MINUTES
OF THE MONETARY COUNCIL MEETING
18 September 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

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 further in 2018, then, if the assumptions of the current projection held, it would slow down gradually from 2019. The inflation target was still expected to be achieved in a sustainable manner from mid-2019.

The Magyar Nemzeti Bank's (MNB) single anchor was inflation. Under the flexible inflation targeting regime, the Monetary Council took account of all factors influencing inflation developments on the five to eight-quarter horizon of monetary policy. These might include developments in commodity prices, changes in the external inflation environment, labour market conditions, the position of the real economy, developments in the exchange rate and credit market conditions. By taking into account all these factors, the Bank was able to assess the likely magnitude and persistence of future price changes, which in turn determined the monetary policy response.

Incoming macroeconomic data for the past quarter had been in line with the Bank's expectations. In August 2018, inflation had stood at 3.4 percent, while core inflation had decreased to 2.3 percent. Volatile fuel and unprocessed food prices had been the main factors contributing to the increase in inflation in the summer months. Inflationary pressures from wages continued to be moderate. According to the European Central Bank's (ECB) projections, underlying inflation would continue to be moderate in the euro area in the coming years as well.

If the assumptions in the September projection held, the consumer price index would remain above 3 percent in the short term. From September, the increase in excise taxes would also contribute to upward pressure on inflation, in addition to fuel and unprocessed food prices, while core inflation excluding indirect tax effects would remain stable around 2.5 percent. With inflation expectations anchored at low levels, second-round effects were not expected to arise. According to our projection, rising consumption would lead to a gradual increase in underlying inflation. As temporary effects faded, the inflation rate was expected to ease back again, and the rise in underlying inflation would ensure that inflation meets the 3 percent target in a sustainable structure from mid-2019.

The Hungarian economy had grown strongly, by 4.8 percent in the second quarter of 2018 relative to a year earlier. Data on economic activity suggested that robust economic growth was likely to continue. Labour demand remained strong. The unemployment rate had fallen to a historically low level. Lending to the corporate and household sectors had continued to expand in July; however, the proportion of long-term, fixed-rate lending to the corporate sector continued to be low.

Looking ahead, economic growth was expected to continue across a broad range of sectors. The general strengthening of domestic demand would continue to play a central role in economic output developments. In the Council's assessment, GDP growth would be 4.4 percent in 2018, higher than last year, then, if the assumptions of the current projection held, it would slow down gradually from 2019. Meanwhile, the country's current account balance was expected to remain in positive territory over the longer term as well.

Sentiment in international financial markets had been volatile in the period since the Council's previous interest rate decision. Developments in international trade policies and events related to vulnerable emerging countries had influenced investors' appetite for risk. Asset price volatility had increased in domestic financial markets as a consequence of the volatile international financial market sentiment. The Bank assessed these developments in light of their relevance to its primary objective, i.e. the sustainable achievement of the inflation target, focusing on their persistence. The current volatile international environment continued to suggest a more cautious approach. The monetary conditions in the euro area might remain loose. The ECB's decisions might have a significant influence on the Magyar Nemzeti Bank's monetary policy.

Following the review of macroeconomic and financial market developments and the September Inflation Report projection, the Monetary Council discussed the details of the current monetary policy decision. Incoming macroeconomic data over the past quarter had been in line with the Bank's expectations; and the macroeconomic projection in the September Inflation Report showed no material shift. The inflation target was still expected to be achieved in a sustainable manner from mid-2019. Members agreed that maintaining the loose monetary policy stance was consistent with the achievement of the inflation target.

In the Council's assessment, inflation remaining around 3 percent and changes in the international monetary policy environment jointly suggested that, in formulating monetary policy, factors that influenced the achievement and maintenance of the inflation target should be taken into consideration with increased cautiousness.

Taking into account leading central banks' experiences with the transformation of their set of policy instruments, the Monetary Council reviewed the MNB's monetary policy instruments in detail. The Council was prepared for the gradual and cautious normalisation of monetary policy, which would start depending on the outlook for inflation. In the Council's assessment, the simplification of the set of instruments affecting short-term yields and the fine-tuning of instruments affecting long-term yields provided adequate support for monetary policy to get prepared. Members stressed that the publication of the instrument strategy setting out the future role of unconventional instruments increased the transparency and predictability of monetary policy, thereby enhancing its efficiency.

The renewed instrument strategy provided an opportunity for the Monetary Council to develop the monetary conditions necessary to achieve the inflation target, depending on the future outlook for inflation. Members stressed that the effects of the European Central Bank's expected decisions on Hungarian monetary conditions should still be closely monitored.

The MNB's primary objective was to achieve the inflation target in a sustainable manner. For this reason, in the Council's assessment, maintaining the loose monetary conditions was necessary.

The Council, however, reviewed its monetary policy instruments and was prepared for the gradual and cautious normalisation of monetary policy.

In order to maintain the loose monetary conditions, the Monetary Council held 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 left the average amount of liquidity to be crowded-out for the fourth quarter of 2018 unchanged, at least at HUF 400-600 billion. On the next occasion, in December 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.

Consistent with the practice of leading central banks, the MNB was also prepared for the gradual and cautious normalisation of monetary policy. The set of unconventional instruments affecting short-term yields would be simplified.The Monetary Council published the background material to the Bank's instrument strategy. In addition, the set of unconventional instruments affecting long-term yields would be fine-tuned.

The set of central bank instruments affecting short-term yields would become more simple and transparent after the Council's decision to phase out the three-month deposit facility by the end of 2018. The current HUF 75 billion stock of three-month central bank deposits would decline to zero by the end of December 2018. The interest rate remunerated on required reserves and preferential deposits would remain equal to the central bank base rate. In the future, required reserves would be the main policy instrument. Furthermore, in its background material to the Bank's instrument strategy, the Monetary Council would communicate about the future role of the individual unconventional monetary policy instruments. Looking forward, the Bank would adjust the monetary conditions necessary to achieve the inflation target in a sustainable manner by creating an optimal combination of two of its instruments: swaps providing forint liquidity and the interest rate corridor.

As part of the fine-tuning of the unconventional policy instruments affecting long-term yields, the Council made a decision to phase out the monetary policy IRS tenders and the mortgage bond purchase programme by the end of 2018. The Council set the annual maximum stock of monetary policy IRS for 2018 at HUF 1,100 billion. The mortgage bond programme would be ended in two stages: purchases in the primary market would continue until 31 December 2018 and purchases in the secondary market until 30 September 2018. In the meantime, the Funding for Growth Scheme Fix (FGS *fix*) would be introduced. The MNB would sterilise the liquidity provided under this programme by a preferential deposit facility bearing interest at the central bank base rate. This would contribute to developing a healthy structure for SME lending, while having a neutral impact on liquidity developments.

The Monetary Council would launch the FGS *fix* with a total amount of HUF 1,000 billion in early 2019. With the new programme, the Council's specific objective was to raise the proportion of long-term, fixed-rate lending to SMEs to an adequate level. In contrast with previous phases, the Bank would sterilise excess liquidity supply arising from lending under the FGS *fix* by using the preferential deposit facility. The Bank published the most important features and introduction aspects of the programme in the form of a background material.

The Council was prepared for the gradual and cautious normalisation of monetary policy, which would start depending on the outlook for inflation. The inflation target was still expected to be achieved in a sustainable manner from mid-2019. To ensure this, in the Council's assessment, maintaining the base rate and the loose monetary conditions was necessary.

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:**	9	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Bianka Parragh, Gyula Pleschinger, László Windisch
Vote against:	0	

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

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 16 October 2018. The minutes of that meeting will be published at 2 p.m. on 7 November 2018.