MINUTES

OF THE MONETARY COUNCIL MEETING

28 FEBRUARY 2017

Time of publication: 2 p.m. on 15 March 2017

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, usually 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://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

In the Council's assessment, Hungarian economic growth continued to pick up. Some degree of unused capacity remained in the economy, but looking ahead, the disinflationary impact of the domestic real economic environment was gradually dissipating. Inflation rose over the forecast period and reached the inflation target in the first half of 2018.

Due primarily to base effects, inflation had risen further in January 2017, while the Bank's measures of underlying inflation had remained broadly unchanged. In the coming months, the price index was likely to rise further temporarily due to the base effects. Thereafter, inflation was likely to decrease again in the spring months as these effects gradually faded. Whole-economy wage growth was likely to remain strong, as a result of continued strong demand for labour and the wage agreement at the end of last year. The upward effect of this on costs was likely to be offset by the reduction in employers' social contributions and corporate taxes. According to our expectations, to a smaller extent this would lead to higher core inflation and, to a greater extent, to a reduction in the trade surplus through an expansion in household consumption. With historically low inflation expectations, the consumer price index approached the inflation target gradually, and was projected to reach the 3 per cent level consistent with price stability in the first half of 2018.

Hungarian economic growth had continued in the fourth quarter of 2016. In December, the volume of retail sales had increased further and industrial production had fallen slightly relative to the same period a year earlier. Including self-employed persons, outstanding lending to small and medium-sized companies had increased by nearly 12 per cent in 2016. Furthermore, the total stock of corporate loans had also increased markedly, by more than 4 per cent. The MNB's Market-based Lending Scheme had supported significantly this dynamic growth: the banks participating in the Scheme had overperformed their net lending commitment of HUF 195 billion for SMEs by more than 50 per cent in 2016 on the whole. The turnaround in household lending experienced last year had proved lasting. Labour demand had remained strong, and therefore the number of employees had increased and the unemployment rate had fallen further. In parallel with strong wage growth expected to continue this year, household consumption was likely to grow dynamically, which would be supported by the realisation of consumption deferred from previous years as well. Hungary's current account surplus was expected to fall to nearly a half of its 2016 amount over the forecast horizon, driven by rising domestic demand. The Monetary Council expected annual economic growth of over 3 per cent both this year and next, to which the Bank's and the Government's measures to stimulate economic growth contributed substantially.

Global financial markets had been volatile since the Council's latest interest rate-setting decision and risk indicators had fallen slightly overall. Developed market equity indices had risen and the majority of yields on long-term government securities had declined. The forint had appreciated against the euro. In the domestic government securities market, yields at maturities of up to one year had been broadly unchanged and those at longer maturities had risen. The amount of liquidity crowded out following the introduction of an upper limit on the stock of three-month deposits had had a marked influence on money market rates. As a consequence, the three-month BUBOR had dropped to a historical low level of 23 basis points and forint yields in the FX swap market had also fallen further.

Hungary's strong external financing capacity and the decline in external debt were contributing to the sustained reduction in the vulnerability of the economy. Forward-looking domestic money market real interest rates had fallen substantially over recent years and were expected to remain in negative territory for a prolonged period. In the Council's assessment, a watchful approach to monetary policy was still warranted due to uncertainty in the global financial environment.

At its meeting in December 2016, the Monetary Council had set a HUF 750 billion upper limit on the stock of three-month central bank deposits as at the end of the first quarter of 2017. The Monetary Council expected that this decision would mean the crowding out of at least HUF 100-200 billion additional liquidity from the deposit facility. The Council considered the limit on the three-month deposit stock and its potential future change an integral part of monetary policy instruments. The Bank aimed to ease monetary conditions and provide a corresponding degree of support to the economy through a decline in money market rates. The Monetary Council intended to ensure that the limit imposed on the stock of three-month deposits exerted its expected easing effect efficiently. The limit was set quarterly. On the next occasion, a decision on its level as at end of the second quarter of 2017 would be made in March 2017.

In the Council's assessment, some degree of unused capacity remained in the economy, but the disinflationary impact of the real economy was gradually dissipating over the policy horizon. Inflation rose over the forecast period and reached the Bank's target in the first half of 2018.

In discussing the current decision, Council members agreed that no event had occurred since the previous rate decision in terms of Hungarian economic fundamentals and the sustainable achievement of the inflation target which would warrant a change to the current level of the base rate or the interest rate corridor. Members noted that leaving the base rate unchanged was consistent with the baseline projection in the December Inflation Report, economic data released in recent months, the Monetary Council's previous communications and market expectations. Several members concluded that underlying inflation had been broadly unchanged and the rise in inflation mainly reflected base effects and was judged to be temporary. One member noted that the Council would make a decision in March on the upper limit on the stock of three-month central bank deposits as at the end of the second quarter of 2017, and therefore the fine-tuning of monetary conditions, if necessary, could be accomplished using unconventional tools. Another member argued that special attention should be given to the potential inflationary effects of the tightening labour market and it should be considered what economic policy tools could be used to manage bottlenecks in the labour market. Members agreed that in the coming period there should be a particular focus on the international economic environment, especially on monetary policy divergence between the leading central banks, and on an analysis of global inflation developments. Taking these factors into account, all members voted unanimously in favour of leaving the base rate, the overnight deposit rate, the overnight lending rate and the one-week lending rate unchanged.

If the assumptions underlying the Bank's projections held, maintaining the current level of the base rate for an extended period and the loosening of monetary conditions by the change in the monetary policy instruments were consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy. The Magyar Nemzeti Bank monitored developments in monetary conditions and markets. If subsequently warranted by the achievement of the inflation target, the Council would stand ready to ease monetary conditions further using unconventional, targeted instruments.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight central bank lending rate and the one-week collateralised central bank lending rate at 0.90% **and** **maintaininging the overnight central bank deposit rate at -0.05%:**	9	Gusztáv Báger, János Cinkotai, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch
Vote against:	0	

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

Gusztáv Báger

János Cinkotai

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

György Matolcsy

Márton Nagy

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 28 March 2017. The minutes of that meeting will be published at 2 p.m. on 12 April 2017.