MINUTES

OF THE MONETARY COUNCIL MEETING

18 FEBRUARY 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 year. While the pace of economic activity was strengthening, output remained below its potential and was likely to return close to that level at the end of the horizon relevant for monetary policy. With employment growing, 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. Global investor sentiment had been volatile recently, and perceptions of the risks associated with Hungary and other economies in the region had deteriorated.

Inflation had continued to fall in January, mainly as a result of the decline in fuel prices. The Bank's measures of underlying inflation capturing the medium-term outlook had risen relative to the previous month, but continued to indicate 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 provide a firmer anchor for inflation expectations. The rate of private sector wage growth had picked up somewhat recently, but still remained moderate. Domestic real economic factors were expected to continue to have a disinflationary impact, although in a moderating pace, as activity in the economy rose further.

Incoming data showed that economic growth had continued in the fourth quarter of 2013. According to the preliminary release, GDP growth in the fourth quarter of 2013 had been stronger than market expectations. Growth was expected to pick up further in the quarters ahead and to return to a more balanced pattern. 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 been volatile as a result of the Fed's ongoing tapering of its asset purchase programme and a downward shift in risk perceptions about emerging economies. A number of emerging market currencies had come under heavy selling pressure. Looking forward, the euro-area policy rate was expected to remain at low levels for an extended period. Perceptions of the risks associated with Hungary and other economies of the region had deteriorated, as reflected in rising CDS spreads and bond yields and the higher volatility of the forint exchange rate. Discussing recent movements in bond yields, two Council members noted that the steepness of the yield curve had increased and the short end of the curve had shifted up since the last interest rate decision. Concerning the exchange rate, they noted that the forint had depreciated the most over the period relative to other currencies of the CEE region. Those members were of the view that these developments indicated that the easing cycle had reached its bottom. In response, one member noted that achieving the Bank's inflation target in the medium term did not yet justify that the easing cycle should come to an end. Movements in the exchange rate should be judged against their impact on the inflation outlook and the real economy, taking financial stability considerations into account. Members agreed that a cautious approach to policy was warranted due to uncertainty related to the global financial environment.

In the Council's judgement, Hungary's position was fundamentally strong compared with other emerging market economies. The country's persistently high external financing capacity and the resulting decline in external debt reduced its vulnerability. The current account had moved into surplus, reflecting the significant adjustment by the government and private sectors, and thereby reducing the country's external debt and the economy's reliance on external financing. However, two members noted that the interest rate differential - required to compensate for the risk associated with Hungary's high government debt - between forint assets and other currencies in the CEE region with a more favourable risk profile, had narrowed markedly, which in turn might pose risks.

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 maintaining an accommodative monetary policy stance.

Conditions in global financial markets had been volatile recently. However, a majority of the Council judged that there remained scope for reducing interest rates in the context of increased uncertainty in financial markets. Members argued that developments in both inflation and the real economy were consistent with a further easing of policy and noted that its strong economic fundamentals clearly distinguished Hungary from those emerging market economies which had been faced with financial market turbulence recently. However, two members were of the view that the current level of interest rates implied that the easing cycle had reached its bottom. That view was also supported by the volatility of the exchange rate, the steepness of the yield curve and rises in short-term yields.

After the discussion, the Chairman invited members to vote on the propositions. Seven members voted in favour of a 15 basis point reduction in the base rate and two members voted for maintaining the base rate. Members agreed that the March issue of the *Quarterly Report on Inflation* would be of key importance in terms of the future conduct of monetary policy. It was proposed at the meeting that the Monetary Council should clearly indicate the possibility of ending the easing cycle in its press release. Finally, the majority of decision-makers judged that the Council should communicate in more detail about the possibility of continuing the easing cycle in view of the March *Report*.

The room for manoeuvre in monetary policy – taking financial stability considerations into account – continued to be influenced by the medium-term achievement of the inflation target, a corresponding degree of support to the economy and a sustained and marked shift in perceptions of the risks associated with the Hungarian economy. The Monetary Council would decide on the need and possibility for continuing the easing cycle after a comprehensive assessment of the macroeconomic outlook and developments in perceptions of the risks about the economy, and in view of the baseline projection and alternative scenarios of the March projection.

Votes cast by individual members of the Council

In favour of reducing the base rate to 2.70%	**7**	Ádám Balog, Andrea Bártfai-Mager, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, László Windisch
In favour of maintaining the base rate at 2.85%	**2**	János Cinkotai, Gyula Pleschinger

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
Gyula Pleschinger
László Windisch

The Council will hold its next policy meeting on 25 March 2014. The minutes of that meeting will be published at 2 p.m. on 9 April 2014.