MINUTES
OF THE MONETARY COUNCIL MEETING
27 MARCH 2018

Time of publication: 2 pm on 11 April 2018

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

Before taking its policy decision on 27 March, 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 further in 2018, then, according to the current projection, 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 February 2018, inflation had stood at 1.9 percent and core inflation at 2.4 percent. Inflation and core inflation had been in line with the Bank's expectations. The Bank's measures of underlying inflation had remained unchanged and had continued to be significantly below 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 effect of this on costs was being offset by the reduction in employers' social contributions at the beginning of the year and in the corporate tax rate in 2017. Services prices had risen somewhat faster at the beginning of 2018 than last year, though still at a moderate pace. Consequently, in line with the Bank's expectations, there had not yet been any significant upward pressure on inflation from wages. Oil prices had increased slightly 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 underlying 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 underlying the current projection held, the inflation target could be achieved sustainably by the middle of 2019.

The Hungarian economy had grown by 4.4 percent in the fourth quarter of 2017. Industrial production and the volume of retail sales had continued to grow in January. Labour demand had remained strong. The unemployment rate had fallen further. Strong credit growth had continued in January. Outstanding lending to the corporate sector had increased by more than 10 percent relative to a year earlier. In the household sector, annual growth in lending had been close to 3 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. 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 volatile in the period since the Council's previous interest rate decision. Risk indicators had risen overall. Expectations related to future monetary policy of the world's leading central banks had been the main factor influencing investors' appetite for risk. The Fed had decided to raise interest rates in March, in line with expectations. The ECB was likely to maintain loose monetary conditions. Investors' perceptions about the Central and Eastern European region had continued to be positive. 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 short end of the market yield curve had shifted upwards in recent months, while the Bank's guidance about the maintenance of loose monetary conditions over an extended period had remained unchanged. Hungarian long-term yield spreads had risen in parallel with the increase in yields in international financial markets in early 2018. Over a longer horizon, however, spreads relative to the euro area and the region had decreased significantly.

Following the review of macroeconomic and financial market developments, the Council discussed the details of the current monetary policy decision. Members agreed that maintaining the current policy stance for a sustained period was in line with the March Inflation Report projection and the expectations of analysts and market participants. Furthermore, Council members agreed that the Fed's policy stance evolving largely in line with expectations as well as the ECB's expected ongoing loose monetary conditions also pointed towards unchanged central bank interest rates. In the Council's view, euro area underlying inflation developments had remained muted, while domestic underlying inflation had been moderate and had continued to fall short of core inflation, in line with the expectations. Members noted that the upward effect of dynamic wage growth on the inflation rate continued to be moderate and inflation would rise gradually towards the target as domestic demand picked up. In the context of achieving price stability in a sustainable manner, however, some decision-makers pointed out that it was of key importance to closely monitor developments in the labour market and in services price inflation. Other members added that no inflation risk was identified even as wage costs were rising, the reason being that the increase in the general price level was curbed by the gradual reduction in employers' contributions and VAT rate cuts earlier in the year, in addition to moderate inflation abroad and inflation expectations stabilising at historically low levels. They were of the view that the focus of Hungarian economic policy on boosting potential output over the longer term helped achieve the inflation target in a sustainable manner. Changing sentiment in international financial markets was identified by members as a risk. Decision-makers judged it necessary to analyse in detail domestic and external monetary conditions, the monetary policy of the Fed, the ECB and the region's central banks as well as developments in the labour market.

Members noted that, due mainly to factors beyond the control of the MNB and also in order to maintain the loose monetary conditions, the average amount of liquidity crowded-out in the first quarter had exceeded the HUF 400-600 billion target set by the Monetary Council in December 2017. For this reason, members concluded that the average amount of liquidity to be crowded-out in the second quarter of 2018 should be set more flexibly, at least at HUF 400-600 billion. The introduction of the MNB's two new unconventional instruments and central bank communications had led to an overall decline in domestic spreads over long-term yields in the euro area and the region. The Council set the maximum stock of monetary policy interest rate swaps in the first half of 2018 at HUF 600 billion. This ensured continuity with the HUF 300 billion set for the first quarter and was consistent with the unchanged monetary policy stance.

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 had maintained the base rate, the overnight collateralised lending rate and the one-week collateralised lending rate at 0.9 per cent and the overnight deposit rate at -0.15 per cent. In the first quarter, the average amount of liquidity crowded out had exceeded the HUF 400-600 billion target set by the Monetary Council in December 2017. In the Council's assessment, crowding out a higher amount of liquidity than the target level had been necessary to maintain the loose monetary conditions. The Council would keep the HUF 75 billion upper limit on the stock of three-month deposits. In addition, the Council 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 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. 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.

The Monetary Council 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. In harmony with the Council's forward guidance, the new instruments contributed efficiently to the maintenance of the loose monetary conditions over a prolonged period and to an improvement in financial stability. The Monetary Council focused on the relative position of domestic long-term yields relative to international yields when evaluating the programme.

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. 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 extended 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:**	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 24 April 2018. The minutes of that meeting will be published at 2 pm on 9 May 2018.