MINUTES
OF THE MONETARY COUNCIL MEETING
19 June 2018

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

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

The Magyar Nemzeti Bank shifted to inflation targeting regime in 2001. Inflation targeting is a monetary policy framework where the central bank's primary objective is to achieve price stability, which it seeks to reach with a publicly announced inflation target. Since 2007, the Magyar Nemzeti Bank has set its medium-term inflation target consistent with price stability as a 3 percent increase in consumer prices. The conditions for price stability are assumed to hold if economic agents can expect over a longer period with confidence that inflation remains steadily around the target. From 2013, the fiscal turnaround achieved in previous years has made it possible to improve the efficiency of inflation targeting. The ±1 percentage point tolerance band around the target, introduced in March 2015, allows the Monetary Council to look through any deviation of inflation from the target in the event of temporary cost shocks, thereby mitigating the real economic costs of achieving and maintaining price stability. The time horizon considered by the Council is 5 to 8 quarters.

In addition to the priority of the price stability objective, the flexible inflation targeting strategy provides a framework where the central bank not only focuses on inflation, but also takes into account financial stability and real economic considerations, in line with its mandate. After 2013, inflation fell significantly below the 3 percent target; therefore, promoting financial stability and stimulating the real economy through underlying developments were fully consistent with the achievement of the inflation target, without jeopardising it. The extension of the Bank's micro- and macroprudential authority, the conversion of foreign currency loans into forints, the Self-financing Programme, the Funding for Growth Scheme, then the Market-Based Lending Scheme contributed successfully to restoring the monetary transmission mechanism impaired during the crisis, to strengthening financial stability and to providing a corresponding degree of support to the real economy. During 2018, however, inflation is likely to be close to the inflation target again, and therefore the Bank's policy focus shifts back to its primary mandate, to the achievement and maintenance of price stability.

The Magyar Nemzeti Bank takes account of all factors influencing inflation developments on the horizon of monetary policy. These may include developments in commodity prices, changes in the external inflation environment, labour market conditions, the position of the real economy, developments in exchange rate and credit market conditions. By taking into account all these factors, the Bank is able to assess the likely magnitude and persistence of future price changes, which in turn determines the monetary policy response. The Magyar Nemzeti Bank's single anchor is inflation.

Before taking its policy decision on 19 June, the Council reviewed recent developments in inflation and the macroeconomy. In the Council's assessment, in parallel with the pick-up in domestic demand Hungarian economic output was close to its potential level. Growth of the Hungarian economy would pick up further in 2018, then, if the assumptions of the current projection held, it would slow down gradually from 2019. The inflation target was still expected to be achieved in a sustainable manner from mid-2019, as the temporary, inflation boosting effects of oil price changes faded.

In May 2018, inflation had stood at 2.8 percent and core inflation at 2.4 percent. Rising fuel prices had been the main factor contributing to the increase in inflation. In line with the Bank's expectations, measures of underlying inflation had continued to be around 2 percent and remained below the level of core inflation. The expansion in domestic employment, the tight labour market as well as increases in the minimum wage and the guaranteed minimum wage had led to a general, dynamic rise in whole-economy wages, which had continued in the first quarter of 2018. The upward effects of this on costs were being offset by the gradual reduction in employers' social contributions and in the corporate tax rate in 2017. In line with the Bank's expectations, upward pressures on inflation from wages continued to be moderate. Oil prices had risen significantly over the spring and had been considerably higher than in the previous year. According to the ECB's projections, however, underlying inflation would continue to be moderate in the euro area in the coming years as well.

If the assumptions in the June projection held, the consumer price index would rise slightly above 3 percent temporarily in the coming months, reflecting the increase in oil prices. With inflation expectations anchored at low levels, higher oil prices were unlikely to generate second-round effects. Over the medium term, rising consumption would lead to a gradual increase in underlying inflation. However, moderate external underlying inflation and inflation expectations stabilising at historically low levels, as well as multistage reductions in employers' social contributions and the VAT rate cuts this year, were slowing the rise in prices. The inflation rate was expected to moderate back again as the direct effects of oil price increases faded, and the increase in underlying inflation would ensure that inflation met the 3 percent target in a sustainable structure from the middle of 2019.

The Hungarian economy had grown strongly, by 4.4 percent, in the first quarter of 2018 relative to a year earlier. On the expenditure side, consumption and fixed investments had been the main factors contributing to growth. In April, industrial production had increased and construction output had risen at a somewhat moderate pace on an annual basis following the outstanding data for the previous period. The volume of retail sales had grown markedly. The performance of services had improved across a wide range of sub-sectors and had made an increasing contribution to economic growth. Labour demand had remained strong. The unemployment rate had fallen to a historically low level. Lending to the corporate and household sectors had continued to expand.

Economic growth continued in a balanced structure. Looking ahead, the general strengthening of domestic demand would continue to play a central role in economic output developments. The build-up of new export capacities and the pick-up in services exports were likely to contribute to export growth and, consequently, to an increase in Hungary's export market share. The country's current account balance relative to GDP was expected to remain in positive territory over the longer term as well. Economic growth this year would also be supported by the budget and the stimulating effects on investment of European Union funding. In the Council's assessment, GDP growth would be 4.4 percent in 2018, higher than last year, then, if the assumptions of the current projection held, it would slow down gradually from 2019. The Magyar Nemzeti Bank's and the Government's measures contributed substantially to this year's economic growth.

Sentiment in international financial markets had been highly volatile in the period since the Council's previous interest rate decision. Expectations related to the policy stance of the world's leading central banks, domestic political events in Europe and global trade policy developments had influenced investors' appetite for risk. The Fed had continued its gradual tightening of monetary conditions. The dollar had appreciated significantly and US long-term yields had risen further over recent months. As a consequence, appetite for risk in emerging markets had deteriorated. This, associated with a generalised increase in volatility, had led to sharp movements in some countries and had had an effect on Central and Eastern European markets as well. The ECB had decided to end its asset purchase programme in December, and therefore the direct effects exerted on the long end of the yield curve would be smaller. However, policy interest rates would remain unchanged at least until the summer of 2019, and therefore the monetary policy environment in the euro area might remain loose. The ECB's decision might have a significant influence on the Magyar Nemzeti Bank's monetary policy.

Asset price volatility also had increased in domestic financial markets in response to turbulence in international markets. The Bank assessed these developments in light of their relevance to its primary objective, i.e. the sustainable achievement of the inflation target, focusing on their persistence. Due to the different inflation paths expected in the countries of the region and the different characteristics of inflation targeting regimes, market prices suggested that monetary policy stances by regional central banks would continue to differ.

Following the review of the June Inflation Report as well as macroeconomic and financial market developments, the Council discussed the details of the monetary policy decision. Members agreed that maintaining the current loose monetary policy stance was consistent with the June Inflation Report projection. Council members stressed that the Bank's single anchor was inflation, and its primary objective was to meet the inflation target in a sustainable manner. The Council considered a wide range of incoming data; however, those data influenced the Council's assessments only through their effects on developments in inflation. In the Council's view, with inflation expectations anchored at low levels, second-round effects due to higher oil prices were not expected. Accordingly, although inflation was likely to rise above the target temporarily due to the direct cost-increasing effect of rising oil prices, it was expected to fall again as these effects dropped out of the base. The inflation target was still to be met sustainably from the middle of 2019.

The Magyar Nemzeti Bank monitored current international trends as well as their possible effects on price stability closely. Risks were being evaluated continuously by the Monetary Council. In terms of the outlook for inflation, the Council identified three key alternative scenarios around the baseline projection. A further deterioration in risk appetite in emerging markets and faster than expected growth in wages and consumption might lead to higher inflation than projected in the baseline scenario. By contrast, weaker growth and more moderate underlying inflation in the euro area might significantly dampen domestic inflation. In the coming months, the Monetary Council would closely monitor the likelihood of these alternative scenarios materialising as well as their effects on inflation and the achievement of the three-percent target.

For members, key questions were how sustained could international financial market volatility experienced in recent months be considered and how this would influence the achievement of the inflation target. They noted that the Bank closely monitored market developments in order to reach the inflation target and maintain financial stability. Most members stressed that the fundamentals of the Hungarian economy were strong and the country's fiscal and net lending positions were stable. Members discussed the effects of the European Central Bank's June decision on domestic monetary conditions. The ECB had decided to end its asset purchase programme in December. However, policy rates would likely remain unchanged at least until the summer of 2019. As a result, in the future the ECB would have a smaller direct effect on the long end of the euro area yield curve, while its interest rate policy might remain loose for longer than previously expected. In the Council's assessment, the international environment was changing, and the ample liquidity seen in previous years, associated with a period of persistently low interest rates, was coming to an end. Members agreed that developments in euro area monetary conditions were of prime importance for the Magyar Nemzeti Bank's monetary policy.

In the Council's assessment, maintaining the loose monetary conditions was necessary to achieve the inflation target in a sustainable manner. To this end, the Monetary Council maintained the base rate, the overnight collateralised lending rate and the one-week collateralised lending rate at 0.9 percent and the overnight deposit rate at -0.15 percent.

Council members agreed to reinforce their commitment to achieving and maintaining price stability. They noted that, due to changes in the international environment, the current loose monetary conditions could not persist for a prolonged period on the monetary policy horizon. For this reason, it was essential to constantly assess monetary conditions while at the same time remaining cautious.

The Council would maintain the HUF 75 billion upper limit on the stock of three-month deposits. In addition, the Council had set the average amount of liquidity to be crowded-out for the third quarter of 2018 at least at HUF 400-600 billion. Furthermore, the Council had stated that the actual amount of liquidity to be crowded out must reach a level sufficient to ensure the maintenance of loose monetary conditions. The Magyar Nemzeti Bank had increased the stock of fine-tuning FX swaps providing forint liquidity. On the next occasion, in September 2018, the Council would decide on the amount of liquidity to be crowded out and would take this into account in setting the stock of central bank swap instruments.

In June, the Monetary Council had set the maximum stock of monetary policy interest rate swaps in the first three quarters of 2018 at HUF 900 billion. The Bank would continue mortgage bond purchases and the monetary policy interest rate swap facility as programmes, and therefore they constituted an integral part of the set of monetary policy instruments. The Council considered the Bank's mortgage bond purchase programme to be successful. As a result of the measures, spreads of mortgage bonds over yields in the government securities market had fallen sharply and had turned negative on average. The decline in financing costs had encouraged issuance in the primary market, thereby facilitating the increase in fixed-rate lending.

The fundamentals of the Hungarian economy continued to be stable. Accompanied by dynamic growth, the country's external debt had declined significantly, and its net lending continued to be persistently strong. Its fiscal position was sustainable, the budget deficit was low and the public debt-to-GDP ratio was contracting. The foreign currency debt ratio had fallen sharply. The debt cap rules, to be introduced in the autumn, would facilitate the healthy, sustainable growth of housing loans.

The Magyar Nemzeti Bank's single anchor was inflation. The inflation target was still expected to be achieved in a sustainable manner from mid-2019, as the temporary, inflation boosting effects of oil price changes faded. In the Council's assessment, maintaining the base rate and the loose monetary conditions was still necessary to achieve the inflation target in a sustainable manner. The current volatile international environment suggested a more cautious approach. The Council would ensure the maintenance of loose monetary conditions, necessary to achieve the inflation target in a sustainable manner, by using the current set of monetary policy instruments.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight collateralised lending rate, the one-week collateralised lending rate at 0.9 percent **and** **maintaining the interest rate on the overnight central bank deposit at -0.15 percent:**	9	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Bianka Parragh, Gyula Pleschinger, László Windisch
Vote against:	0	

<u>The following members of the Council were present at the meeting:</u>

Gusztáv Báger

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

György Matolcsy

Márton Nagy

Bianka Parragh

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 24 July 2018. The minutes of that meeting will be published at 2 p.m. on 8 August 2018.