MINUTES

OF THE MONETARY COUNCIL MEETING

23 JUNE 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

At its meeting, the Monetary Council discussed the baseline projection in the *Inflation Report* to be published on 25 June 2015. In the Council's view, persistently loose monetary conditions were consistent with the achievement of price stability. Inflation was likely to be below the inflation target this year and next, and was likely to rise to levels around 3 per cent only towards the end of the forecast period. Robust economic growth might continue, supported by rising external demand, in addition to growing domestic demand. In the Council's assessment, there continued to be a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate. The real economy was likely to have a disinflationary impact at the policy horizon and the negative output gap was expected to close only gradually.

Significant differences remained across the individual regions in terms of economic growth. Of the world's developed regions, growth in the euro area had picked up slightly on the preliminary estimate in the first quarter of 2015, broadly in line with expectations. By contrast, the US economy had contracted relative to the previous quarter. Growth had been stable or slowing in most of the major emerging market economies. Global inflation remained moderate, reflecting low crude oil prices and subdued demand, and inflationary pressure in the global economy was likely to remain moderate looking ahead. The monetary policy stance of globally influential central banks pointed in the direction of persistently loose monetary conditions: the ECB had continued its quantitative easing policy within the framework of its extended asset purchase programme, the Bank of Japan had maintained the pace of its asset purchases and the Federal Reserve was likely to fine-tune the appropriate timing and magnitude of its interest rate increase likely postponed to a later date. Monetary conditions remained loose overall and, consequently, global interest rate and liquidity conditions continued to be supportive.

The Council expected inflation to be significantly below the inflation target over the short term. Data available in recent months had been slightly higher than the projection in the March issue of the *Inflation Report*, mainly reflecting higher-than-expected fuel prices. Inflation had departed from its historical low in recent months and was likely to remain in positive territory looking ahead. Core inflation was likely to rise gradually as the effects of the low-cost environment faded, domestic demand picked up and wages increased. However, inflation was expected to approach levels around the 3 per cent target only towards the end of the forecast period, reflecting moderate underlying inflation. The stabilisation of inflation expectations around the target was likely to ensure that price and wage-setting would be consistent with the inflation target over the medium term as domestic demand growth strengthened.

Growth in the domestic economy had continued over the recent period. In the coming years, domestic demand was likely to remain the main driver of growth; however, rising exports reflecting strengthening growth in Hungary's export markets were also expected to support domestic economic growth. The low inflation environment and the improvement in the labour market would contribute to household real income growth, which in turn was expected to boost household consumption. The conversion of foreign currency loans would reduce the household sector's vulnerability, which might facilitate the gradual easing of consumers' precaution. In addition to the general improvement in economic activity, the Funding for Growth Scheme also supported private sector investment. Household investment activity was expected to strengthen at the forecast horizon, due to the pick-up in the housing market and the extension of the housing subsidy system. Export growth was likely to be strong, reflecting higher growth in Hungary's export markets. The negative output gap was expected to close at the end of the forecast period, and therefore the real economic environment was likely to continue to have a disinflationary impact in the coming quarters.

Hungary's external financing capacity had continued to increase in the fourth quarter of 2014. Based on the four-quarter values, the trade surplus had risen again, with domestic agents continuing to use a significant amount of EU transfers in the final quarter. Looking at the structure of external financing, the outflow of debt liabilities, and consequently, the decline in Hungary's debt ratios had continued in 2014. Non-debt liabilities had increased overall. Looking ahead, the external financing capacity was expected to remain robust, exceeding 9 per cent of GDP in 2015. Net exports were likely to rise further, reflecting the expected improvement in external demand and the positive impact on the terms of trade of the decline in oil prices. Transfers from the EU presumably would be lower in 2016. The expected stabilisation of the deficit on the income balance was likely to reflect the combined effect of the decline in interest expenses and rising profits of foreign-owned companies, in addition to a falling debt path. Continued very high net lending was likely to contribute to a gradual decline in the country's external debt ratios.

Sentiment in international financial markets had been volatile but rather unfavourable. In April, the positive effect of strong macroeconomic data from the euro area had offset the negative effect of political events in Greece, mixed macroeconomic data from the US and geopolitical tensions. However, global investor sentiment had deteriorated throughout the latter, greater part of the period, reflecting the downgrade of Greek sovereign debt and the postponement of debt repayments as well as weak macroeconomic data from the US economy. Of the domestic risk indicators, the CDS spread had increased slightly and long-term yields on forint-denominated bonds had risen significantly in the period since publication of the March *Report*, in line with international trends. The forint had depreciated against the euro in the past quarter, due mainly to international factors. In the Council's assessment, a cautious approach to monetary policy was still warranted due to uncertainty in the global financial environment.

Based on the June *Inflation Report*, the Council assessed that the macroeconomic outlook was surrounded by both upside and downside risks. The Monetary Council considered three alternative scenarios around the baseline projection in the June *Report*, which might influence significantly the future conduct of monetary policy. The rise in yields in developed markets might lead to an increase in the risk premium on developing markets, and therefore the inflation target could be achieved with tighter monetary policy than assumed in the baseline projection. Mounting geopolitical tensions might involve a protracted decline in external demand and a sudden, sharp increase in the risk premium, and therefore tighter monetary policy than assumed in the baseline projection ensured the achievement of the inflation target at the forecast horizon as well. On the other hand, the alternative scenario assuming a persistently low-cost environment and increasing second-round effects might lead to lower inflation and stronger economic growth, which might justify even looser monetary conditions than the baseline projection.

In the Council's assessment, there continued to be a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate. The real economy was likely to have a disinflationary impact at the policy horizon and the output gap was expected to close only gradually.

Based on available data, the risk of second-round effects materialising due to excessively low inflation expectations had moderated. In view of the June *Inflation Report* projection, following a comprehensive assessment of the medium-term outlook for inflation, the Council assessed that the medium-term achievement of the inflation target pointed in the direction of a further, slight easing of the policy rate.

Taking into account the assessment in the *Inflation Report* and the time profile of the projection as well as reviewing the consequences of the various alternative scenarios for monetary policy, several members of the Council thought that a more cautious forward guidance than previously should be formulated. One member noted that there had been a slight reversal in the indicators of underlying inflation in recent months, which might influence the outlook for inflation looking ahead, as it might suggest weaker disinflation than in previous quarters. The overwhelming majority of members argued that it would be inappropriate to end the easing cycle due to the inflation outlook, and persistently loose monetary conditions were consistent with the achievement of price stability. For one Council member, issuing a forward guidance suggesting that the easing cycle had ended was justified, as that member thought the 1.50 per cent base rate ensured that inflation would be around the 3 per cent target at the forecast horizon.

After the discussion, the Chairman invited members to vote on the propositions put to the Council. Members voted in favour of reducing the base rate by 15 basis points. Members thought the decision was consistent with the Bank's earlier behaviour and market expectations, and therefore it strengthened the Bank's credibility and predictability. The overwhelming majority of decision-makers assessed it necessary to change the forward guidance and agreed that the medium-term achievement of the inflation target pointed in the direction of a further, slight reduction in interest rates. For one member, it was justified to end the easing cycle.

Votes cast by individual members of the Council:

In favour of reducing the base rate to 1.50%	**8**	Ádám Balog, Andrea Bártfai-Mager, János Cinkotai, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, 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

László Windisch

The Council will hold its next policy meeting on 21 July 2015. The minutes of that meeting will be published at 2 p.m. on 5 August 2015.