MINUTES
OF THE MONETARY COUNCIL MEETING OF
21 NOVEMBER 2017

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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, 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 21 November, the Council reviewed recent developments in inflation and the macroeconomy. In the Council's assessment, Hungarian economic growth picked up over the forecast horizon. Some degree of unused capacity had remained in the economy, but this was likely to be gradually absorbed as output grew dynamically. The inflation target was expected to be achieved in a sustainable manner by the middle of 2019.

In October 2017, inflation had decreased to 2.2 percent and core inflation to 2.7 percent. Both headline and core inflation had come in somewhat below the Bank's and the market's expectations, with the moderate dynamics of services and tradables prices accounting for most of the difference. The Bank's measures of underlying inflation had declined compared with the previous month and had continued to be significantly 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. 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 this year. In line with the Bank's expectations, there had not yet been any significant upward pressure on inflation from wages. Oil prices had risen in recent months. Global underlying inflation continued to be moderate. External inflation, particularly in the euro area, was likely to remain low for a prolonged period.

Following a temporary rise, the consumer price index was likely to decline again to the bottom of the tolerance band by the end of 2017. Core inflation was expected to decrease in the second half of next year as the temporary effects related to changes in tobacco and dairy product prices faded. Looking ahead, the Bank's measures of underlying inflation were expected to be around 2 percent. Moderate imported inflation and historically low inflation expectations as well as the VAT rate cuts, announced for next year, were slowing the rise in domestic prices. In the September projection, the inflation target could be achieved sustainably by the middle of 2019.

The Hungarian economy had grown by 3.6 percent in the third quarter of 2017. In September, industrial production had increased relative to a year earlier at a rate similar to those in previous months, and the volume of retail sales had picked up. Labour demand had remained strong: employment had been at historically high levels in the third quarter of 2017. The unemployment rate had continued to fall. The general increase in 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 over the forecast horizon in response to rising domestic demand. Economic growth this year would also be supported by the fiscal budget and the stimulating effects on investment of EU funding. The Monetary Council expected annual economic growth of 3.6 percent in 2017 and stable growth of between 3-4 percent over the coming years. 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. Monetary policy decisions by the world's leading central banks and the latest macroeconomic data had been the main factors influencing investors' appetite for risk. The Fed's balance sheet reduction programme had started in October 2017; however, market prices suggested no major change in interest rate expectations. In October, the European Central Bank had announced that it would slow the pace of its asset purchases from January 2018. Nevertheless, persistently loose monetary conditions were expected in the period ahead. Market participants anticipated the ECB's first interest rate hike to occur even later than previously thought, in the middle of 2019. 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 pricing suggested that the timing of central bank actions would differ.

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. Therefore, the importance of the stock and maturity structure of central bank swap instruments providing forint liquidity would increase. In the future, the Council would decide on the amount of liquidity crowded out on a regular frequency and would adjust the stock of central bank swap instruments accordingly. The reduction in the overnight deposit rate in September, the amount of liquidity crowded out due to the introduction of an upper limit on the stock of three-month deposits and central bank communication addressing longer-term yields had had a marked influence on domestic money market rates. In addition, the stock of central bank swap instruments providing forint liquidity had continued to increase and the average maturity of outstanding swap contracts had lengthened, in line with the Council's aim. The three-month BUBOR had been at its historic low. Long-term yields had declined in the government securities and interbank markets since the previous interest rate decision, and therefore the difference between short and long-term yields had narrowed. However, the yield curve was still steep in international comparison.

Following the review of macroeconomic and financial market developments, the Council discussed the details of the current policy decision. Members noted that the unchanged base rate and interest rate corridor were consistent with the baseline projection in the September Inflation Report, the Council's previous communications and market expectations. Members concluded that providing further support to the real economy might be achieved most efficiently through a reduction in long-term yields by pushing down financing and borrowing costs. Members also agreed that the reduction in long-term yields was of key importance in promoting financial stability as well as in maintaining loose monetary conditions over a sustained period. One member pointed out that the Bank's previous unconventional programmes had also been aimed at supporting the pass-through of loose monetary conditions in long-term yields as well. If economic agents had access to long-term loans with low, fixed interest rates, that would decrease the interest rate risk of loans. To ensure this, the Council decided to introduce two unconventional instruments from January 2018, which would constitute an integral part of the Bank's set of monetary policy instruments. Their main purpose was to ensure that loose monetary conditions had their effect not only at the short but also at the longer end of the yield curve. Members decided to introduce a new unconditional interest rate swap (IRS) facility with five and ten-year maturities, the allocation amount of which was set at HUF 300 billion for the first quarter of 2018. In addition, the Council decided to launch a targeted programme as well, aimed at purchasing mortgage bonds with maturities of three years or more. The mortgage bond purchase programme would support the development of the mortgage bond market in addition to meeting the Bank's policy objectives. Both programmes would support the effective transmission of monetary policy in longer-term yields and enhance financial stability through an increase in the share of loans with long periods of interest rate fixation.

In discussing the current decision, several members stressed that it was important to closely monitor the actions of the world's leading central banks, as these alone had an effect on domestic relative monetary conditions. Several members noted that movements in oil and other commodity prices, geopolitical risks and uncertainty surrounding future developments in the international financial environment continued to warrant a cautious approach to monetary policy.

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. In the Council's assessment, maintaining the base rate and loose monetary conditions for an extended period were 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:**	9	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, 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

György Matolcsy

Márton Nagy

Bianka Parragh

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 19 December 2017. The minutes of that meeting will be published at 2 pm on 10 January 2018.