MINUTES
OF THE MONETARY COUNCIL MEETING
27 MAY 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. While the pace of economic activity was strengthening, output remained below potential and was likely to approach that level in the course of next year. With employment rising, 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 moderate over the medium term.

CPI inflation had been -0.1 per cent in April. The Bank's measures of underlying inflation capturing the medium-term outlook continued to indicate moderate inflationary pressures in the economy, reflecting 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. Domestic real economic and labour market factors continued to have a disinflationary impact, but demand-side disinflationary pressures were weakening as activity gathered pace.

Several Council members noted that the latest inflation data pointed towards further cautious policy easing. In connection with better-than-expected real economic data, one member noted that all of this might raise questions about future interest rate policy, but recent data did not suggest inflationary pressures, only an easing in disinflationary pressure. Another member thought that price stability was expected in Hungary at the forecast horizon and that there was no risk of deflation, as that meant a persistent decline in prices across of a wide range of goods and services.

Data available since the Council's latest interest rate decision showed that economic growth had continued, as reflected in the 2014 Q1 preliminary GDP release as well as monthly data on industrial output, retail sales and the performance of construction. Growth was expected to pick up gradually in the quarters ahead and to return to a more balanced structure, with domestic demand likely to make an increasing contribution. Along with the Government's infrastructure projects using EU funding and rising corporate investment due to the Funding for Growth Scheme, the recovery in household consumption was likely to be gradual. For another member, further growth in investment would require an increase in the stock of orders. In the absence of such an improvement, it seemed unlikely that low lending rates would be able to significantly boost demand for credit. The expansion in real incomes was expected to be partly offset by the ongoing reduction in debts accumulated in the years prior to the crisis and the slow easing in tight credit conditions. According to labour market data for March, demand for labour had increased and unemployment had fallen, which could point to a tighter labour market looking forward.

Global investor sentiment had been supportive in the past month, but future developments were surrounded by uncertainty due to the ongoing conflict between Ukraine and Russia. Domestic risk premia had fallen on balance, and the forint exchange rate had appreciated steadily in the past month. Hungary's persistently high external financing capacity and the resulting decline in external debt were reducing its vulnerability. The MNB's announcement of its programme of self-financing may have also contributed to the improvement in perceptions of the risks associated with the economy. One member noted that reducing interest rates further would contribute to risks more strongly than previously, while maintaining the current level of rates would make it possible to maintain an accommodative monetary policy for a longer period of time. Another member thought that a reduction in rates had little measurable impact on economic growth, while there was a question of when the current benign financial market conditions might start to deteriorate. Several members noted that financial market conditions were stable and might remain supportive in the period ahead, due to the accommodative policy by developed country central banks. In the Council's judgement, a cautious approach to policy was warranted due to uncertainty in the global financial environment.

In the Council's judgement, there remained a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate for an extended period. The negative output gap was expected to close gradually at the policy horizon, but achieving price stability in the medium term pointed in the direction of monetary easing. The improvement in perceptions of the risks associated with the economy had provided scope for a further cautious reduction in interest rates.

After the discussion, the Chairman invited members to vote on the propositions. Seven members voted in favour of a 10 basis point reduction and two members voted for maintaining the base rate. The two members who voted to maintain the base rate did not support the forward-looking message formulated in the press release, as they were of the view that the easing cycle had already come to an end and the current level of the base rate ensured the medium-term achievement of the target and the necessary support for the economy. They felt that a further reduction in the policy rate would pose risks, while its positive impact would be limited.

In its press release accompanying the decision, the Monetary Council had indicated that it would decide on the need and possibility of reducing the base rate further after a comprehensive assessment of the macroeconomic outlook and developments in perceptions of the risks about the economy, in view of the baseline projection and alternative scenarios in the June issue of the *Inflation Report*.

Votes cast by individual members of the Council

In favour of reducing the base rate to 2.40%	**7**	Ádám Balog, Andrea Bártfai-Mager, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, László Windisch
In favour of maintaining the base rate at 2.50%	**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 24 June 2014. The minutes of that meeting will be published at 2 p.m. on 9 July 2014.