MINUTES
OF THE MONETARY COUNCIL MEETING
22 MAY 2018

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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, but at least twice a month, according to a pre-announced schedule. At the second scheduled meeting each month, members consider issues relevant to decisions on interest rates. 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

Before taking its policy decision on 22 May, the Council reviewed recent developments in inflation and the macroeconomy. In the Council's assessment, in parallel with the pick-up in domestic demand Hungarian economic output was close to its potential level. Growth of the Hungarian economy would pick up in 2018, then, if the assumptions of the current projection held, it would slow down gradually from 2019. The inflation target was expected to be achieved in a sustainable manner by the middle of 2019.

In April 2018, inflation had stood at 2.3 percent and core inflation at 2.5 percent. Inflation and core inflation developments had been in line with the Bank's expectations. The Bank's measures of underlying inflation had continued to be around 2 percent and remained below the level of core inflation. The expansion in domestic employment, the tight labour market as well as increases in the minimum wage and the guaranteed minimum wage had led to a general, dynamic rise in whole-economy wages, which had continued into early 2018. The upward effects of this on costs were being offset by the reduction in employers' social contributions at the beginning of the year and in the corporate tax rate in 2017. In line with the Bank's expectations, there had not yet been any significant upward pressure on inflation from wages. Oil prices had continued to rise over the past month. According to the ECB's projections, underlying inflation would continue to be moderate in the euro area in the coming years as well.

If the assumptions in the March projection held, the consumer price index would remain in the lower half of the tolerance band in the coming months. Over the medium term, buoyant domestic demand and the increase in wage costs would point to an increase in domestic core inflation. However, moderate external inflation and inflation expectations stabilising at historically low levels, as well as subsequent reductions in employers' social contributions and the VAT rate cuts this year, were slowing the rise in prices. If the assumptions of the current central bank projection held, the inflation target can be achieved sustainably by the middle of 2019.

The Hungarian economy had expanded dynamically in the first quarter of 2018. Gross domestic product had grown by 4.4 percent relative to the same period a year earlier, according to preliminary data. In March, industrial production had decreased and construction output had risen at a slower pace on an annual basis following the outstanding data for the previous period. The volume of retail sales had grown markedly. Labour demand had remained strong. The unemployment rate had decreased to a historically low level. Strong credit growth had continued in March. Outstanding lending to the corporate sector had increased by 10.3 percent relative to a year earlier. In the household sector, annual growth in lending had been 2.7 percent. A significant part of this had been related to the expansion in housing loans.

Looking ahead, the general strengthening of domestic demand would continue to play a central role in economic growth. Robust growth in construction and the expansion in the performance of the service sector were likely to continue in the coming months. From a historically high level of 6 percent in 2016, Hungary's current account surplus relative to GDP was expected to fall to below 2 percent in 2018, driven by rising domestic demand. However, it was expected to remain in positive territory over the longer term as well. Economic growth this year would also be supported by the fiscal budget and the stimulating effects on investment of European Union funding. In the Council's assessment, GDP growth would be above 4 percent in 2018, higher than last year, then, according to the current projection, it would slow down gradually from 2019. The Bank's and the Government's measures contributed substantially to this year's economic growth.

Sentiment in international financial markets had been highly volatile in the period since the Council's previous interest rate decision. The dollar had appreciated significantly and US long-term yields had risen. As a consequence, appetite for risk in emerging markets had deteriorated, which in turn had also had an impact on developments in Central and Eastern European markets. Due to the different inflation paths expected in the countries of the region and the different characteristics of inflation targeting regimes, market prices suggested that monetary policy stances by regional central banks would continue to differ. The Monetary Council's guidance about the maintenance of loose monetary conditions over an extended period had remained unchanged; however, the market yield curve had shifted upwards. Yields in the FX swap, interbank, and government securities markets had risen and market volatility had increased. The Bank assessed these developments in light of their relevance to its primary objective, the sustainable achievement of the inflation target.

Following the review of macroeconomic and financial market developments, the Council discussed the details of the monetary policy decision. Council members agreed that incoming data in the last month had been consistent with the March baseline projection. Members emphasised that the Bank's primary objective was to meet the inflation target in a sustainable manner. In their assessment an important question was how long increasing volatility in international financial markets observed recently was likely to persist and to what extent this would influence the achievement of the target. Several members emphasised that the fundamentals of the Hungarian economy were strong, the country's fiscal and economic position were stable and its external vulnerability had declined steadily and considerably since the outbreak of the crisis. Government debt has been decreasing steadily since 2011. Hungary's net external debt had fallen to a fraction of the level observed in 2011. The current account was in surplus, which was likely to remain stable in the coming years. Increased use of EU transfers contributed materially to the stabilisation of Hungary's net lending position at a high level of around 4 percent of GDP. Some decision-makers emphasised that the monitoring and comprehensive assessment of the monetary policy practices followed by central banks of both the region and developed countries as well as the detailed analysis of the relative position of domestic monetary conditions were of great importance. In addition, members stressed that the Bank closely monitored market developments in order to maintain financial stability.

In the Council's assessment, maintaining the loose monetary conditions for an extended period was necessary to achieve the inflation target in a sustainable manner. To this end, the Monetary

Council maintained the base rate, the overnight collateralised lending rate and the one-week collateralised lending rate at 0.9 percent and the overnight deposit rate at -0.15 percent.

The Council would maintain the HUF 75 billion upper limit on the stock of three-month deposits. In addition, in March, the Council had set the average amount of liquidity to be crowded-out for the second quarter of 2018 at least at HUF 400-600 billion. Furthermore, the Council had stated that the actual amount of liquidity to be crowded out must reach a level sufficient to ensure the maintenance of the loose monetary conditions for an extended period. The Magyar Nemzeti Bank had increased the stock of fine-tuning FX swaps providing forint liquidity. On the next occasion, in June 2018, the Council would decide on the amount of liquidity to be crowded out and would take this into account in setting the stock of central bank swap instruments.

In March, the Monetary Council had set the maximum stock of monetary policy interest rate swaps in the first half of 2018 at HUF 600 billion. The Council's aim was that the loose monetary conditions had their effect not only at the short but also at the longer end of the yield curve. To ensure this, the Bank would continue mortgage bond purchases and the monetary policy interest rate swap facility as programmes, continuously and for a prolonged period, and therefore they constituted an integral part of the set of monetary policy instruments. The Council considered the Bank's mortgage bond purchase programme to be successful. Under the programme, the MNB had purchased mortgage bonds amounting to more than HUF 150 billion up to the middle of May. Transactions in the primary market had accounted for more than one-third of total purchases. As a result of the measures, spreads of mortgage bonds over yields in the government securities market had fallen sharply and had turned negative on average. The decline in financing costs had encouraged issuance in the primary market, thereby facilitating the increase in fixed-rate lending. The Monetary Council focused on the relative position of domestic long-term yields relative to international yields when evaluating the two programmes.

In the current volatile financial market environment, the fundamentals of the Hungarian economy continued to be stable. The country's external debt had declined significantly, and its net lending position continued to be strong. Its fiscal position was sustainable, the budget deficit was low and the government debt-to-GDP ratio was contracting, associated with a significant decline in the foreign currency debt ratio.

The inflation target was expected to be achieved in a sustainable manner by the middle of 2019. In the Council's assessment, maintaining the base rate and the loose monetary conditions at both the short and long ends for an extended period was necessary to achieve the inflation target in a sustainable manner. In line with the Council's forward guidance, the current set of instruments contributed efficiently to the maintenance of the loose monetary conditions over a prolonged period and to an improvement in financial stability. The Council would closely monitor developments in monetary conditions and would ensure the persistence of loose monetary conditions over a prolonged period by using the current set of monetary policy instruments.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight collateralised lending rate, the one-week collateralised lending rate at 0.9 percent **and** **maintaining the interest rate on the overnight central bank deposit at -0.15 percent:**	7	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, Márton Nagy, Bianka Parragh, Gyula Pleschinger
Vote against:	0	

<u>The following members of the Council were present at the meeting:</u>

Gusztáv Báger

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

Márton Nagy

Bianka Parragh

Gyula Pleschinger

The Council will hold its next policy meeting on 19 June 2018. The minutes of that meeting will be published at 2 p.m. on 4 July 2018.