MINUTES
OF THE MONETARY COUNCIL MEETING OF
19 DECEMBER 2017

Time of publication: 2 pm on 10 January 2018

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

Before taking its policy decision on 19 December, 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 continue to be dynamic in 2018, then it would slow down. The inflation target was expected to be achieved in a sustainable manner by the middle of 2019.

In November 2017, inflation had stood at 2.5 percent and core inflation at 2.7 percent. In the autumn months, inflation had been basically in line with the September Inflation Report projection; however, core inflation had fallen short of the forecast. The difference had been mainly attributable to the price dynamics of market services. The Bank's measures of underlying inflation had remained unchanged compared with the summer months and had continued to be significantly below 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. The upward effect of this on costs was being offset by the reduction in employers' social contributions and in the corporate income tax rate early in 2017. In line with the Bank's expectations, there had still not yet been any significant upward pressure on inflation from wages. Oil prices had risen in recent months. In the euro area, underlying inflation would continue to be moderate in the coming years as well.

According to our current projection, following a temporary rise in November, the consumer price index was likely to decline again to close to 2 percent at the end of 2017, then in the first months of 2018 it would level off at the bottom edge of the tolerance band. Over the medium term the second-round effects resulting from buoyant domestic demand, the increase in wage costs, as well as higher commodity prices would point to an increase in domestic core inflation. However, moderate external inflation and inflation expectations stabilising at historically low levels, as well as subsequent reductions in employers' social contributions, the VAT rate cuts, announced for next year, were slowing the rise in prices. In our projection, the inflation target could be achieved sustainably by the middle of 2019.

The Hungarian economy had grown by 3.9 percent in the third quarter of 2017. Industrial production and the volume of retail sales had picked up in October. Labour demand had remained strong: employment had been close to historically high levels in August-October 2017. The unemployment rate had continued to fall.

Looking ahead, the general strengthening of domestic demand would continue to play a central role in economic growth. Robust growth in construction and the expansion in the performance of the service sector were likely to continue in the coming months. Hungary's current account surplus was expected to fall in 2017-2018, driven by rising domestic demand. Economic growth this year would also be supported by the fiscal budget and the stimulating effects on investment of European Union funding. In the Council's assessment, GDP growth would approach 4 percent in

2017 and 2018, then it would slow down from 2019 onwards according to the current projection. The Bank's and the Government's stimulating measures contributed substantially to economic growth.

Sentiment in international financial markets had, on the whole, been positive in the period since the Council's previous interest rate decision. News of negotiations between the European Union and the United Kingdom, favourable projections for global growth and the European political events had been the main factors influencing investors' appetite for risk. In December, the Fed had decided to further increase the base rate; however, market prices had suggested no major change in interest rate expectations. Looking ahead, the European Central Bank was likely to maintain loose monetary conditions for an extended period. Investors' perceptions about the Central and Eastern European region had continued to be positive. 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 the timing of central bank actions would differ.

Yields in the domestic money and capital markets had declined to their historic low. Short-term yields were at a level close to or below zero. The liquidity crowded out due to the introduction of an upper limit on the stock of three-month deposits, the reduction in the overnight central bank deposit rate, as well as the increase in the size and the average original maturity of the stock of central bank swap instruments providing forint liquidity had had a marked influence on short-term yields. Long-term yields had decreased significantly in the last three months, which had been mostly the result of the MNB's forward guidance and the announcement of the central bank interest rate swap instruments and the mortgage bond purchase programme in November. The Hungarian yield curve had shifted downwards markedly in a regional comparison as well; however, it was still steep in international comparison.

Following the review of macroeconomic and financial market developments, the Council discussed the details of the current monetary policy decision. Members agreed that data becoming available over recent months had been in line with the baseline scenario of the September projection and underlying inflation in the euro area had remained moderate. Members concluded that the upward effect of dynamic wage growth on the inflation rate continued to be moderate and inflation would rise gradually towards the target as domestic demand picked up. Several members stressed that it should be closely monitored when and how domestic wage growth and oil prices, rising again over the past quarter, would influence the increase in consumer prices. In regard to the external environment, the direction in which the policy stance of the ECB and central banks of the CEE region would be likely to change was an important factor.

In the Council's assessment, maintaining the loose monetary conditions for an extended period were 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, the one-week collateralised lending rate at 0.9 percent, and the overnight deposit rate at -0.15 percent unanimously. In the Council's assessment, the gradual limitation on the stock of three-month deposits had fulfilled its role and the HUF 75 billion year-end upper limit on the stock would not be reduced further. In line with maintaining monetary conditions, the Council set a HUF 400-600 billion band for the targeted average liquidity crowded-out (the stock of marketable forint central bank liabilities with an interest rate other than the base rate) for the first quarter of 2018, which was equal to the liquidity crowded-out of the fourth quarter of 2017. On the next occasion, the Council would decide on the amount of liquidity crowded out in March 2018 and would adjust the stock of central bank swap instruments accordingly.

The Council's aim was that the loose monetary conditions had their effect not only at the short but also at the longer end of the yield curve. To ensure this, in November 2017, the Council had decided to introduce two unconventional instruments from January 2018, which would constitute an integral part of the Bank's set of monetary policy instruments. Having considered the results of several rounds of consultation with banks, the Council had invited the Magyar Nemzeti Bank's Executive Board to make a decision on the operational details of the programmes before 22 December 2017, and to inform market participants about this in a release. In harmony with the Council's forward guidance, the new instruments contributed efficiently to the maintenance of loose monetary conditions over a prolonged period, particularly to the management of the long end of the yield curve. Accordingly, the Council would introduce unconditional interest rate swap (IRS) facilities with five and ten-year maturities, the maximum allotted amount of which had been set at HUF 300 billion for the first quarter of 2018. In addition, the Magyar Nemzeti Bank would launch a targeted programme aimed at purchasing mortgage bonds with maturities of three years or more. The Council expected an increase in mortgage bond issuance and an improvement of market activity due to the measure. The maximum allotted amount for the security purchase programme amounted to 50 percent of the ever-prevailing mortgage-bond stock on the market. Both programmes would contribute to an increase in the share of loans with long periods of interest rate fixation, thereby improving financial stability.

Members were of the view that no material change was expected in the monetary policy framework; however, the Bank's set of monetary policy instruments might be fine-tuned in the future. Members agreed that close attention should be paid to both the operation of the extended set of monetary polic instruments and monetary conditions.

The inflation target was expected to be achieved in a sustainable manner by the middle of 2019. In the Council's assessment, maintaining the base rate and the loose monetary conditions at both short and long ends for an extended period was necessary to achieve the inflation target in a sustainable manner. The Council would closely monitor developments in monetary conditions and would ensure the persistence of loose monetary conditions over a prolonged period by using the extended 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:**	8	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, Márton Nagy, Bianka Parragh, Gyula Pleschinger, László Windisch
Vote against:	0	

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

Gusztáv Báger

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

Márton Nagy

Bianka Parragh

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 30 January 2018. The minutes of that meeting will be published at 2 pm on 14 February 2018.