MINUTES

OF THE MONETARY COUNCIL MEETING

22 JULY 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. Despite the pick-up in domestic demand, capacity utilisation was expected to improve only gradually due to the protracted recovery in Hungary's export markets. 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 for an extended period.

Based on the inflation data for June, consumer prices continued to show historically low dynamics. The Bank's measures of underlying inflation capturing the medium-term outlook still indicated moderate inflationary pressures in the economy, reflecting low inflation in external markets, the degree of unused capacity in the economy, subdued wage dynamics, the fall in inflation expectations and the reductions in administered prices, implemented in a series of steps. Domestic real economic and labour market factors continued to have a disinflationary impact and low inflation was likely to persist for a sustained period. However, domestic demand-side disinflationary pressures were weakening gradually as activity gathered pace, and inflation was likely to reach levels around 3 per cent consistent with price stability at the end of the forecast horizon.

Several members briefly reviewed the macroeconomic effects of the Bank's easing cycle that had begun in August 2012 and agreed that there remained scope for some policy easing. They also agreed that, with a 20 basis point cut, the base rate might reach a level which ensured the medium-term achievement of the inflation target and a corresponding degree of support for the economy. Several members noted that it was justified to end the easing cycle because of the need to remove uncertainty about the bottom of the interest rate path, and therefore they suggested that, with the current 20 basis point reduction in interest rates, the easing cycle should be ended. One member commented that price stability had already been achieved and inflation over the forecast horizon was expected to be in line with the inflation target set by the Bank under the MNB Act. Moreover, further policy easing is not warranted, and it would only facilitate economic growth to a barely perceptible degree. The economic growth could be just as well facilitated with unconventional central bank instruments, namely, the Funding for Growth Scheme. The same member then added that, if investor sentiment were to change, further easing of monetary policy could pose financial risks, whereas its positive effects would be limited. Another member noted that the main message of the current decision was not the size of a further interest rate cut, but rather the completion of the easing cycle; and therefore, while maintaining that the extent to which a reduction would increase risks was greater than its possible positive impact and considering the main message of the decision, that member supported the proposal to end the easing cycle with a 20 basis point cut.

Based on data available since the last interest rate decision, economic growth had continued, as reflected in data for industrial production and retail sales. In the Council's judgement, the Hungarian economy had returned to a growth path in 2013. Looking ahead, economic growth might continue in a more balanced pattern than previously, with the recovery in domestic demand likely to make a larger contribution. Investment was likely to continue accelerating, reflecting the increasing use of EU funding and the easing in credit constraints also due to the Bank's Funding for Growth Scheme. Household consumption was also likely to grow gradually, mainly as a result of the expected increase in the real value of disposable income and the reduced need for deleveraging. Propensity to save, however, was expected to remain above levels seen prior to the crisis. Based on labour market data for May, the number of employees, excluding those employed under public employment programmes, had remained broadly unchanged relative to the previous month, and the unemployment rate had fallen. The labour market was expected to become tighter.

International investor sentiment had been volatile in the past month, mainly due to the escalation of geopolitical conflicts and weaker-than-expected European macroeconomic data. Hungarian risk premia remained broadly unchanged in the period and the forint exchange rate had depreciated slightly, with country-specific factors playing a role, in addition to external factors. Hungary's persistently high external financing capacity and the resulting decline in external debt had contributed to the reduction in its vulnerability. The announcement of the Bank's self-financing concept might contribute to an improvement in perceptions of the risks associated with the domestic economy. In the Council's judgement, a cautious approach to policy was warranted due to uncertainty about future developments 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 monetary policy horizon. The majority view was that it was justified to end the easing cycle because of the need to remove uncertainty about the bottom of the interest rate path, and the medium-term achievement of price stability had made it necessary to implement a further 20 basis point reduction in interest rates.

After the discussion, the Chairman invited members to vote on the propositions. Members agreed that, with the current interest rate move, the easing cycle would end. Eight members voted in favour of a 20 basis point reduction and the proposition to end the easing cycle, and one member voted for maintaining the base rate. Several decision-makers noted that the Bank's communications had been credible throughout the cycle and the individual moves had been in line with market expectations and consequently further enhanced institutional credibility. Members agreed that, based on the macroeconomic outlook, monetary conditions might remain accommodative for an extended period.

The Council judged that the central bank base rate had reached a level which ensured the medium-term achievement of price stability and a corresponding degree of support for the economy. That meant that the two-year easing cycle of a significant cumulative reduction of 490 basis points had ended. Looking ahead, the macroeconomic outlook pointed in the direction of persistently loose monetary conditions.

Votes cast by individual members of the Council

In favour of reducing the base rate to 2.10%	**8**	Ádám Balog, Andrea Bártfai-Mager, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, Gyula Pleschinger, László Windisch
In favour of maintaining the base rate at 2.30%	**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
Gyula Pleschinger
László Windisch

The Council will hold its next policy meeting on 26 August 2014. The minutes of that meeting will be published at 2 p.m. on 10 September 2014.