MINUTES

OF THE MONETARY COUNCIL MEETING

26 JANUARY 2016

Time of publication: 2 pm on 10 February 2016

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 Monetary Council's assessment, Hungarian economic growth continued. A degree of unused capacity remained in the economy, and therefore the domestic real economic environment continued to have a disinflationary impact. Inflation remained substantially below the Bank's target.

The annual inflation rate had increased, while core inflation had been unchanged in December 2015. The Bank's measures of underlying inflation continued to indicate moderate inflationary pressures in the economy. There had been a marked fall in oil prices recently. As a result, inflation might be lower over the short term than earlier expected. Core inflation was likely to rise gradually as a result of an expansion in household consumption and an acceleration in wage growth, but the persistently low global inflationary environment contained the increase in the domestic consumer price index. Inflation expectations had fallen to a historic low. Inflation was expected to remain below the 3 per cent target over the forecast period, and was only likely to approach it by the end of the forecast horizon.

In the third quarter of 2015, Hungarian economic growth had continued at a weaker rate than in previous quarters. The decline in agricultural production and the moderation in industrial production dynamics had been the main factors contributing to the deceleration. As in previous months, growth in retail sales had been stable in November, with their volume increasing across a wide range of products. Employment had increased slightly and unemployment had declined again after stagnating in the previous month. Slower growth in emerging markets and the deceleration in funding from the EU would lead to a slowdown in growth this year. A recovery was expected from the second half of 2016, mainly reflecting the strengthening performance of Hungary's export markets as well as the Bank's and the Government's policy measures. In the Monetary Council's assessment, the Bank's Growth Supporting Programme and the recent steps taken by the Government to encourage home building were expected to dampen the slowdown in the rate of growth. In addition to these factors, rising household consumption was likely to support the economic expansion in the coming years.

Overall, sentiment in global financial markets had deteriorated since the Monetary Council's latest policy decision. In the second part of December, investor sentiment had improved temporarily following the Fed's interest rate decision. In January, risk indicators had risen significantly in certain emerging countries in response to unfavourable macroeconomic data from China, the fall in the Chinese equity market and the significant drop in oil prices. At the end of the period, the European Central Bank's communications had affected investor sentiment favourably. Domestic financial markets had remained stable even in the deteriorating investor environment. The forint exchange rate had appreciated and domestic risk indicators had been mixed in the period since the previous policy decision. Hungary's persistently strong external financing capacity and the resulting decline in external debt were contributing to the sustained reduction in the vulnerability of the economy. In the Monetary Council's assessment, a cautious approach to monetary policy was still warranted due to uncertainty in the global financial environment.

Market yield expectations had been in line with the Bank's forward guidance that the base rate would be held constant over an extended period. The unconventional, targeted monetary policy instruments introduced by the Bank also facilitated a decline in long-term yields and, consequently, a loosening in monetary conditions. Forward-looking money market real interest rates were in negative territory and were declining even further as inflation rose.

In the Monetary Council's assessment, the reduction in unused capacity was stopping temporarily as economic growth slowed, and therefore the negative output gap would close only at the end of the policy horizon. Inflationary pressures would remain moderate over a sustained period. Several members noted that for them the sustainable achievement of the target meant that inflation would approach the target not only for a short period but would stay close to the price stability target on a sustainable basis. This required stable economic growth and persistently loose monetary conditions. However, some members pointed out that, for example, the global effect of the slowdown in China or the sharp decline in oil prices might result in lower inflation in the short term than previously expected, but the medium-term outlook for inflation had not changed as there had been no change in perceptions about the output gap, wage growth and underlying economic fundamentals. Some members noted that with the Fed starting to raise interest rates and communications by the ECB suggesting further policy easing, the divergence between monetary policies of the world's two major central banks had widened. The current level of the base rate and maintaining loose monetary conditions for an extended period, over the entire forecast horizon, were consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy. In view of these, members unanimously voted in favour of leaving the base rate unchanged. In the Monetary Council's view, the current decision was consistent with the Bank's past behaviour and previous communication as well as with market expectations, and therefore it strengthened the Bank's credibility and predictability.

With the gradual phasing-out of the two-week central bank deposit facility, serving to ease monetary conditions, and with the more active use of central bank interest rate swaps, a set of instruments effectively supporting the monetary policy objectives would be developed. Long-term government securities yields had fallen after the announcement of Phase 3 of the Self-Financing Programme and were likely to continue declining as the announced measures were implemented. Members agreed that the January announcement could be taken as an easing of monetary conditions, however, its effects should be carefully watched and continuously assessed. The Monetary Council constantly monitored whether the resulting looser monetary conditions ensured the sustainable achievement of the inflation target. In this context, the Monetary Council closely examined developments in the foreign monetary environment, particularly the measures of the European Central Bank. If the Monetary Council considered it necessary, further monetary loosening would be implemented, primarily using the existing unconventional tools.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 1.35%	**9**	Gusztáv Báger, Andrea Bártfai-Mager, János Cinkotai, Ferenc Gerhardt, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch

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

Gusztáv Báger

Andrea Bártfai-Mager

János Cinkotai

Ferenc Gerhardt

György Kocziszky

György Matolcsy

Márton Nagy

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 23 February 2016. The minutes of that meeting will be published at 2 pm on 9 March 2016.