MINUTES

OF THE MONETARY COUNCIL MEETING

23 SEPTEMBER 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 AND INTEREST RATE DECISION

In the Monetary Council's judgement, with the easing cycle finished, the achievement of the Bank's medium-term inflation target and a corresponding degree of support to the real economy warranted maintaining the current low level of interest rates for an extended period. In addition to the primary goal of meeting the inflation target, the Council also considered the condition of the real economy and incorporated financial stability aspects into its decisions.

The Council expected the inflation rate to remain around zero per cent on average this year, before rising gradually to levels around the medium-term target in the course of next year. The dynamics of consumer price inflation had remained historically low in recent months. Numerous factors had contributed to the low inflation environment, such as low inflation in external markets, favourable developments in commodity prices and imported inflation, subdued domestic demand, the fall in inflation expectations and the reductions in administered energy prices. At the forecast horizon, the domestic real economy was expected to continue having a disinflationary impact, albeit to a declining extent, as domestic demand recovered gradually. As a result of improvements in productivity and moderate wage growth alongside economic growth, low inflation was likely to persist for a sustained period, despite the pick-up in domestic demand. Low inflation environment for a prolonged period was likely to lead to a sustained reduction in expectations, which was expected to help anchor inflation expectations playing a key role in determining the nominal path of the economy around the Bank's medium-term inflation target.

Several members of the Monetary Council noted that current interest rates helped to achieve the medium-term inflation target and a corresponding degree of stimulus to the real economy, and therefore judged that changing their level was not warranted. A number of members emphasised that, following the Bank's forward guidance accompanying the July and August policy decisions, maintaining interest rates was consistent with market expectations in terms of credibility and fitted well with the Council's earlier communication. The majority of members judged inflation risks to be symmetrical, and therefore felt that a decision to change the policy stance was not warranted. One member noted that, looking ahead, the expected interest rate increase by the Fed might lead to turbulence in emerging financial markets. Several members concluded that it was not warranted to change the stance of the loose monetary conditions for an extended period and to change the base rate from its current level, as there had been no significant macroeconomic development which would have caused a change in the inflation environment.

The recovery in the real economy had continued over the past quarter, with output rising across a wide range of sectors as employment continued to grow. The protracted recovery in Hungary's external markets and the economic sanctions imposed due to the conflict between Ukraine and Russia had resulted in a slightly weaker external demand environment; however, economic growth was expected to continue, reflecting the pick-up in domestic demand. The improvement in the outlook for activity, the effect of the

Funding for Growth Scheme, the easing in credit constraints and the increasing use of EU funding were expected to support investment growth. As seen in previous quarters, the gradual improvement in employment and rising household real income due to low inflation were playing a key role in the recovery in household consumption. As a result of the legal and legislative processes affecting household loans, household net financial wealth was expected to increase, accelerating the deleveraging process. However, the recovery in consumption was likely to remain moderate, due to the slow decline in precautionary motives following the crisis. The decision was expected to contribute to an increase in household income, but the saving rate was likely to remain above pre-crisis levels, reflecting the slow fall in precautionary motives. Looking ahead, Hungarian economic growth might continue in a more balanced pattern than previously.

The external position of the economy had continued to improve in the first half of 2014, as reflected in the decline in external debt ratios. The trade surplus, while remaining substantial in the coming years even as imports continued to rise due to increasing consumption and investment, was likely to keep the current account surplus high over the coming years. The slight decline in the income balance deficit was expected to contribute to Hungary's external position remaining strong. The external financing capacity of the economy was likely to remain substantial as the use of EU transfers remained high despite the new budget cycle. Consistent with this, the debt ratios, which were key in terms of the country's vulnerability, were likely to continue declining. At the same time, the Bank's self-financing programme might contribute to a decline in the country's gross external debt.

International investor sentiment had been volatile in the past quarter, mainly reflecting the escalation of geopolitical conflicts, uncertainty surrounding an interest rate increase by the US Federal Reserve, the interest rate reduction by the European Central Bank and its additional monetary policy measures. Of the domestic risk indicators, the CDS spread and foreign currency bond spreads had not changed significantly since publication of the June *Inflation Report*. Long-term yields had also remained around levels seen at the beginning of the quarter, following a sharp rise due to temporary factors. The forint exchange rate had depreciated in the past quarter, due in part to country-specific reasons, but mainly as a result of changes in international investor sentiment. Hungary's persistently high external financing capacity and the resulting decline in external debt had contributed to a reduction in its vulnerability. In the Council's judgement, a cautious approach to monetary policy was warranted due to uncertainty about future developments in the global financial environment.

The Monetary Council had considered three scenarios around the baseline projection in the September *Report*, which, if they materialised, might influence the future stance of monetary policy. In the alternative scenario assuming a weaker-than-expected recovery in Hungary's trading partner countries and, consequently, lower inflation, the inflation target could be achieved with looser monetary conditions than assumed in the baseline scenario. In the risk scenario assuming earlier-than-expected monetary policy tightening by globally influential central banks, tighter domestic monetary conditions than suggested in the baseline projection could ensure that inflation moved in line with price stability in the medium term. A third scenario, which assumed more robust growth in domestic employment and consumption, and, consequently, stronger domestic activity growth and a faster increase in inflation relative to the baseline projection, also implied a tighter monetary policy stance.

In the Council's judgement, there remained a degree of unused capacity in the economy and inflationary pressures were likely to remain moderate in the medium term. The negative output gap was expected to close gradually at the monetary policy horizon. Looking ahead, therefore, the disinflationary impact of the real economy was likely to decline. It was the unanimous view of the Council that, with current monetary conditions maintained, inflation was likely to move into line with the target over the medium term.

After the discussion, the Chairman invited members to vote on the proposition put to the Council. All members voted in favour of the proposition. Several decision-makers noted that the current level of the central bank base rate contributed to the achievement of the medium-term inflation target. The Council judged that, if the assumptions underlying the Bank's projection held, achieving the medium-term inflation target pointed in the direction of maintaining current loose monetary conditions for an extended period.

Votes cast by individual members of the Council

In favour of maintaining the base rate at 2.10%	**9**	Ádám Balog, Andrea Bártfai-Mager, János Cinkotai, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, Gyula Pleschinger, László Windisch

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 28 October 2014. The minutes of that meeting will be published at 2 p.m. on 12 November 2014.