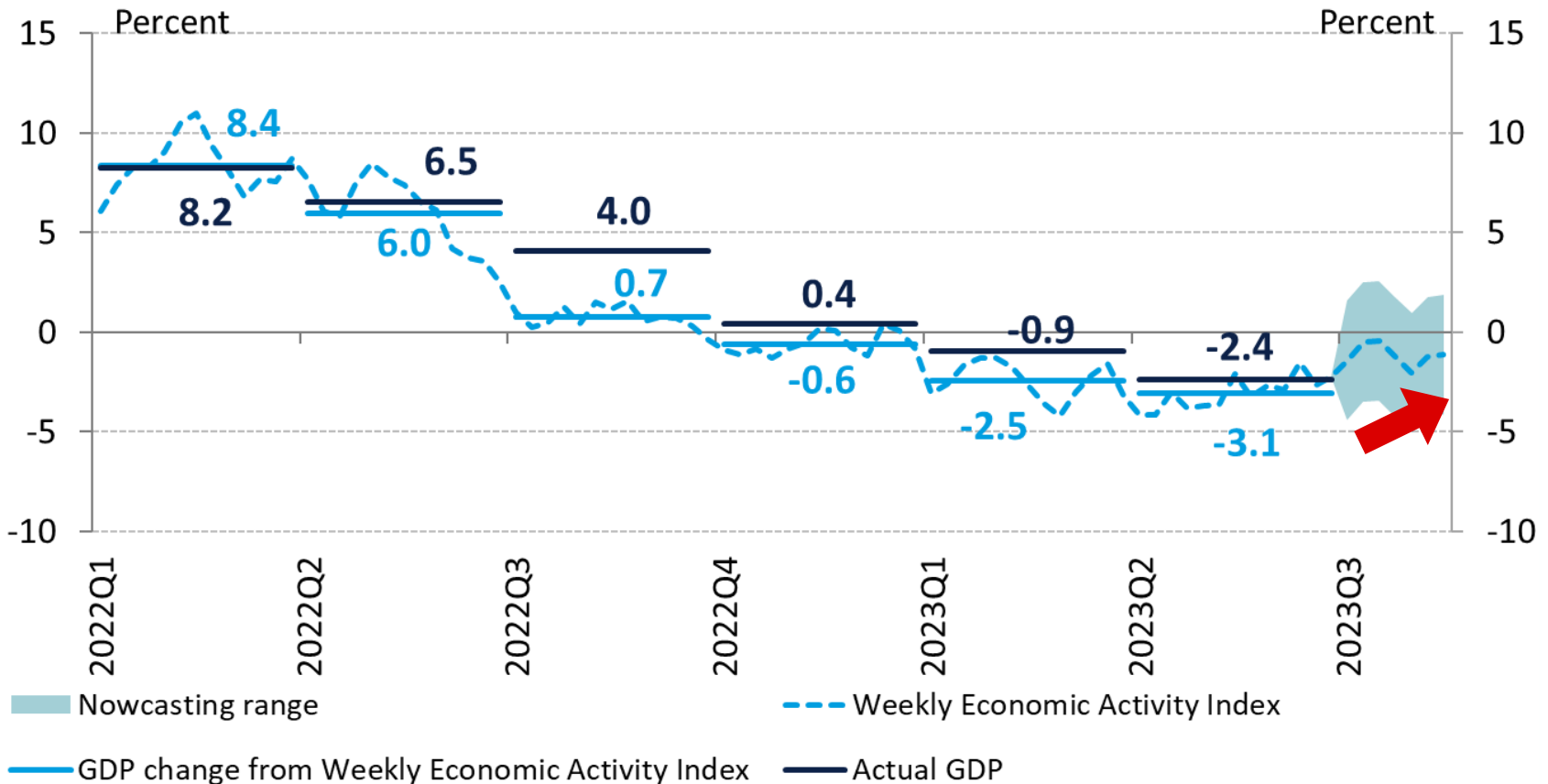


## INFLATION AND PRICE CHANGES COMPARED TO THE PREVIOUS DECEMBER IN COUNTRIES OF THE EUROPEAN UNION (JULY 2023)

Note | Based on HICP data.

Source | Eurostat

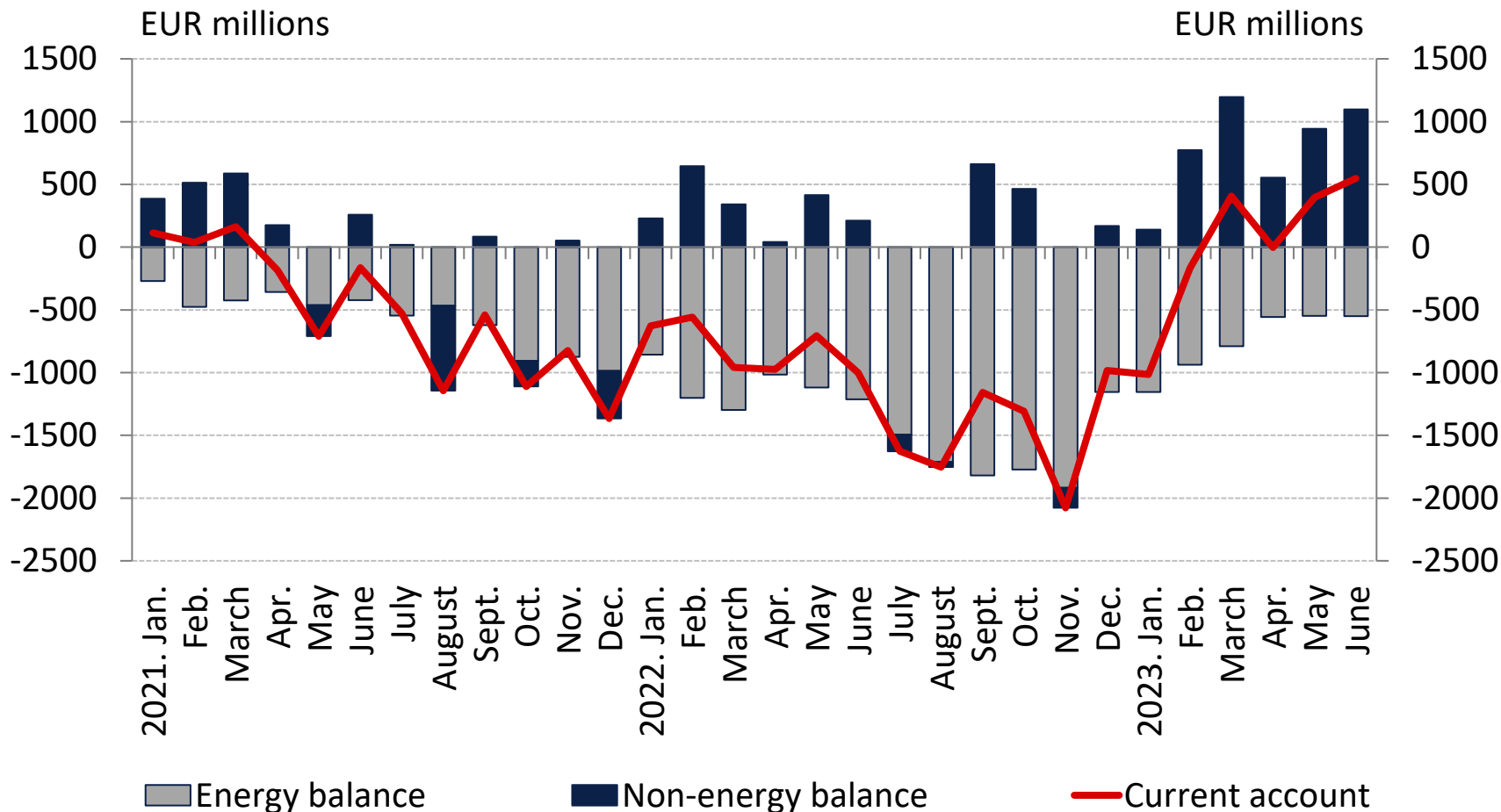
# IN Q3, GROWTH MAY PICK UP SLOWLY AS INFLATION FALLS MARKEDLY



## WEEKLY ECONOMIC ACTIVITY INDEX

Source | HCSO, MNB-calculation

# THE RAPID IMPROVEMENT IN THE EXTERNAL BALANCE HAS CONTINUED

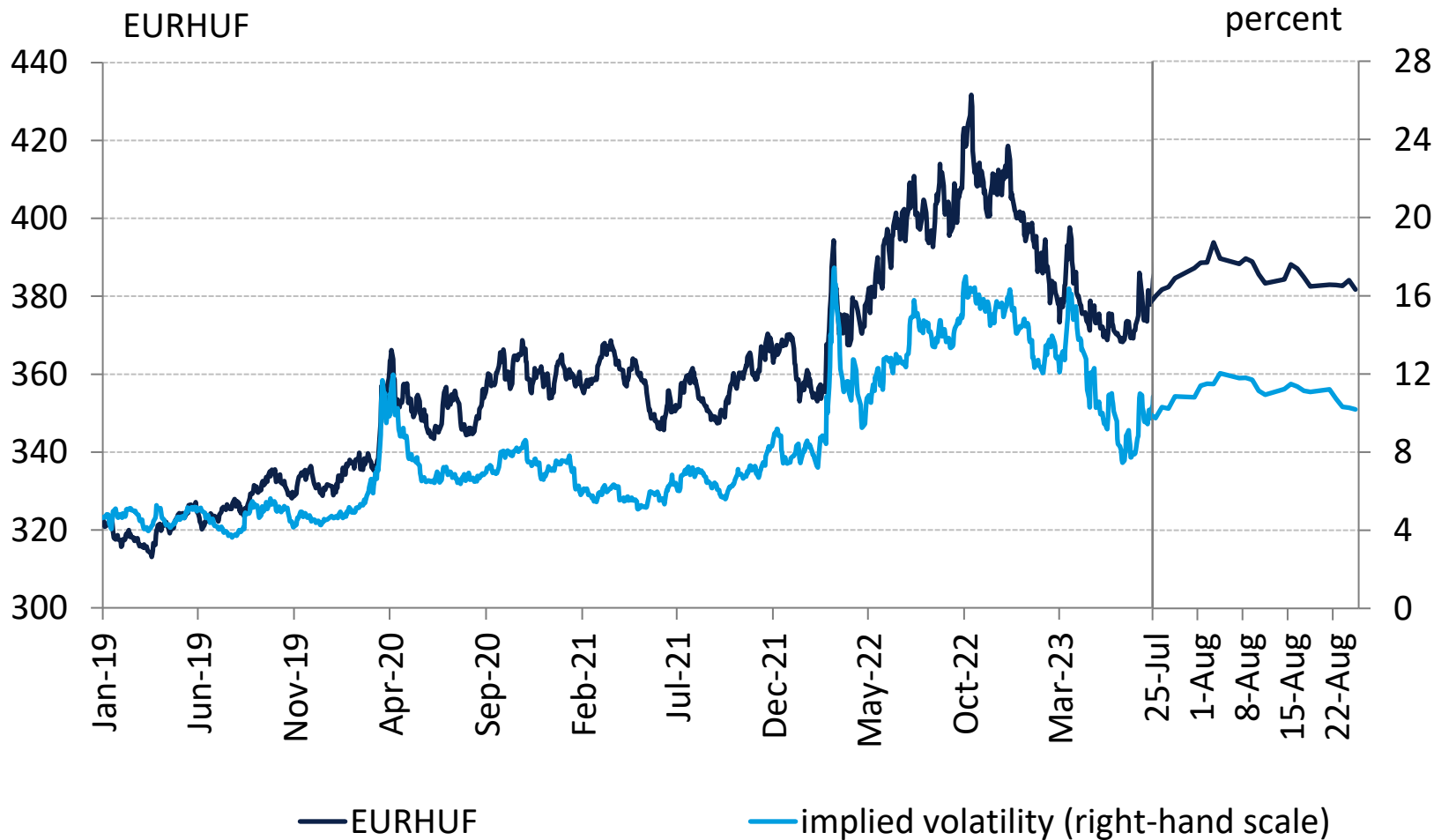


## DEVELOPMENTS IN THE CURRENT ACCOUNT AND THE ENERGY BALANCE

Note | The June value of the Energy balance is an estimate.

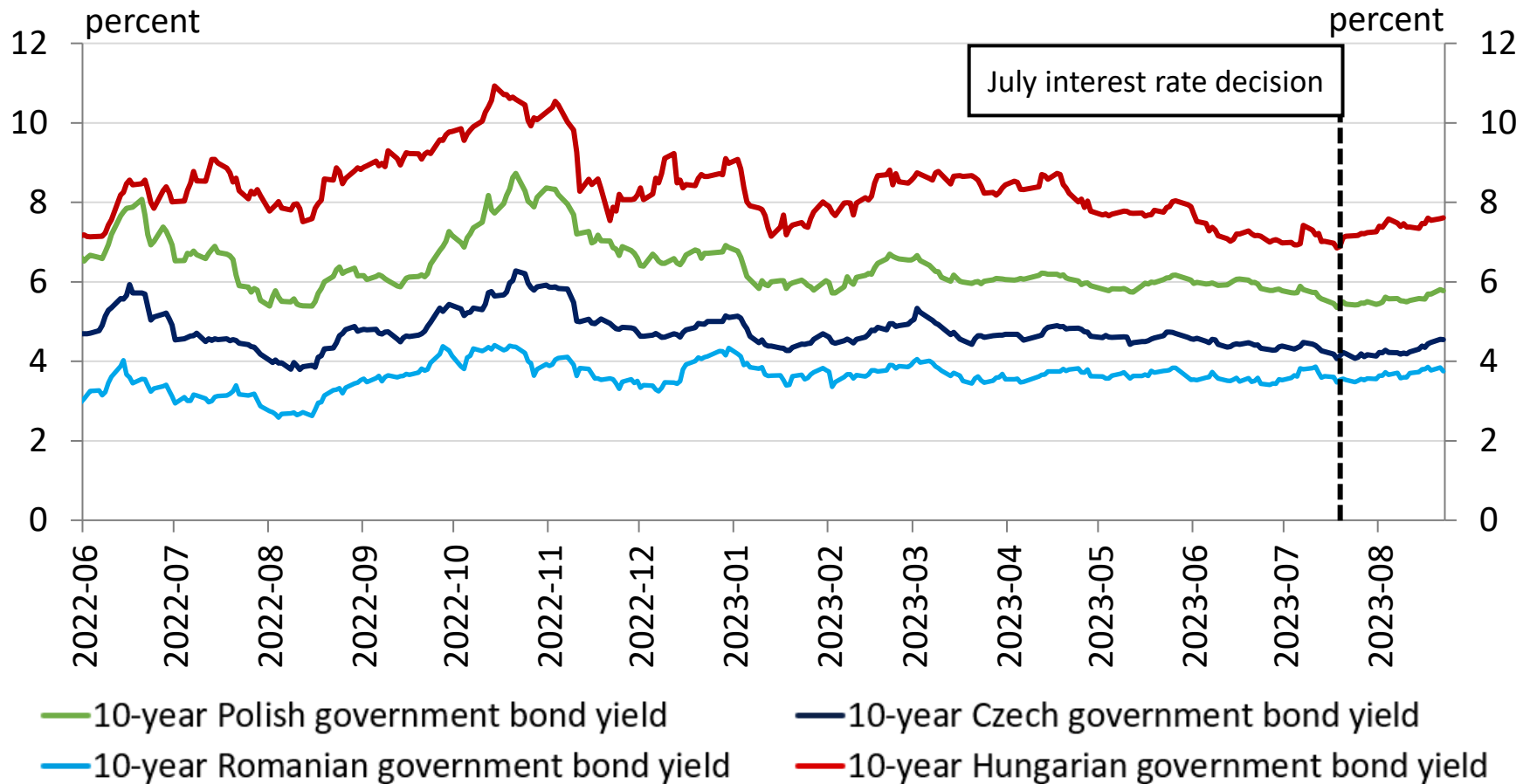
Source | HCSO, MNB

# DETERIORATION IN INTERNATIONAL FINANCIAL MARKET SENTIMENT INCREASED VOLATILITY IN THE FX-MARKET



EUR/HUF EXCHANGE RATE AND THE IMPLIED VOLATILITY OF EXCHANGE RATE EXPECTATIONS

# DOMESTIC 10-YEAR GOVERNMENT BOND YIELDS ROSE IN LINE WITH LONG-TERM YIELDS IN THE REGION



## DEVELOPMENTS IN 10-YEAR GOVERNMENT BOND YIELDS IN REGIONAL ECONOMIES



# MONETARY POLICY



# THE GRADUAL CONVERGENCE OF THE O/N QUICK DEPOSIT TENDER RATE TO THE BASE RATE CONTINUES



The external market environment has remained volatile, to which domestic financial markets react more sensitively.



The current account balance may be significantly more favourable than previously expected.



By the end of 2023, inflation is expected to be noticeably below 10 percent. However, this is still significantly above the central bank target.



Perceptible decrease in inflation may trigger GDP growth.

# A CAREFUL ASSESSMENT OF THE PERSISTENCE OF IMPROVEMENT IN RISK PERCEPTIONS IS NECESSARY



## External balance developments

Current account balance



Terms of trade



## Market stability

Structural state of the foreign exchange market, swap market developments



Government securities market, auctions



Energy and gas prices



## International environment

International investor sentiment



Interest rate paths of the world's leading central banks



Uncertainties related to the Russia-Ukraine war



# WHEN SETTING THE O/N DEPOSIT QUICK TENDER RATE, THE MNB TAKES A CAUTIOUS AND GRADUAL APPROACH



The Monetary Council's forward guidance:

*„If the improvement in risk perceptions persists, the Bank will continue to close the gap between the interest rate conditions of one-day tenders and the base rate.”*

The main aspects of decreasing the O/N deposit tender rate are as follows:



Cautious



Market effects, interest rate expectations



Gradualism



Communication in advance

# THE MONETARY COUNCIL'S AUGUST INTEREST RATE DECISION



Central bank instrument	Interest rate	Previous interest rate (percent)	Change (basis points)	New interest rate (percent)
Central bank base rate		13.00	<i>No change</i>	<b>13.00</b>
O/N deposit rate	Central bank base rate minus 0.50 percentage points	12.50	<i>No change</i>	<b>12.50</b>
O/N collateralised lending rate	Central bank base rate plus 3.50 percentage points	17.50	<i>-100</i>	<b>16.50</b>

The Council decided to **reduce the interest paid on optional reserves by 100 basis points, from 15 to 14 percent** with effect from 30 August.

According to the Council's assessment, it is also warranted to reduce the interest rate on the one-day quick deposit tenders and foreign exchange swap tenders by **100 basis points**.

# MONETARY POLICY WILL ENTER A NEW PHASE



With the future closing of the gap between the one-day quick tender rate and the base rate, **monetary policy will enter a new phase.**

It is necessary to maintain tight monetary conditions in order to achieve price stability.

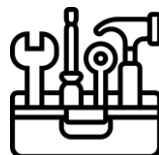


With the acceleration of disinflation, the domestic real interest rate will soon move to positive territory, which will help to achieve the inflation target.

**After closing the gap, the central bank's toolkit will be restructured and simplified.**

Instruments that are no longer necessary will be phased out.

Instruments that effectively support financial market stability (e.g. swap tenders and the discount bill) will remain part of the toolkit.



# IN THE NEW PHASE, THE COUNCIL WILL MAKE DATA-DRIVEN, STEP-BY-STEP DECISIONS ON INTEREST RATE CONDITIONS



**The focus of monetary policy remains on achieving the inflation target and maintaining financial market stability.**

**The resumption of GDP growth can be achieved by a rapid decrease of inflation.**




**Data-driven, step-by-step decision-making on interest rate conditions.**



**At each scheduled rate-setting meeting, the Council will decide on the interest rate conditions depending on incoming data and factors affecting the inflation path.**

**The September Inflation report will be the first important reference point in this process.**



**The future path of interest rates depends on the disinflation process and developments in the country's risk perceptions.**



*„In the Monetary Council’s assessment, **maintaining the current level of the base rate will ensure that inflation expectations are anchored and the inflation target is achieved in a sustainable manner.** Looking ahead, financial market stability is also key to achieving price stability. In the current environment, a cautious and gradual approach is warranted. The MNB is 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 persists, the Bank will continue to close the gap between the interest rate conditions of one-day tenders and the base rate.**”*



THANK YOU FOR YOUR  
KIND ATTENTION!