MINUTES
OF THE MONETARY COUNCIL MEETING
27 FEBRUARY 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, 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 February, 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 continue to be dynamic in 2018, then it would slow down from 2019 if the assumptions underlying the current projection held. The inflation target was expected to be achieved in a sustainable manner by the middle of 2019.

In January 2018, inflation had stood at 2.1 percent and core inflation at 2.5 percent. Inflation and core inflation had been in line with the Bank's expectations. The Bank's measures of underlying inflation had remained unchanged overall 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. 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. As last year, there had been moderate price movements in the service sector at the beginning of 2018, thus, in line with the Bank's expectations, there had not yet been any significant upward pressure on inflation from wages. Oil prices had fallen significantly following the rise in recent months. According to the European Central Bank's projections, underlying inflation would continue to be moderate in the euro area in the coming years as well.

According to our current projection, the consumer price index would level off at the bottom edge of the tolerance band in the first months of 2018. Over the medium term, buoyant domestic demand, the increase in wage costs, as well as the second-round effects resulting from higher commodity prices would point to an increase in domestic core inflation. However, moderate external inflation and inflation expectations stabilising at historically low levels, as well as gradual reductions in employers' social contributions, the VAT rate cuts this year, were decelerating the rise in prices. In our projection, 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 December. Labour demand remained strong: employment was at historically high levels in the final quarter of 2017. The unemployment rate had fallen further. Strong credit growth had continued. Outstanding lending to the corporate sector had increased by some 10 percent relative to a year earlier. Within this, the stock of lending to SMEs had grown even more strongly. In the household sector, annual growth in lending was close to 2 percent. A significant part of this was 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

5.5 percent observed earlier, Hungary's current account surplus was expected to fall to around 2 percent in 2018, driven by rising domestic demand, and 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 around 4 percent in 2018, as in 2017, then it would slow down from 2019 if the assumptions underlying the current projection held. The Bank's and the Government's measures contributed substantially to economic growth.

Sentiment in international financial markets had, on the whole, deteriorated in the period since the Council's previous interest rate decision, accompanied by increased volatility. Macroeconomic data releases and expectations related to future monetary policy of the world's leading central banks were the main factors influencing investors' appetite for risk. The Fed decided to maintain interest rates at the end of January. Market participants continued to expect the next interest rate increase to take place in March. Looking ahead, the European Central Bank was likely to maintain loose monetary conditions for an extended period. Investors' perceptions about the Central and Eastern European region 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 monetary policy stances by regional central banks would continue to differ.

The short end of the market yield curve had shifted upwards, 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 amid the increase in yields in international financial markets over the recent period. 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 data becoming available over the previous month had been in line with the baseline scenario of the December projection and no such real economy or financial market event had occurred that would justify a change in the monetary policy stance. In the members' opinion, underlying inflation in the euro area had remained moderate, while domestic underlying inflation, had continued to fall short of core inflation, in accordance with the expectations. Members concluded 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. Some members pointed out that, in relation to achieving price stability in a sustainable manner, it was of key importance that developments in inflation expectations were in line with the MNB's inflation target. Changes in global oil prices, developments in the international financial market and the ECB's future monetary policy deserved particular attention in terms of the external environment. Several members pointed out that the global monetary policy environment was gradually changing and the monetary policy stance of regional central banks would continue to differ. Long-term yields in the US and in the euro area had risen further moderately; however, according to market expectations, loose monetary conditions were likely to remain in the euro area. As a result of the MNB's two new unconventional instruments and the Bank's communication, since September 2017 domestic long-term yields had decreased substantially compared with yields in the euro area and in the region as well. Members agreed that in the assessment of the new instruments the relative position of Hungarian yields compared to international yields should be monitored closely.

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, the one-week collateralised lending rate at 0.9 percent, and the overnight deposit rate at -0.15 percent. In line with maintaining monetary conditions, while keeping the HUF 75 billion upper limit on the stock of three-month deposits, the Council set a HUF 400-600 billion band for the targeted average liquidity crowded-out for the first quarter of 2018, which was equal to that of the fourth quarter of 2017. On the next occasion, in March 2018, the Council would decide on the amount of liquidity to be crowded out and would adjust the stock of central bank swap instruments accordingly.

The Council's aim was that the loose monetary conditions have their effect not only at the short but also at the longer end of the yield curve. To ensure this, the Bank had started targeted mortgage bond purchases in January and held its tenders of the unconditional monetary policy interest rate swap facility. In view of the experiences gained from the first tender, the Bank had fine-tuned the details of the programme to achieve more effective monetary transmission, as a result of which tenders held in February had been in line with the Bank's aims. The MNB would continue mortgage bond purchases and the monetary policy interest rate swap facility as programmes, continuously and for a prolonged period, thus they constitute 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 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 loose monetary conditions at both 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 27 March 2018. The minutes of that meeting will be published at 2 pm on 11 April 2018.