MINUTES

OF THE MONETARY COUNCIL MEETING

27 JANUARY 2015

Article 3 (1) of the MNB Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines achieving and maintaining price stability as the primary objective of the Magyar Nemzeti Bank. 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 immediate policy decisions. 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://english.mnb.hu/Monetaris_politika/decision-making/mnben_mt_jegyzokonyv

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

In the Council's judgement, Hungarian economic growth was likely to continue. While the pace of economic activity was strengthening, output remained below potential and the domestic real economy was expected to continue to have a disinflationary impact, albeit to a diminishing extent. Despite the pick-up in the components of domestic demand, capacity utilisation was expected to improve only gradually due to the protracted recovery in Hungary's export markets. With employment rising, the unemployment rate continued to exceed its long-term level determined by structural factors. Inflationary pressures in the economy were likely to remain moderate for an extended period.

Based on the inflation data for December, consumer prices showed historically low dynamics. The Bank's measures of underlying inflation capturing the medium-term outlook still indicated moderate inflationary pressures in the economy, reflecting persistently low inflation in external markets, moderate movements commodity prices and imported inflation, the degree of unused capacity in the economy, subdued wage dynamics and the moderation in inflation expectations. The continued decline in oil prices and the fall in processed food prices had contributed to the further easing in inflation. Domestic real economic and labour market factors continued to have a disinflationary impact and low inflation was likely to persist for a sustained period. However, domestic demand-side disinflationary pressures were likely to weaken gradually as activity gathered pace, and inflation was likely to reach levels around 3 per cent consistent with price stability in the latter half of the forecast period.

In the Council's judgement, economic growth was likely to continue even as external demand had weakened slightly. Industrial output had continued to grow and the trade surplus had risen. The dynamics of retail sales had been stable or increasing slightly in recent months. Looking ahead, domestic demand was likely to be the main engine of growth. The prolonged Funding for Growth Scheme was likely to promote corporate investment this year, but weak global economic activity and lower receipts of EU funding were likely to work in the opposite direction. Household consumption was also likely to pick up gradually, mainly as a result of the expected increase in the real value of disposable income and the reduced need for deleveraging. According to seasonally adjusted data, employment had been broadly unchanged in November, with the increase in the number of those employed under public employment programmes also playing a role.

International investor sentiment had been volatile in the past month, with risk aversion dominating financial markets. Global sentiment had deteriorated significantly around the end of the year, due to the turbulence in Russian financial markets and the political events in Greece. Then, following a temporary improvement, global risk appetite had fallen again from the middle of the month, reflecting the further decline in oil prices and the surprise announcement by the Swiss National Bank. The European Central Bank had decided to extend its asset purchase programme aiming to bring euro-area inflation into line with the inflation target corresponding to price stability. International factors had been a major driver behind movements in the forint exchange rate. Domestic risk measures had been little changed as the temporary effects of the financial market turbulence at the end of the year had dissipated. Hungary's persistently high external financing capacity and the resulting decline in external debt had contributed to the reduction in its vulnerability. In the Council's judgement, a cautious approach to monetary policy was warranted due to uncertainty about future developments in the global financial environment.

The Swiss franc had appreciated significantly against the forint and other currencies shortly after the Swiss National Bank had announced that it had abandoned the franc's peg against the euro. The exchange rate at which Hungarian foreign currency-denominated household mortgage loans would be converted into forints had been fixed in advance in November 2014. In agreement with the MNB's proposal, the conversion had been effected in a single step for all households with foreign currency-denominated household mortgage loans. The MNB had provided nearly EUR 9 billion liquidity required for settlements and forint conversions, thereby allowing time for participants of the domestic financial system to manage exchange rate risk. Therefore, the appreciation of the Swiss franc might affect the domestic banking sector mainly through losses incurred on Swiss franc-denominated corporate loans, and household loans unaffected by the conversion. That, however, in the Council's judgement was expected to have a moderate impact and did not pose systemic risk.

In the Council's judgement, there remained a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate in the medium term. The negative output gap was expected to close gradually at the monetary policy horizon. Looking ahead, therefore, the disinflationary impact of the real economy was likely to moderate. Based on data available since the latest policy decision, there had been a shift towards the alternative scenario implying looser monetary policy in the December 2014 *Inflation Report*. Members agreed that, with current monetary conditions maintained, there had been no second-round effects yet, despite disinflationary trends in external markets, and therefore inflation was likely to move into line with the target in the second half of the forecast horizon.

The Council judged that the current level of the central bank base rate was consistent with the medium-term achievement of price stability and a corresponding degree of support to the real economy, and therefore no change was warranted. Members agreed that the risks pointing in the direction of looser monetary policy had increased in the short term; however, a decision to change the monetary policy stance was not warranted, and therefore leaving the base rate unchanged contributed to the Bank's credibility and predictability. Several members noted that a decision to change the monetary policy stance was not warranted as the second-round effects of the external disinflkation environment had not yet been seen. Some members added that maintaining the Council's forward guidance in an unchanged form and cautious communication might help strengthen the Bank's credibility and predictability. Members agreed that the Council should decide on the possibility of changing the base rate after a comprehensive assessment of the outlook for inflation and the real economy and in view of the March issue of the *Inflation Report*.

After the discussion, the Chairman invited members to vote on the proposition put to the Council. Members voted unanimously in favour of maintaining the base rate at 2.10 per cent. The Council judged that, if the assumptions underlying the Bank's projection held, achieving the medium-term inflation target pointed in the direction of maintaining current loose monetary conditions for an extended period.

Votes cast by individual members of the Council

In favour of maintaining the base rate at 2.10%	**9**	Ádám Balog, Andrea Bártfai-Mager, János Cinkotai, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, Gyula Pleschinger, László Windisch

The following members of the Council were present at the meeting:

Ádám Balog

Andrea Bártfai-Mager

János Cinkotai

Ferenc Gerhardt

Csaba Kandrács

György Kocziszky

György Matolcsy

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 24 February 2015. The minutes of that meeting will be published at 2 p.m. on 11 March 2015.