MINUTES

OF THE MONETARY COUNCIL MEETING

22 SEPTEMBER 2015

Time of publication: 2 pm on 7 October 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://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

The three-month, fixed-rate central bank deposit would be the Magyar Nemzeti Bank's main policy instrument from 23 September 2015, replacing the two-week deposit facility. Consequently at its meeting of 22 September, the Monetary Council had made its policy decision on the interest rate on this facility. The three-month deposit facility would be available without limit; the maturity of the policy interest rate would be extended from two weeks to three months. The two-week central bank deposit would remain part of the Bank's instruments; however, the facility would be offered at auctions, with quantity limits. Quantitative limits would be placed on the stock of two-week deposits first on 23 September 2015. Thereafter, the stock of deposits would fall gradually to the HUF 1,000 billion limit set by the end of the year.

At its meeting, the Council reviewed the projection in the September Inflation Report to be published on 24 September. In the Council's assessment, 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 expected to rise to levels around 3 per cent only in the second half of 2017. Domestic economic growth was likely to continue, supported by a gradual rise in both external and domestic demand. There continued to be a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate. The negative output gap was expected to close only gradually over the policy horizon.

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 in the second quarter of 2015. The US economy had grown strongly in the period. Most major emerging market economies were decelerating. Reflecting low crude oil and commodity prices as well as a subdued demand environment, global inflation trends and inflationary pressure in the global economy were likely to remain moderate looking ahead. The monetary policy stance of globally influential central banks had remained unchanged although had continued to be different in recent months: the ECB and the Bank of Japan continued their asset purchase programmes, while the US Fed was preparing for the appropriate timing and magnitude of its interest rate increase postponed to a later date than the market had expected. 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. According to data becoming available in recent months, the underlying trends had on balance been in line with the projection in the June issue of the Inflation Report. The difference between the projection and the actual outcome for the consumer price index had been mainly accounted for lower fuel prices. Inflation was likely to move firmly into positive territory towards the end of the year. Core inflation was likely to pick up gradually as costs increased continuously and at a slow pace from low levels and as a result of an expansion in domestic demand and rises in wages. However, the horizon over which the inflation target was expected to be achieved had been extended by around two quarters relative to the previous projection, due to the persistently low cost environment and slightly lower underlying inflation looking ahead, and therefore inflation was expected to rise to levels around 3 per cent only in the second half of 2017. The stabilisation of inflation expectations around the target was likely to help 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 recent period. Domestic demand was likely to make an increasing contribution to growth. Rising exports reflecting growth in Hungary's export markets were also expected to support domestic economic growth. The improvement in the labour market and the low inflation environment contributed to household real income growth, which in turn was expected to facilitate the expansion in household consumption. The conversion of foreign currency loans reduced the household sector's vulnerability, which might support the gradual easing of consumers' precaution. Household investment activity was expected to strengthen over the forecast horizon, due to the pick-up in the housing market and the extension of the housing subsidy system. Lower transfers from the EU were likely to have an opposite effect on growth. Economic growth was expected to slow in early 2016 as EU transfers decline; however, economic performance was expected to improve from the second half of next year, supported by the improvement in lending activity and the resumption in EU funding. The negative output gap was expected to close at the end of the forecast horizon, and therefore it was likely to continue to have a disinflationary impact in the coming quarters.

Hungary's external financing capacity had increased further in early 2015, with the surpluses on foreign trade and the transfer balance continuing to be the major contributing factors. Looking at the structure of external financing, the outflow of debt liabilities had continued, the effect of which had been mitigated by a fall in interest rates and exchange rate revaluation due to the appreciation of the US dollar. As a result, the country's external debt ratios had remained broadly unchanged. Hungary's external financing capacity was likely to remain strong over the forecast horizon, exceeding 9 per cent of GDP this year. Net exports were expected to rise further in 2015–2016, reflecting the positive impact on the terms of trade of the decline in oil prices and favourable external demand. In 2016, the external financing capacity was likely to remain high, but was expected to fall slightly, due to lower transfers from the EU. The deficit on the income balance was likely to stabilise, reflecting the effect of the decline in interest expenses in addition to a declining debt trajectory and rising profits of companies as economic growth continued. In addition to the continuing very high level of net lending, the Bank's self-financing programme and the conversion into forint of foreign currency loans were also likely to contribute to a further decline in the country's external debt ratios.

During the period, developments related to Greek government debt problems, concerns over growth in emerging economies and China, disturbances in Chinese capital markets and uncertainty about an interest rate increase by the US Fed had been the main factors contributing to negative investor sentiment. Of the domestic measures of risk, the CDS spread had risen slightly, while long-term forint bond yields had fallen since publication of the June Inflation Report. The forint had remained broadly unchanged against the euro in the past quarter. In the Council's assessment, a cautious approach to monetary policy was still warranted due to uncertainty in the global financial environment.

The Monetary Council considered two alternative scenarios around the baseline projection in the September Inflation Report, which might influence significantly the future conduct of monetary policy. In the first alternative scenario, the persistently low cost environment and strengthening second-round effects posed an upside risk to economic growth and a downside risk to inflation. Consequently, the inflation target could be achieved with looser monetary conditions than assumed in the baseline projection. In the second alternative scenario, financial market turbulence led to a sudden, sharp increase in the risk premium and a decline in external demand. For this alternative scenario, tighter monetary policy than assumed in the baseline projection ensured the achievement of the inflation target at the forecast horizon.

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 negative output gap was expected to close only gradually over the policy horizon.

In view of the projection in the September Inflation Report, the Monetary Council assessed that the current level of the base rate and maintaining loose monetary conditions for an extended period, even over a longer horizon than expected, were consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy.

Taking into account the assessment in the Inflation Report, the time profile of the baseline projection and considering the consequences of alternative scenarios for monetary policy, Council members agreed to maintain the base rate. Several members noted that, based on money market yields, the expected date of the first interest rate increase shifted later, and the overwhelming majority of analysts expected Hungarian interest rates to remain unchanged until the end of 2016 even if the Fed meanwhile raised interest rates. All this suggested that the Bank's forward guidance had been successful, as to its effect yields declined at longer maturities as well, although at the time of the meeting they were not fully consistent with the time horizon at which the Council aimed to maintain interest rates. Several members indicated that the change to the main policy instrument itself had no material impact on monetary conditions. One member added that the exact effects of the change to monetary policy instruments (the introduction of the three-month deposit) on monetary conditions would depend on future developments in the effective interest rate. Another member noted that the latest fall in oil prices would have second-round effects in an environment of low inflation lasting for several years. For this reason, yields should also be lowered further at the longer end of the curve, which the Council could support by issuing a forward guidance suggesting that interest rates would be maintained for longer. Members were of the view that the decision was consistent with the Bank's past behaviour and market expectations, therefore it strengthened the Bank's credibility and predictability.

After the discussion, the Chairman invited members to vote on the propositions put to the Council. Members voted unanimously in favour of maintaining the base rate at 1.35 per cent and agreed in view of the projection in the September Inflation Report, that the current level of the base rate and maintaining loose monetary conditions for an extended period, over a longer horizon than expected, were consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy.

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 20 October 2015. The minutes of that meeting will be published at 2 p.m. on 4 November 2015.