MINUTES

OF THE MONETARY COUNCIL MEETING

21 JANUARY 2014

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 OF CURRENT ECONOMIC CONDITIONS AND THE INTEREST RATE DECISION

In the Council's judgement, Hungarian economic growth was likely to continue this year and next. While the pace of activity was strengthening, the level of output remained below its potential and was likely to approximate that level again at the end of the horizon relevant for monetary policy. With employment growing steadily, the unemployment rate was falling, but still exceeded its long-term level determined by structural factors. Inflationary pressures in the economy were likely to remain subdued over the medium term.

Inflation had continued to fall in December, mainly as a result of the reduction in regulated energy prices in November. In addition to temporary factors reducing inflation, the Bank's measures of underlying inflation capturing the medium-term outlook also indicated moderate inflationary pressures in the economy, which reflected the effects of weak domestic demand and low inflation in external markets. The persistently low inflation environment might facilitate the adjustment of inflation expectations. The rate of private sector wage growth had picked up slightly recently, but still remained moderate. The Council expected domestic real economic factors to continue having a disinflationary impact, although to a declining extent, as activity in the economy strengthened further. One member, however, noted that further depreciation of the forint against the euro could lead to an increase in the domestic price level through import prices, which might be amplified by the closing of the output gap and the recovery in domestic consumption.

Incoming data showed that economic growth had continued in the fourth quarter, as reflected by monthly data on industrial production, the trade surplus, construction output and retail trade turnover. The Council expected economic growth to continue in the quarters ahead and to return to a more balanced pattern. Domestic demand was expected to grow over the next years, in addition to rising exports. Along with the increase in corporate investment due to the Funding for Growth Scheme and the Government's infrastructure projects using EU funding, the recovery in household consumption was likely to be gradual. Growth in real income was expected to be partly offset by the ongoing reduction in debt accumulated during the years prior to the crisis and the slow easing in tight credit conditions.

Global investor sentiment had remained supportive, despite the decision by the Fed to reduce the pace of its asset purchases at the end of last year. Perceptions of the risks associated with the Hungarian economy had improved, as reflected in the declines in CDS spreads and bond yields. Hungary's persistently high external financing capacity and the resulting decline in external debt reduced the country's vulnerability. One Council member noted that the interest rate differential between forint assets and other currencies of the CEE region with a more favourable risk profile had narrowed markedly, which might pose risks.

In the Council's judgement, a cautious approach to policy was warranted due to uncertainty related to the global financial environment. However, one member thought that communications by the world's leading central banks suggested that the European Central Bank, the Fed and the Bank of Japan would maintain their accommodative monetary policy stance. In that member's view, this suggested that the benign financial market environment would persist.

In the Council's judgement, there remained a significant degree of unused capacity in the economy and inflationary pressures were likely to remain moderate for an extended period. Delivering price stability in the medium term pointed in the direction of monetary easing. The global financial environment had remained supportive. A sustained and marked shift in perceptions of the risks associated with the Hungarian economy might influence the room for manoeuvre in monetary policy.

In line with the discussion at the Council's policy meeting in December 2013, members agreed that although delivering price stability pointed in the direction of monetary easing, developments in international financial markets were surrounded by uncertainty, which was also reflected in recent turbulence in emerging markets. However, decision-makers judged it important to note that, for the time being, the decision by the Fed to begin tapering its asset purchases had not led to a marked change in perceptions of the risks associated with the Hungarian economy. Risk indicators for Hungary had even improved in the period preceding the interest rate decision. Taking this into account, the Monetary Council judged that it was justified to hold back the pace of interest rate reductions. However, members' views were divided over the extent to which the Council should slow the pace of easing. One member proposed to reduce the base rate by 10 basis points, taking into account the interest rate differential between the forint and other currencies of the CEE region as well as the decline in the steepness of the yield curve for Hungarian government securities, which for that member indicated that the easing cycle had reached its bottom. For other members of the Council, a 15 basis point reduction in the base rate was warranted, considering recent real economic developments and the supportive international environment.

In the Council's judgement, considering the outlook for inflation and taking into account perceptions of the risks associated with the economy as well as the improvement in the pace of economic growth, further cautious easing of monetary policy might follow.

Votes cast by individual members of the Council

In favour of reducing the base rate to 2.85%	**7**	Ádám Balog, Andrea Bártfai-Mager, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, László Windisch
In favour of reducing the base rate to 2.90%	**1**	János Cinkotai

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 18 February 2014. The minutes of that meeting will be published at 2 p.m. on 5 March 2014.