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BACKGROUND DISCUSSION FOLLOWING THE MONETARY COUNCIL'S 23 JULY DECISION

Analyst background discussion

23 July 2024



MAIN MESSAGES: MONETARY POLICY OUTLOOK

- **Restrictive monetary policy** remains the key to the maintenance of financial market stability and the achievement of the inflation target in a sustainable manner.
- **The cornerstones of restrictive monetary policy:** all factors that affect the domestic inflation outlook, the country's risk perception, our relative position within the region, and the development of the international risk and monetary policy environment.
- **From June a new phase has begun:** based on incoming data, the Council takes month-by-month decisions on the level of the base rate. **The decision is made between maintaining the rate and a small interest rate cut.**
- Market analysts expect **another 1-2 interest rate cuts** for the second half of the year, with different timing. This is considered realistic based on current information.
- **The one and a half, two-year interest rate expectations have shifted significantly downwards** in recent weeks, at the same time, **more incoming data is needed to judge the sustainability of the processes.**



MAIN MESSAGES: MONETARY POLICY DECISION IN JULY

- **External balance processes** develop favourably, and **the reduction of the fiscal deficit** has also started.
- **Global risk appetite** has improved but remains volatile. In recent weeks the amount of rate cuts expected from the Fed until the end of the year has increased.
- **The latest inflation data**, which is better than market expectations, does not change the expected inflation path, but **in addition to the strengthening of the country's risk perception, it allowed earlier implementation of the interest rate cut.**
- Based on all these, at its meeting today, the Council **lowered the base rate by 25 basis points to 6.75 percent.**
- Approaching the decision in July, market analysts were increasingly expecting an interest rate cut. In the days before the interest rate decision, **the majority of analysts expected a 25 basis points cut.**
- **We can't sit back:** looking ahead, a **careful and patient** approach to monetary policy is still warranted.



MAIN MESSAGES: MACROECONOMIC AND FINANCIAL MARKET OUTLOOK

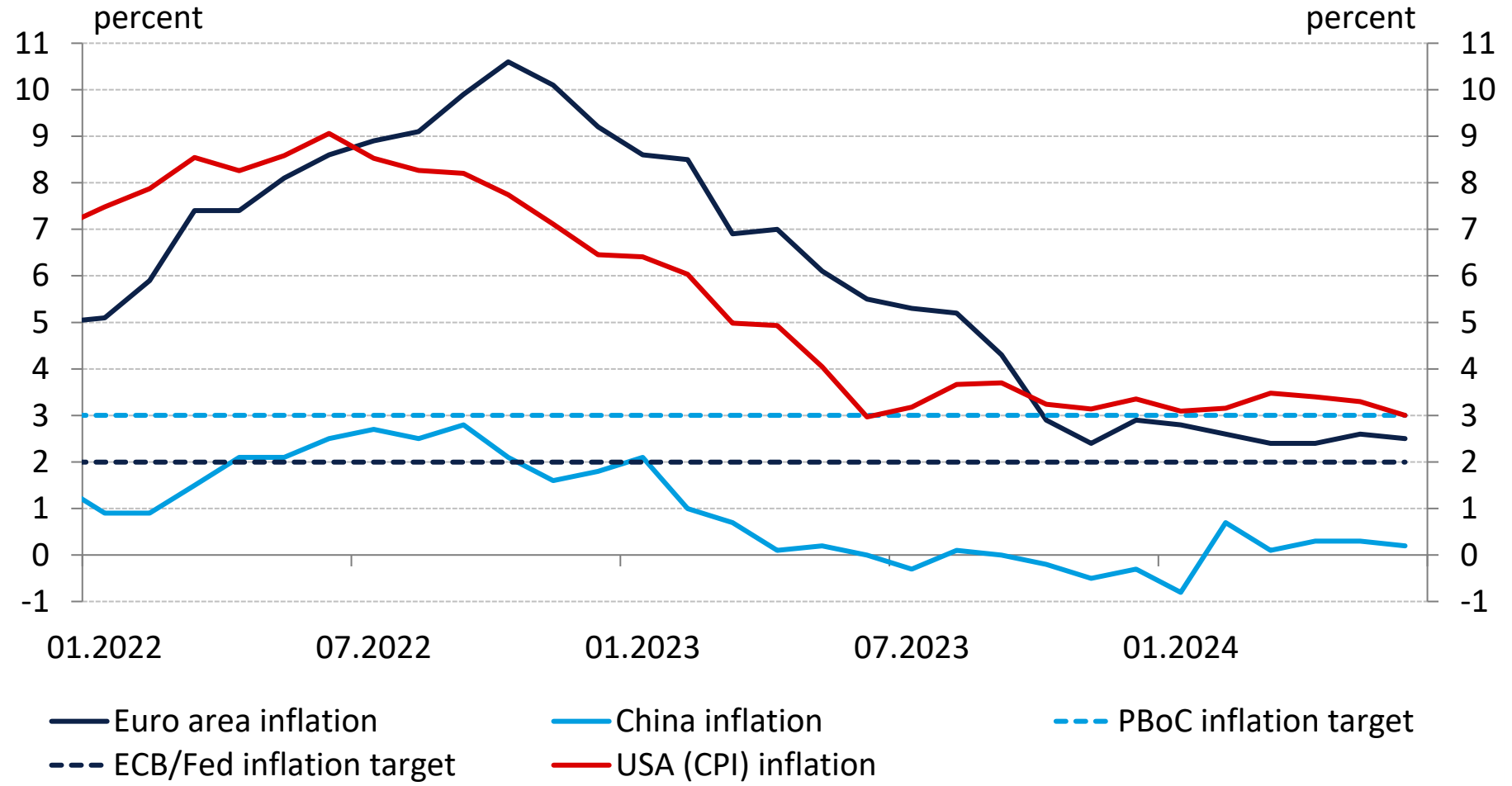
- **Spreads on European financial assets fell following** the election results in France and the UK.
- Economic data released in the US in recent weeks **have increased the probability of an interest rate reduction by the Fed** at its September meeting. The market pricing shows two–three 25 basis points rate cuts this year starting from September.
- **The inflation rate remained within the central bank tolerance band in June as well.** The inflation data was consistent with the projection in the June Inflation Report, while it was below the market expectations. The decline in core inflation stopped in June.
- The **inflation rate** is expected to fluctuate close to the upper bound **of the tolerance band** in the coming months, too.
- **The inflation outlook continues to be consistent with the projection of the June Inflation Report. In the second half of the year, the inflation will remain lower than the market expectations despite the repricing that will be higher than the historical average.**
- **The deficit reduction measures, announced in July, will support the achievement of the deficit targets in 2024 and 2025.**
- **In May, the current account registered another substantial surplus.**



MACROECONOMIC AND FINANCIAL MARKET ASSESSMENT AND OUTLOOK



IN JUNE, INFLATION DECREASED BOTH IN THE EURO ZONE AND IN THE UNITED STATES

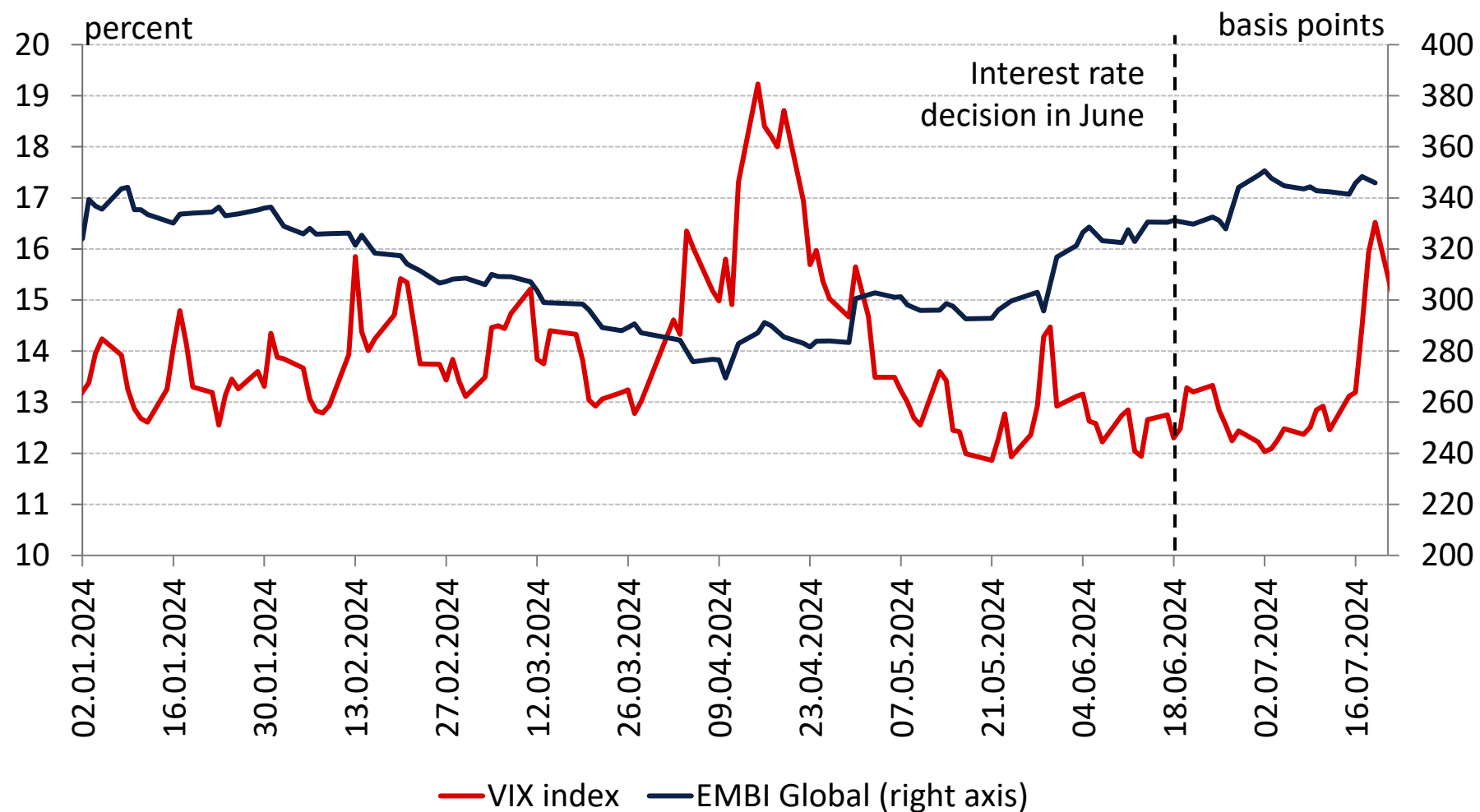


INFLATION IN THE UNITED STATES, CHINA AND THE EURO AREA

Source | Eurostat, OECD



GLOBAL INVESTOR SENTIMENT REMAINS VOLATILE

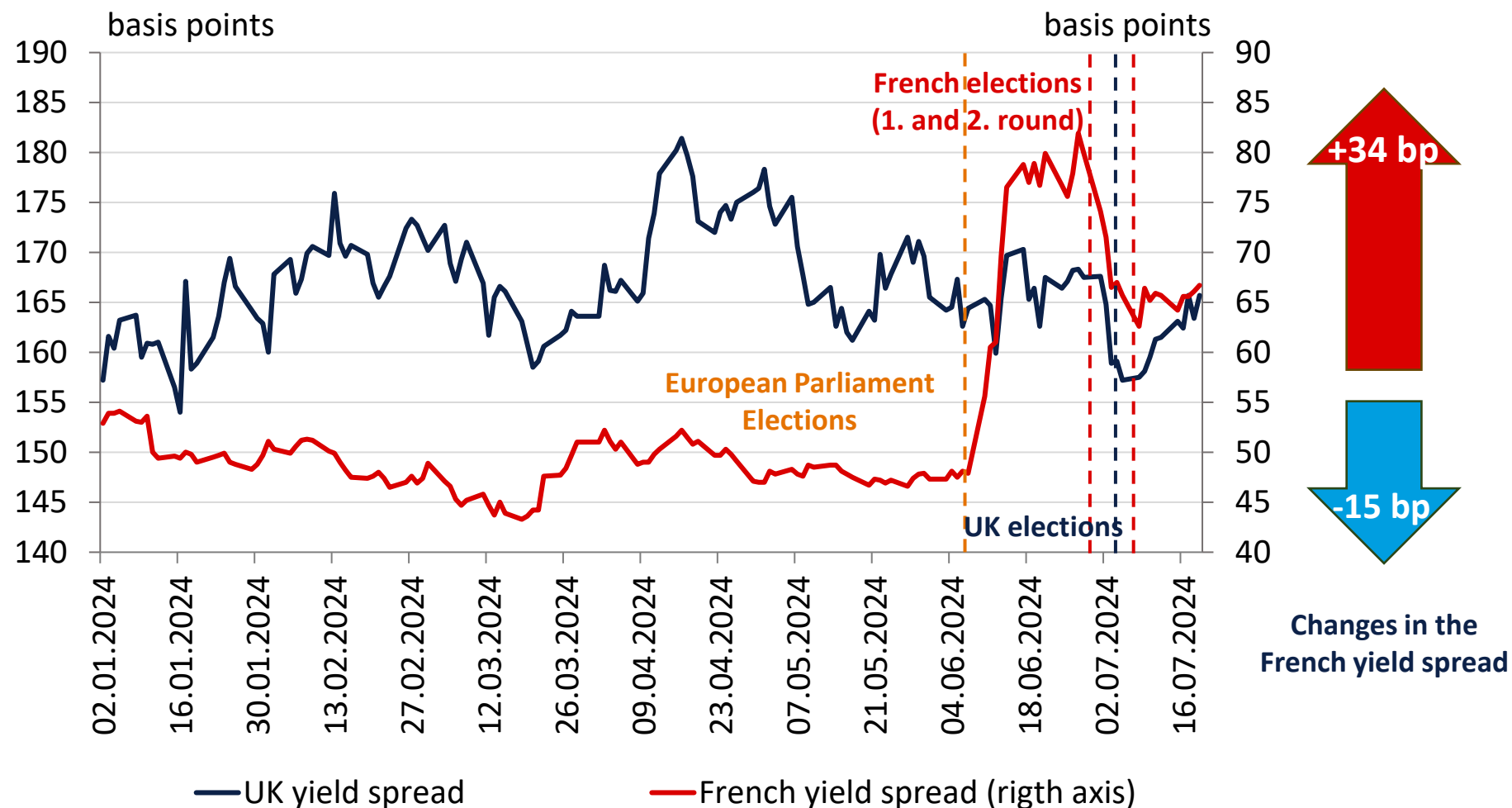


THE VIX INDEX AND THE EMBI GLOBAL INDEX

Source | Bloomberg



AFTER THE TURBULENCE DURING THE ELECTION PERIOD, YIELD SPREADS IN THE EUROPEAN MARKETS MODERATED

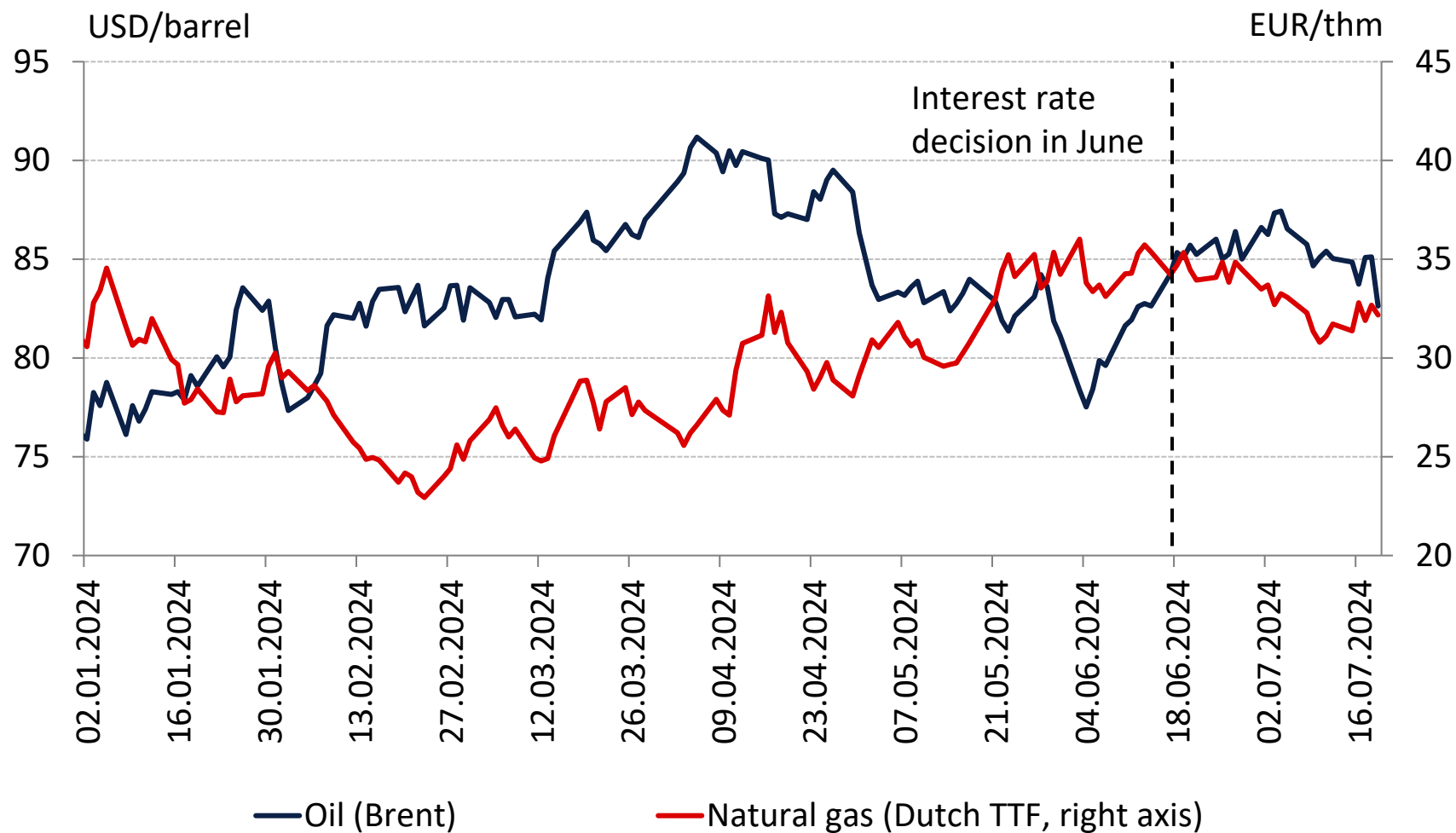


FRANCE AND UK 10-YEAR GOVERNMENT BOND YIELD SPREADS COMPARED TO THE GERMAN 10-YEAR GOVERNMENT BOND YIELD

Source | Bloomberg



OIL AND GAS PRICES HAVE SLIGHTLY DECREASED SINCE THE LATEST INTEREST RATE DECISION



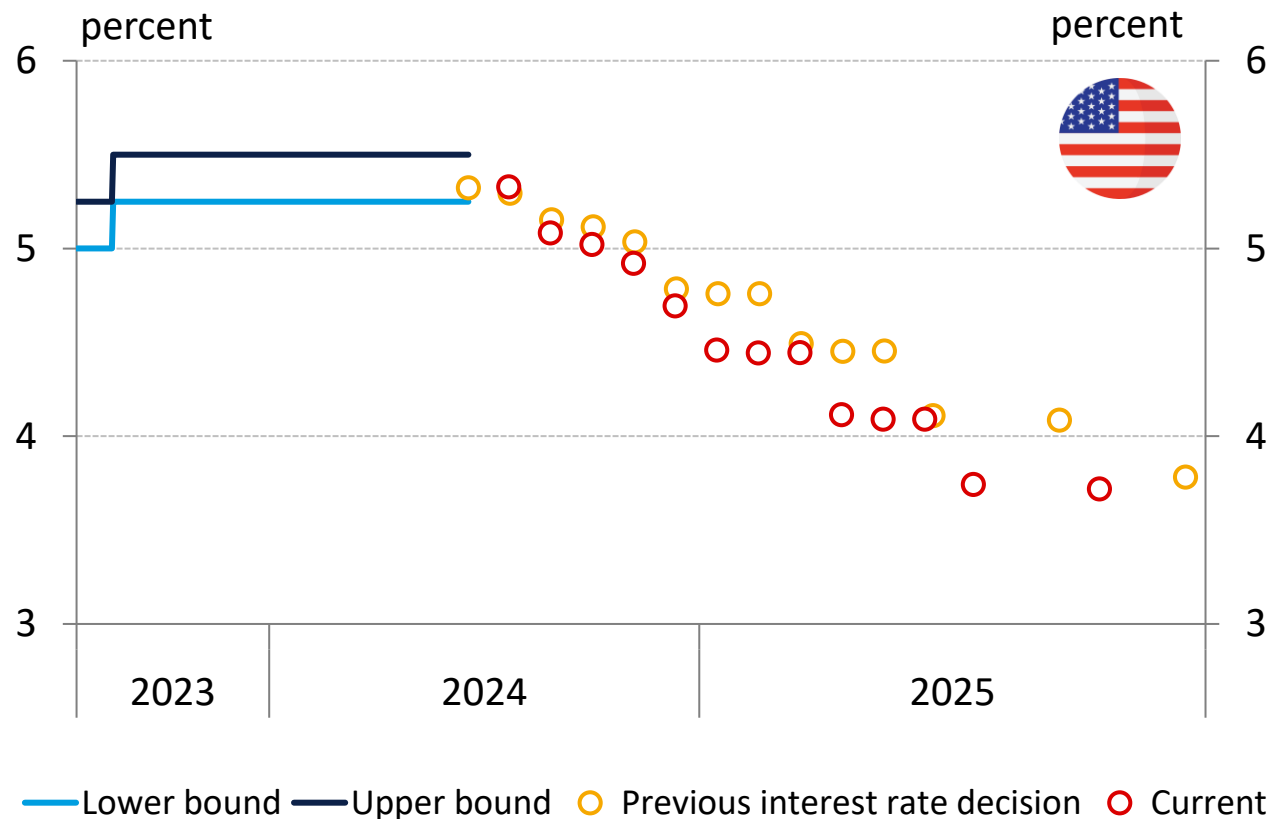
DEVELOPMENTS IN OIL AND GAS PRICES

Source | Bloomberg, MNB



IN RECENT WEEKS, THE PROBABILITY OF AN INTEREST RATE REDUCTION BY THE FED AT ITS SEPTEMBER MEETING HAVE INCREASED

The market pricing shows two–three possible rate cuts of 25 basis points this year, starting in September.



Possibility of interest rate cut in September

At the time of the previous interest rate decision

~60 percent



Currently

>90 percent

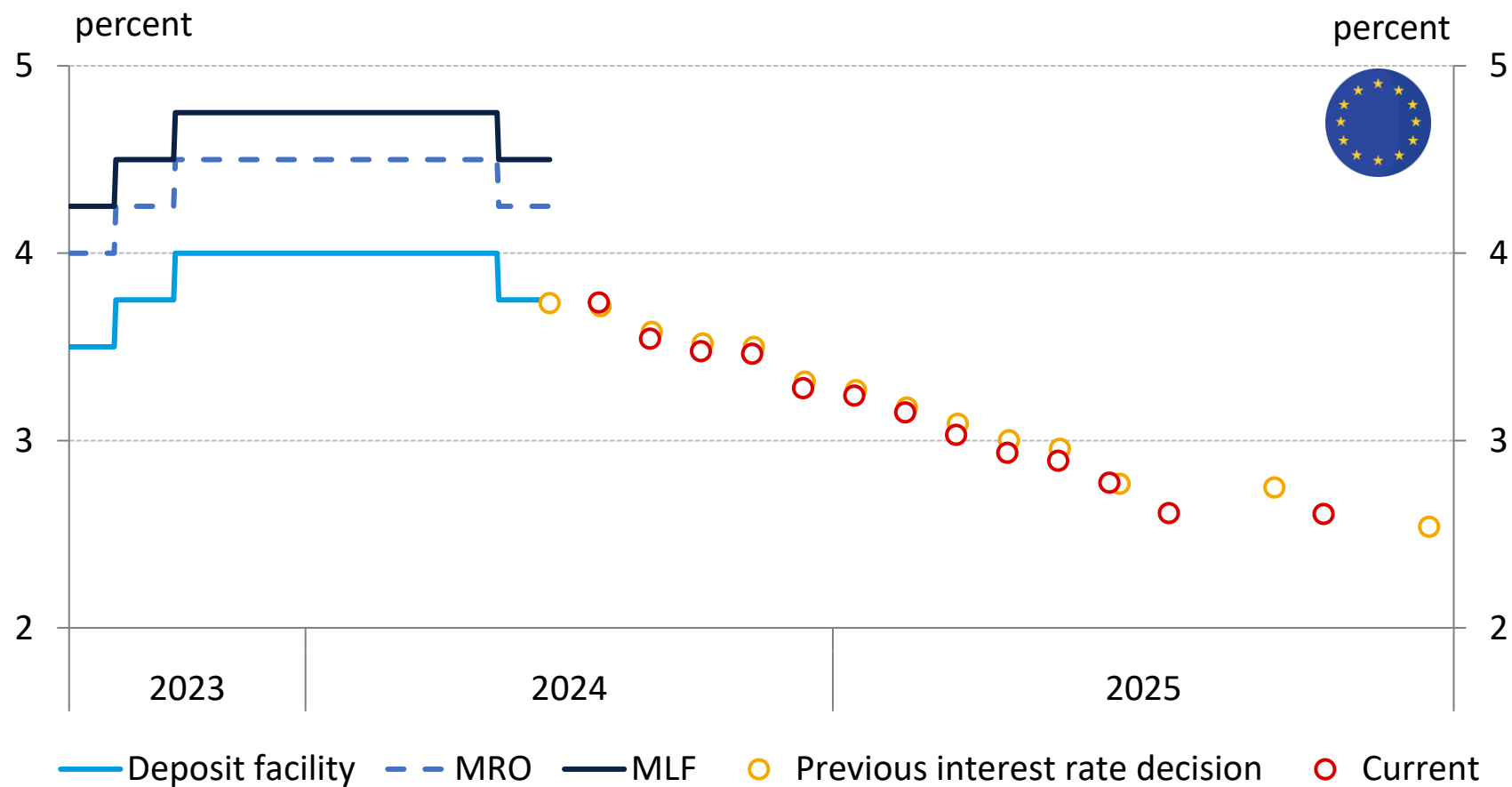
THE EXPECTED INTEREST RATE PATH OF THE FED BASED ON MARKET PRICING

Source | Bloomberg



BASED ON THE ECB COMMUNICATION, THE PACE AND TIMING OF THE RATE CUTS WILL CONTINUE TO BE DETERMINED BY INCOMING DATA

Based on current market pricing, the market participants expect one–two 25 basis points interest rate cuts this year.



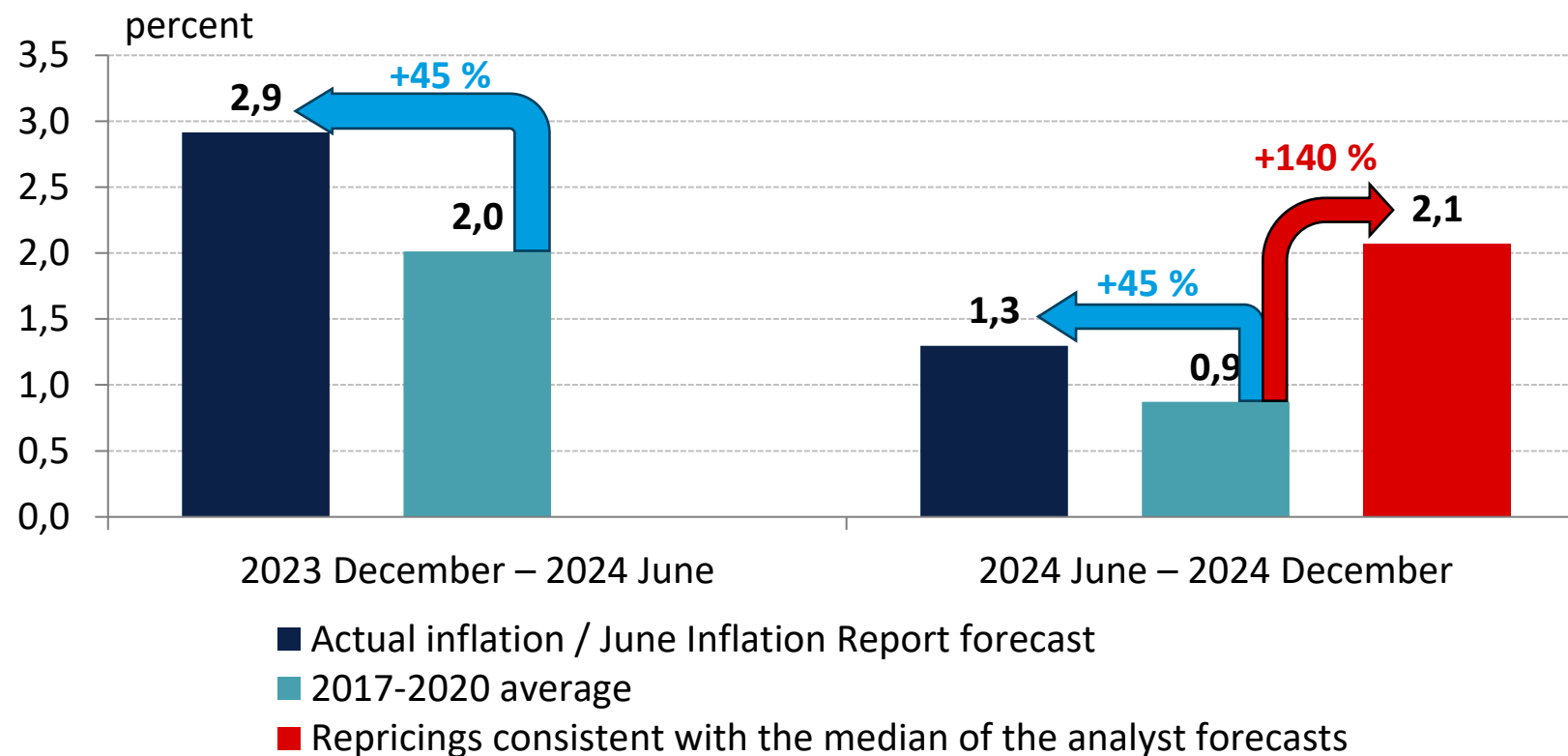
THE EXPECTED INTEREST RATE PATH OF THE ECB BASED ON MARKET PRICING

Source | Bloomberg



DOMESTIC INFLATION IS EXPECTED TO FLUCTUATE CLOSE TO THE UPPER BOUND OF THE TOLERANCE BAND IN THE SECOND HALF OF THE YEAR

In the second half of the year, the inflation will remain lower than the market expectations despite the repricing that will be higher than the historical average.

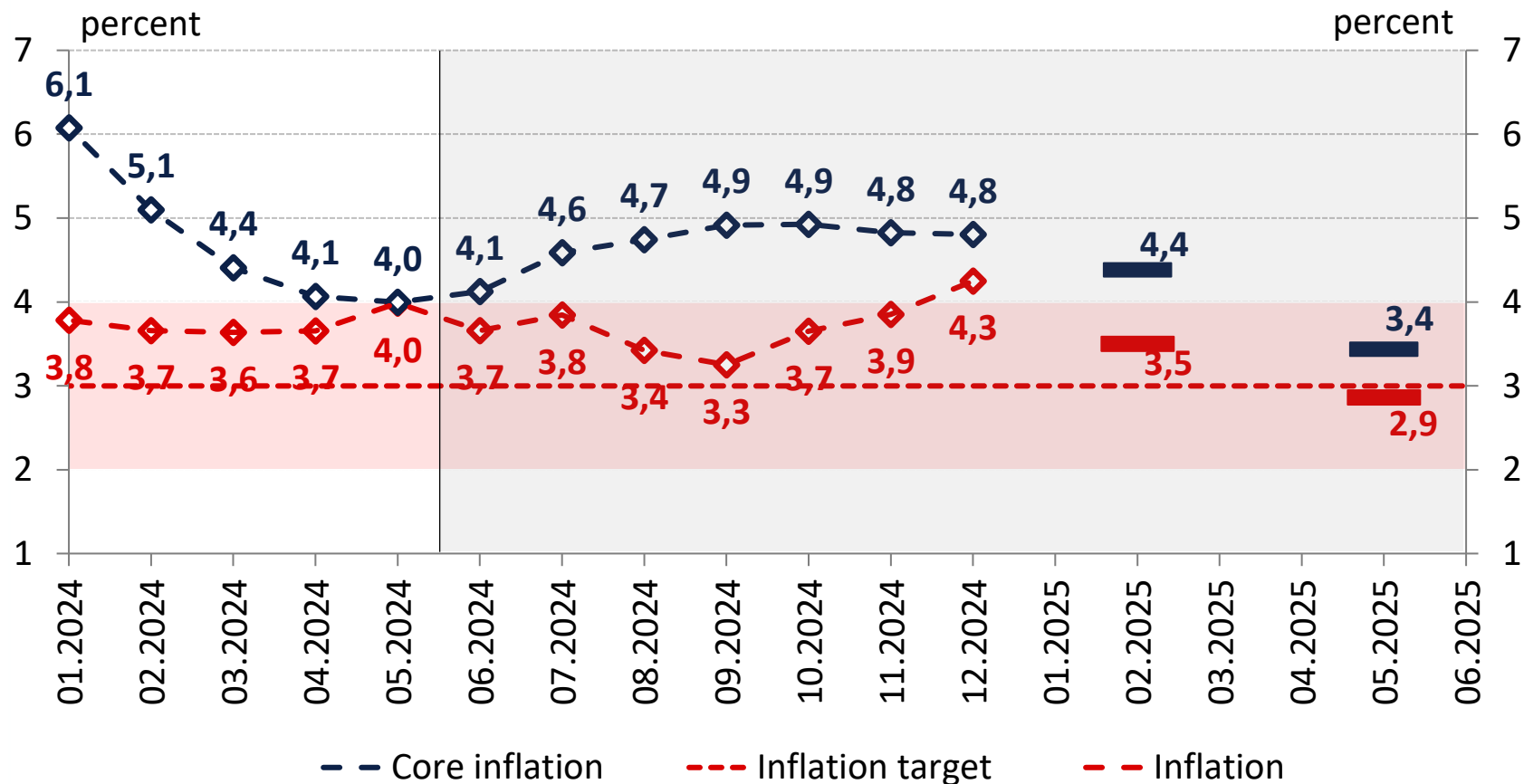


CUMULATIVE PRICE CHANGES IN 2024

Note | The analyst consensus is based on the median of 10 forecasts published on Portfolio.hu before the release of June inflation data. The median of the analyst forecasts for December 2024 inflation is 5.0 percent.
Source | HCSO, MNB, Portfolio.hu



IN JUNE, THE DECREASE IN CORE INFLATION STOPPED, IT IS EXPECTED TO TEMPORARILY INCREASE IN THE COMING MONTHS



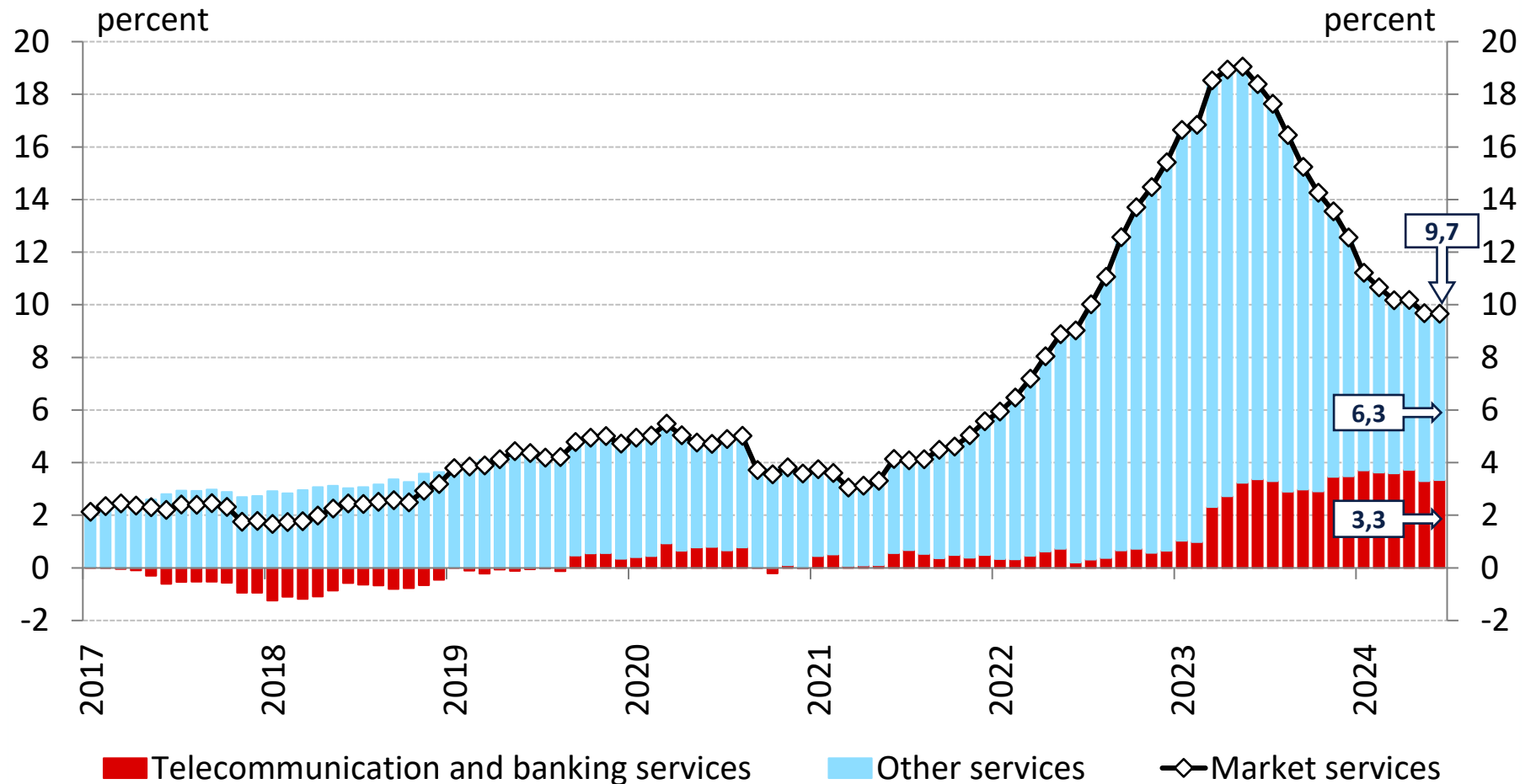
DEVELOPMENTS IN INFLATION AND CORE INFLATION IN THE RECENT PERIOD

Note | The inflation projections for 2025 are shown as quarterly averages.

Source | HCSO, MNB



DISINFLATION OF MARKET SERVICES CONTINUES TO BE SLOW, AND THEREFORE THE COUNCIL PAYS SPECIAL ATTENTION TO PRICING DECISIONS IN THE SECTOR

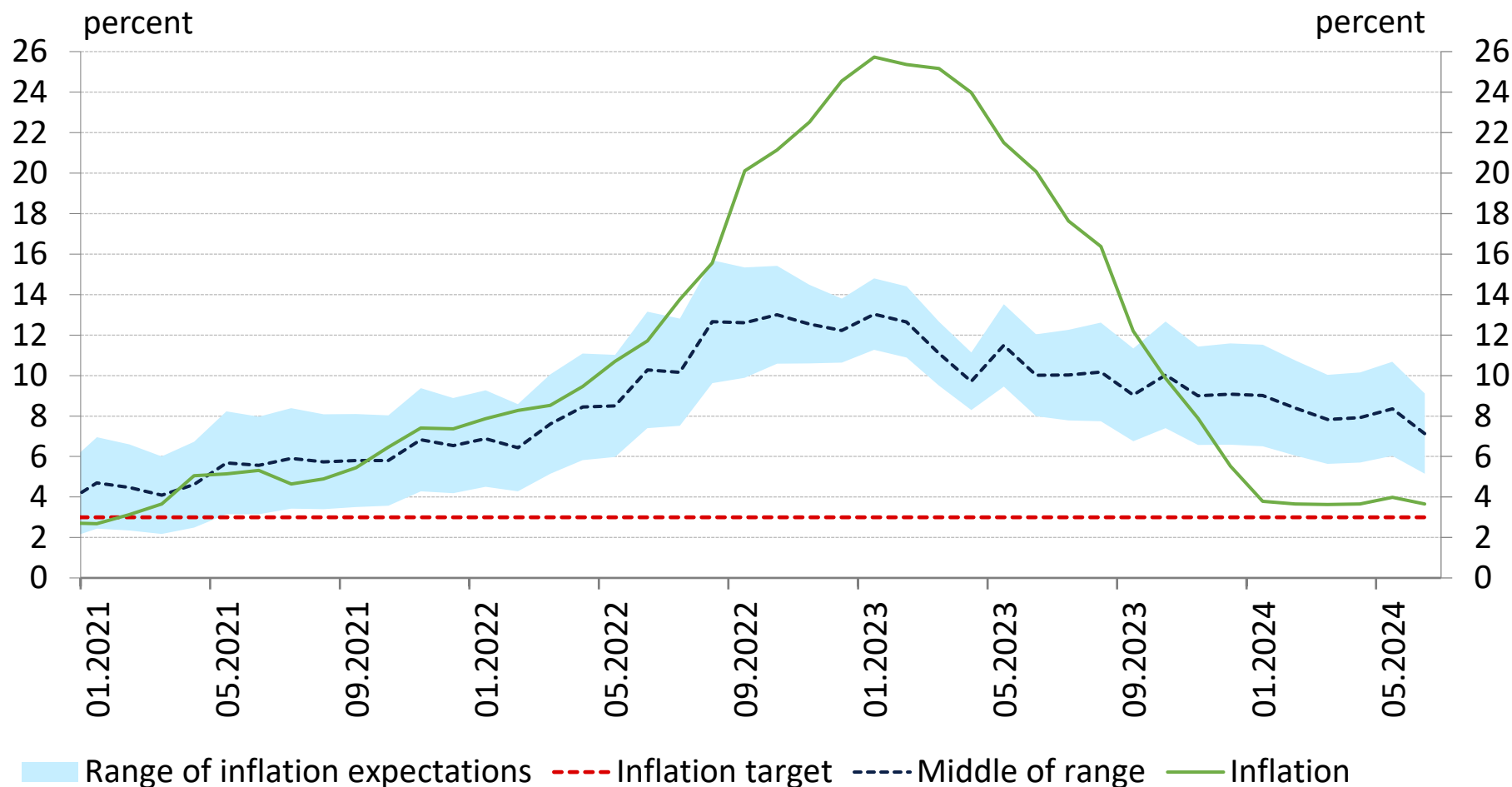


DECOMPOSITION OF MARKET SERVICES INFLATION

Source | HCSO, MNB



THE DECLINE IN INFLATION EXPECTATIONS IS A PROLONGED PROCESS, EXPECTATIONS MUST BE ANCHORED ON THE INFLATION TARGET AGAIN

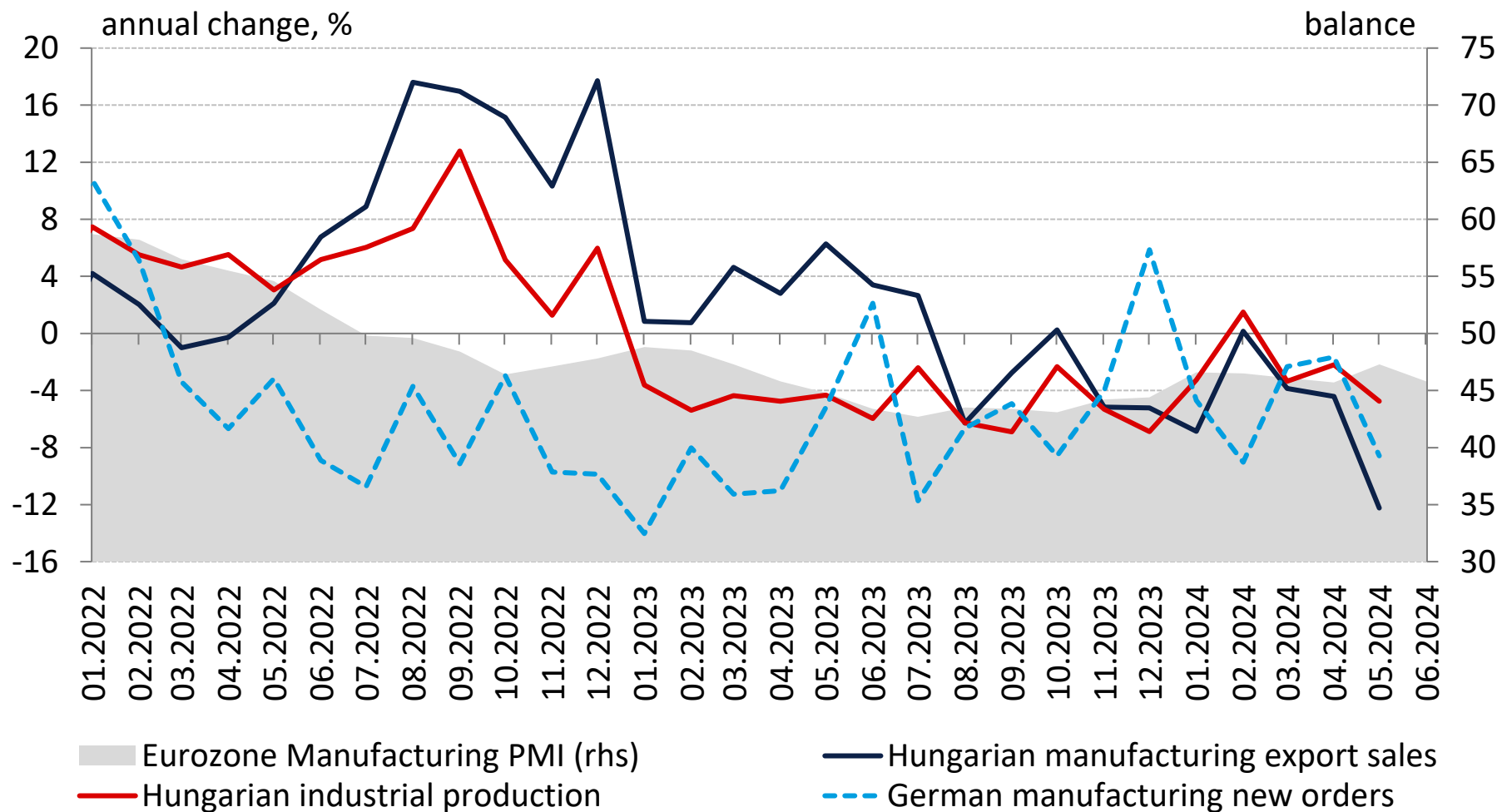


DOMESTIC INFLATION EXPECTATIONS IN HUNGARY

Source | MNB calculation based on European Commission data



THE IMPACT OF RESTRAINED EUROPEAN ACTIVITY IS MORE PERSISTENT



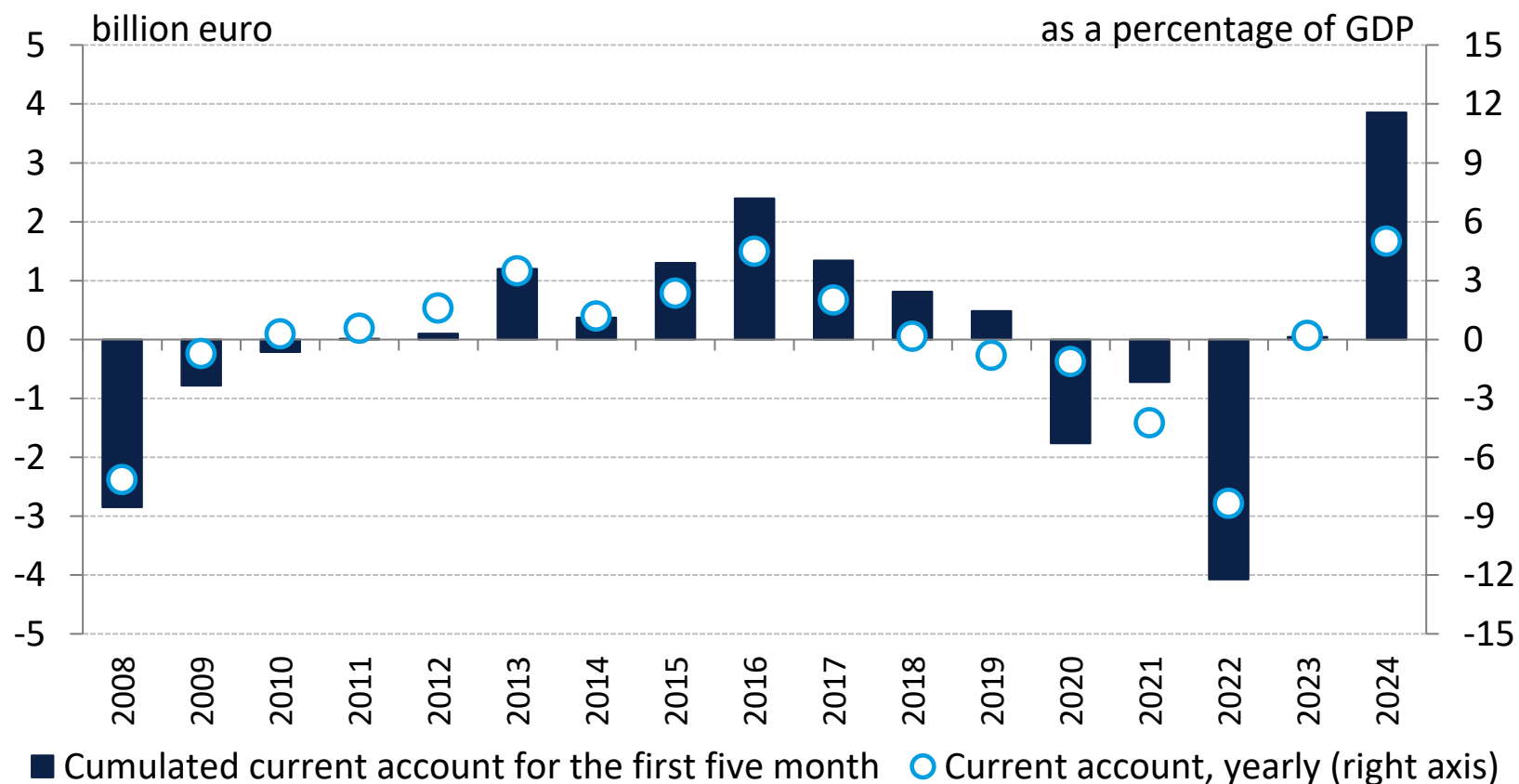
EVOLUTION OF INDICATORS OF HUNGARIAN INDUSTRIAL PRODUCTION AND EXTERNAL DEMAND

Note | Seasonally and calendar adjusted data.
Source | HCSO, Destatis, Bloomberg



IN MAY, THE CURRENT ACCOUNT REGISTERED ANOTHER SUBSTANTIAL SURPLUS

In May 2024, the current account showed a surplus of 838 million euros.



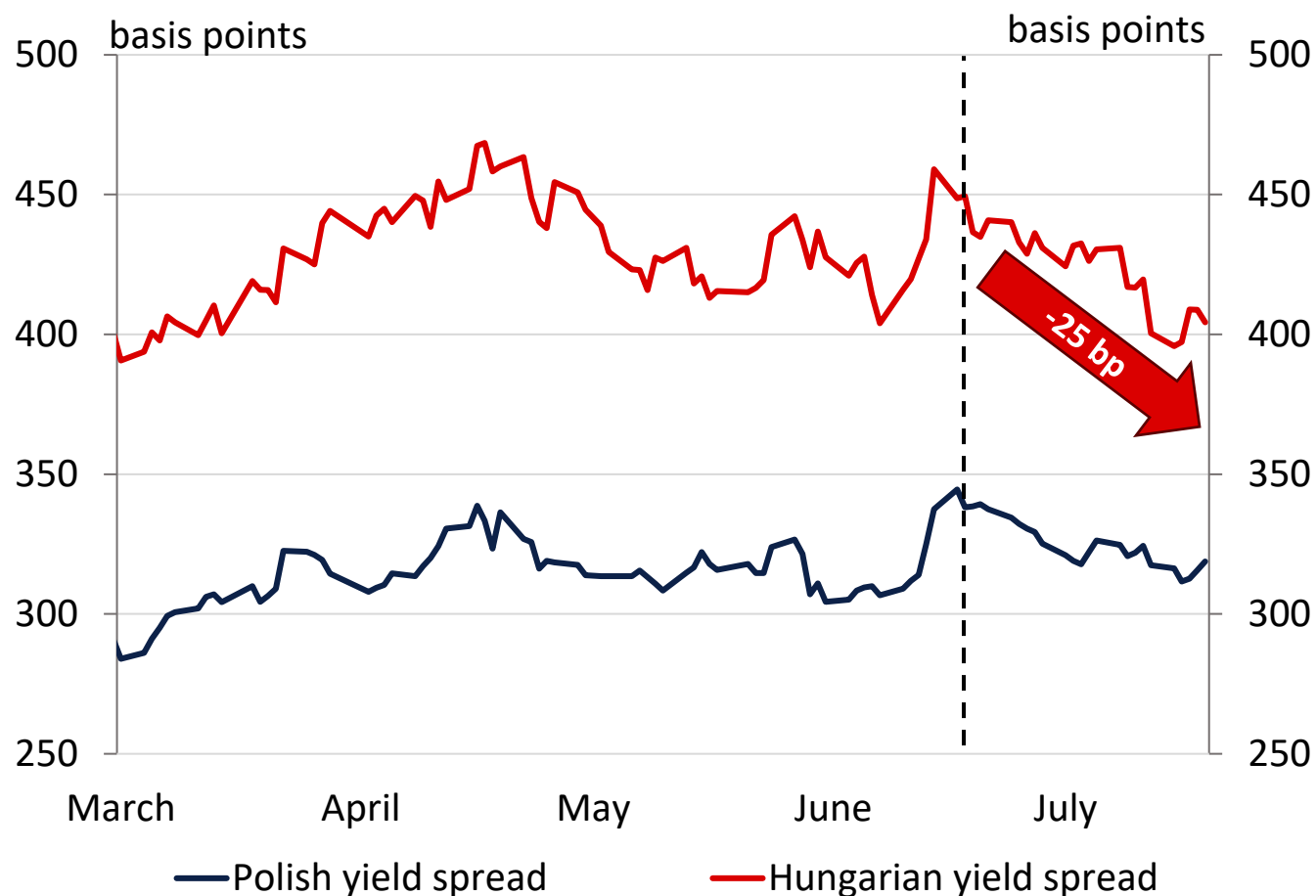
THE ANNUAL AND THE CUMULATIVE FIRST FIVE-MONTH BALANCE OF THE CURRENT ACCOUNT

Note | The 2024 value of the current account balance in proportion to GDP is an estimate based on the data of the first five months.

Source | MNB



THE DIFFERENCE BETWEEN THE HUNGARIAN AND THE POLISH YIELD SPREAD HAS DECREASED SUBSTANTIALLY



**Hungarian - Polish
yield spread:**

112 basis points



88 basis points

**Hungarian government
10Y bond yield**

6.84 percent



6.47 percent

DEVELOPMENTS OF HUNGARIAN AND POLISH YIELD SPREADS OVER THE YIELD OF 10-YEAR GERMAN GOVERNMENT BONDS

Note | We compared the difference between the Hungarian and Polish yield spreads and the developments of 10-year Hungarian government bond yields based on the average of the week before the June and the July interest rate decision.

Source | MNB



THE MEASURES INTRODUCED IN JULY WILL SUPPORT THE ACHIEVEMENT OF THE DEFICIT TARGET

2024



Expenditure side measures



Revenue increasing measures

0.6 percent of GDP

2025



Mainly **revenue** measures

0.7 percent of GDP

The measures will support the achievement of the fiscal deficit targets in 2024 and 2025.

2024

4.5 percent

2025

3.7 percent



MONETARY POLICY



A CAUTIOUS AND DATA-DRIVEN APPROACH IS STILL WARRANTED

GLOBAL RISK FACTORS

The risks that defined the past period are still present, which can quickly cause risk appetite to deteriorate as a result of one piece of negative news.



In the last few weeks, the probability of the Fed's interest rate cut in September and the measure of interest rate reduction expected by the end of the year have increased.

DOMESTIC INFLATION

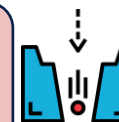
In June the inflation data was below market expectations. Looking ahead, inflation will fluctuate close to the upper bound of the central bank's tolerance band.



Disinflation of market services continues to be slow. Looking ahead, core inflation will continue to rise, and inflation expectations will be only slowly falling.

FURTHER FACTORS

The deficit reduction measures, announced in July, will support the achievement of the deficit targets in 2024 and 2025, at the same time, it takes time to assess the long-term sustainability of these steps.





SUSTAINABLE ACHIEVEMENT OF THE INFLATION TARGET STILL REQUIRES A DISCIPLINED AND RESTRICTIVE MONETARY POLICY

From June a new phase has started: based on incoming data, the Council takes month-by-month decisions on the level of the base rate. The decision is made between maintaining the rate and a small interest rate cut.

We are following closely:



The outlook for inflation



Financial market stability



The country's risk perception



The relative position of our country to the region

The Council intends to achieve the interest rate path that ensures the achievement of price stability and financial market stability.

The latest inflation data, which is better than market expectations, does not change the expected inflation path, but in addition to the strengthening of the country's risk perception, it allowed earlier implementation of interest rate cut.

ANALYST OPINIONS GRADUALLY SHIFTED IN THE DIRECTION OF A 25 BASIS POINTS INTEREST RATE CUT

Results of analyst surveys on expectations for the pace of interest rate cuts in July 2024 (person):

	Bloomberg	Reuters	Portfolio	Total
0 bp	8	8	2	10
25 bp	17	9	9	25



Approaching the decision in July, market analysts were increasingly expecting an interest rate cut, ...



... and thus expectations for a 25 basis points interest rate cut in July became the majority.



THE MONETARY COUNCIL'S JULY INTEREST RATE DECISION

Central bank instrument	Interest rate	Previous interest rate (percent)	Új mérték (százalék)
Central bank base rate		7.00	6.75
O/N deposit rate	Central bank base rate minus 1.00 percentage point	6.00	5.75
O/N collateralised lending rate	Central bank base rate plus 1.00 percentage point	8.00	7.75



THE MONETARY POLICY OUTLOOK REMAINED UNCHANGED

We can't sit back: looking ahead, a **careful and patient** approach to monetary policy is still warranted.



The financial market stability remains crucial to achieving price stability.

Restrictive monetary policy remains the key to the maintenance of financial market stability and the achievement of the inflation target in a sustainable manner.



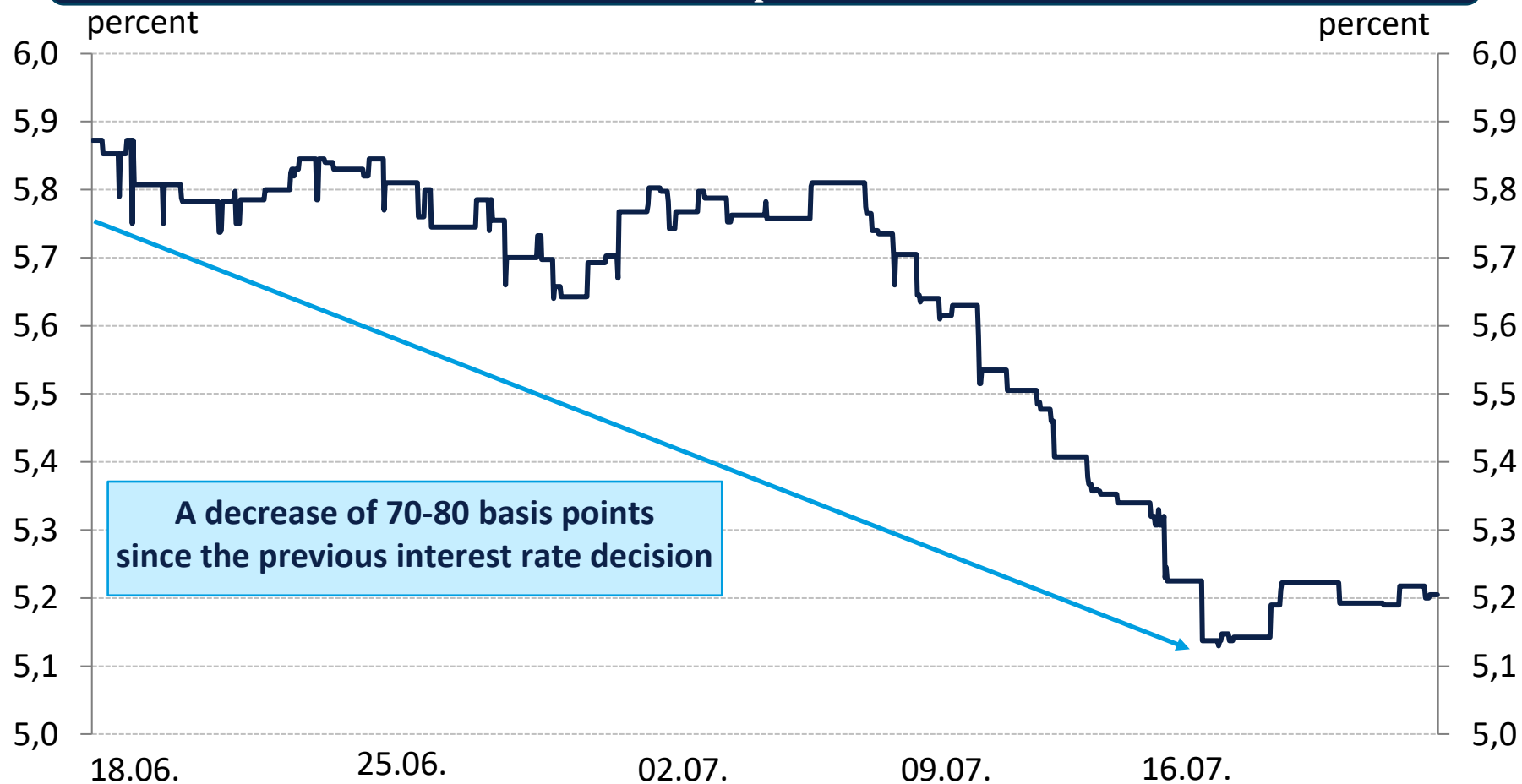
The change in the **country's risk perception** influences greatly how the domestic monetary policy room for manoeuvre develops in the second half of the year.

Market analysts expect another 1-2 interest rate cuts for the second half of the year, with different timing. This is considered realistic based on current information.



THE ONE AND A HALF, TWO-YEAR INTEREST RATE EXPECTATIONS HAVE SHIFTED SIGNIFICANTLY DOWNWARDS IN RECENT WEEKS

... at the same time, more incoming data is needed to judge the sustainability of the developments.



THE DEVELOPMENT OF THE THREE-MONTH INTERBANK YIELD STARTING TWO YEARS FROM NOW

Source | Bloomberg



THE MONETARY COUNCIL'S FORWARD GUIDANCE

*„Looking ahead, risks surrounding global and domestic disinflation, volatility in international investor sentiment and expected interest rate policies of the world’s leading central banks warrant a careful and patient approach to monetary policy. The Council is constantly assessing incoming macroeconomic data, the outlook for inflation and developments in the risk environment, based on which **it will take decisions on the level of the base rate in a cautious and data-driven manner.**”*

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YOUR KIND
ATTENTION!**

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gyarapodásáért*