MINUTES
OF THE MONETARY COUNCIL MEETING
16 October 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.

In September 2018, inflation had risen to 3.6 percent and core inflation to 2.4 percent. In addition to a sharp rise in volatile items, particularly fuel and unprocessed food prices, the increase in excise taxes on tobacco products, had been the main factors contributing to the pick-up in price level. In line with the Bank's expectations, the measures of underlying inflation had been broadly unchanged, staying stable at around 2.5 percent. Both core inflation excluding indirect tax effects and sticky-price inflation had stagnated, while demand-sensitive inflation had risen modestly. As a result, the difference between the consumer price index and the measures of underlying inflation had widened further. Inflationary pressures from wages continued to be moderate. Oil prices had increased since the previous interest rate decision. According to the European Central Bank's (ECB) projection, 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. Beginning from the autumn months, 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. Rising consumption in the September projection 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 4.9 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 August; 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 pick up and stand at 4.4 percent in 2018, 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.

On the whole, sentiment in international financial markets had deteriorated in the period since the Council's previous interest rate decision. Expectations related to the monetary policy stance of the world's major central banks as well as news about international trade policies, developments in the supply of crude oil and Italy's government budget had been the main factors influencing investors' appetite for risk. The current volatile international environment continued to suggest a more cautious approach. 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. 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.

Taking into account the country's long-term national and economic policy strategy objectives, the Magyar Nemzeti Bank's Monetary Council had increased Hungary's official gold reserves significantly, in line with its previous decision. Accordingly, the amount of gold reserves had expanded from the earlier 3.1 tons to 31.5 tons in October 2018. The Magyar Nemzeti Bank had purchased gold for the first time since 1986. Following the significant increase in the physical form of the stock of gold reserves, it had already been transported to Hungary.

Following the review of macroeconomic and financial market developments, the Council discussed the details of the current monetary policy decision. Inflation in September slightly exceeded, while the measures of underlying inflation were consistent with the projection of the September Inflation Report. Several members emphasized that mainly volatile factors had led to a rise in inflation recently. According to a few members, the volatility of oil prices had recently increased primarily as a result of geopolitical events. Council members agreed that the effect of the increase in commodity prices on underlying inflation needed to be closely monitored, and incoming data should be assessed on the basis of more persistent inflationary effects. Furthermore, in view of past experience the members noted that developments in inflation expectations was of key importance. Expectations continued to be anchored at a low level.

Council members agreed that maintaining the loose policy stance was still necessary. In addition, it was highlighted that with the September decision 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. Members noted that the renewed policy instruments provided the room for manoeuvre necessary for the Bank to react to the changes in the macroeconomic and financial market environment with due caution and flexibility.

The Bank'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. Consistent with the practice of leading central banks, the MNB was also prepared for the gradual and cautious normalisation of monetary policy. As part of the instrument strategy presented in September, the Monetary Council would phase out the three-month deposit facility by the end of 2018. In the future, required reserves would be the main policy instrument. Looking ahead, the Bank would adjust monetary conditions necessary to achieve the inflation target in a sustainable manner by creating an optimal combination of two of its instruments: the stock of swap instruments providing forint liquidity and the interest rate corridor. As part of the fine-tuning of the unconventional policy instruments affecting long-term yields, mortgage bond purchases in the secondary market had ended, consistent with the Council's September decision. In addition, the mortgage bond purchase programme in the primary market would be completed and the monetary policy IRS instrument would be phased out by the end of 2018. Furthermore, the Monetary Council would launch the Funding for Growth Scheme Fix at the beginning of 2019. The MNB would sterilise the liquidity provided under this programme using a preferential deposit facility bearing interest at the central bank base rate.

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. In addition, in September the Council had 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.

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 current level of 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 20 November 2018. The minutes of that meeting will be published at 2 pm on 5 December 2018.