MINUTES

OF THE MONETARY COUNCIL MEETING

23 MAY 2017

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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, usually 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

In the Council's assessment, Hungarian economic growth picked up over the forecast horizon. Some degree of unused capacity had remained in the economy, but this was likely to be gradually absorbed as output grew. Inflation reached the central bank target sustainably from the first half of 2018.

In April 2017, inflation had eased to 2.2 per cent. The moderation in inflation had mainly reflected the decline in the price index for fuel, due primarily to base effects. Developments in the Bank's measures of underlying inflation had remained stable, in line with expectations. Inflation was likely to remain close to the current level over the coming period. Whole-economy wage growth was likely to pick up further, reflecting the dynamic expansion in employment, the tight labour market and the wage agreement at the end of 2016. The upward effect of this on costs was likely to be offset by the reduction in employers' social contributions and in the corporate income tax rate. To a smaller extent, this was expected to lead to higher core inflation and, to a greater extent, to a reduction in the trade surplus through an expansion in household consumption. In the baseline projection, inflation reached the 3 per cent level consistent with price stability in a sustainable manner from the first half of 2018.

The Hungarian economy had expanded dynamically in the first quarter of 2017. Gross domestic product had grown by 4.1 per cent relative to the same period a year earlier, according to preliminary data. In March 2017, industrial production had risen significantly. In addition, construction output had also grown strongly and growth was expected to continue over the coming months. The expansion in the volume of retail sales had continued in March. Growth in the value of imports had outpaced that in the value of exports. As a result, the trade surplus had decreased in March. Labour demand had remained strong. Employment had risen slightly in the first quarter of 2017 and the unemployment rate had remained at historically low levels. In parallel with strong wage growth, household consumption was likely to grow dynamically, which would be supported by the compensation of consumption deferred from previous years as well. Hungary's current account surplus was expected to fall significantly over the forecast horizon, driven by rising domestic demand. Economic growth this year would also be supported by the fiscal budget and the stimulating effects on investment of EU funding. The Monetary Council expected stable annual economic growth of between 3–4 per cent over the coming years, to which the Bank's and the Government's measures to stimulate economic growth contributed substantially.

The Funding for Growth Scheme, which had been launched in June 2013, had ended at the end of March 2017. After the Scheme was phased out, the transition to lending under market conditions was ensured by the Bank's Market-Based Lending Scheme. In consequence, growth in lending to micro, small and medium-sized enterprises might be maintained in the upper half of the 5-10 per cent range, deemed necessary for sustainable growth, over the medium term.

Sentiment in international financial markets had been mostly favourable since the Council's latest interest rate-setting meeting, but had deteriorated at the end of the period. Risk appetite had been mainly influenced by developments in geopolitical tensions, the Fed's and ECB's monetary policy, the US government's actions, the election outcomes in Europe and the aftereffects of the abandonment of the exchange rate floor in the Czech Republic. Risk indicators had not changed significantly overall, while developed market equity indices had typically risen over the period. The amount of liquidity crowded out due to the introduction of an upper limit on the stock of three-month deposits had continued to have a marked influence on domestic money market rates. As a consequence, the three-month BUBOR had remained at a historically low level. The interbank yield curve had become flatter and yields had fallen markedly. Domestic short-term government security yields had been little changed, while there had been a significant decline at the middle and the long end of the yield curve of Hungarian government securities. As a result, three and five-year yields had reached near record low levels. Hungary's strong external financing capacity and the decline in external debt were contributing to the sustained reduction in the vulnerability of the economy. Forward-looking domestic money market real interest rates had fallen significantly over recent years and were expected to remain in negative territory for a prolonged period. In the Council's assessment, a watchful approach to monetary policy was still warranted due to uncertainty in the global financial environment.

In the Council's assessment, some degree of unused capacity had remained in the economy, but this was likely to be absorbed gradually as output grew. Over the forecast period, inflation reached the target sustainably from the first half of 2018.

In discussing the current decision, the Council assessed that no event had occurred since the previous rate decision in terms of Hungarian economic fundamentals and the sustainable achievement of the inflation target which would warrant a change to the current level of the base rate or the interest rate corridor. Members pointed out that the unchanged base rate and maintaining the loose monetary conditions achieved by changing monetary policy instruments were consistent with the baseline projection in the March Inflation Report, economic data released over recently as well as with the Monetary Council's previous communications and market expectations. Several members mentioned that underlying inflation had been broadly unchanged and inflation expectations had remained moderate. However, some members noted that the latest inflation data had been below expectations, and there were downside risks to the path of inflation, due to future movements in the prices of volatile items expected currently. In addition, the effects of the wage increase on underlying inflation had so far been moderate, which might contribute to downside risks to inflation. Members emphasised that special attention should be given to inflation developments at home and abroad as well as to the potential effects of the global environment on domestic inflation.

The swap instruments with maturities of 6 and 12 months, introduced in March, had been used with success, with strong demand by banks at the FX swap tenders. The Council considered the limit on the three-month deposit stock and its potential future change an integral part of monetary policy instruments. The Bank continued to aim to maintain loose monetary conditions and provide support to the economy through money market rates. The Monetary Council intended to ensure that the limit imposed on the stock of three-month deposits exerted its expected effect efficiently. The limit was set quarterly. On the next occasion, a decision on its level as at end of the third quarter of 2017 would be made in June 2017. Taking these factors into account, all members voted unanimously in favour of leaving the base rate, the overnight deposit rate, the overnight lending rate and the one-week lending rate unchanged.

If the assumptions underlying the Bank's projections held, maintaining the current level of the base rate and loose monetary conditions achieved through the change in monetary policy instruments for an extended period was consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy. The Monetary Council monitored developments in monetary conditions and markets. If inflation remained persistently below the target, the Council would stand ready to ease monetary conditions further using unconventional, targeted instruments.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight central bank lending rate and the one-week collateralised central bank lending rate at 0.90% **and** **maintaininging the overnight central bank deposit rate at -0.05%:**	9	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Bianka Parragh, Gyula Pleschinger, László Windisch
Vote against:	0	

The following members of the Council were present at the meeting:

Gusztáv Báger

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

György Matolcsy

Márton Nagy

Bianka Parragh

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 20 June 2017. The minutes of that meeting will be published at 2 p.m. on 5 July 2017.