MINUTES

OF THE MONETARY COUNCIL MEETING

22 MARCH 2016

Time of publication: 2 pm on 13 April 2016

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

In the Council's assessment, Hungarian economic growth continued. A degree of unused capacity remained in the economy, and therefore the domestic real economic environment continued to have a disinflationary impact. The path of inflation had shifted downwards significantly relative to the December projection and remained substantially below the Bank's target.

The annual inflation rate and core inflation both had decreased in February 2016 relative to the previous month. The Bank's measures of underlying inflation continued to indicate moderate inflationary pressures in the economy. Core inflation was rising only gradually as a result of rising household consumption and moderate wage growth. The persistently low global inflationary environment contained the increase in the domestic consumer price inflation. Inflation expectations had fallen further and were at historically low levels. Inflation remained below the 3 per cent target over the forecast period, and only approached it in the first half of 2018.

The Hungarian economy had grown dynamically again in the fourth quarter of 2015 following subdued growth in the previous quarter. Over the year as a whole, the economy had grown at a rate close to 3 per cent. Based on detailed data, the expansion in services and industry had continued to be the main driver of economic growth. The performance of industry had weakened in January. According to January data, retail sales had grown less strongly than in previous months. The employment rate had remained broadly unchanged and the unemployment rate had fallen again in January. The deceleration in funding inflows from the EU led to a slowdown in growth, but the Bank's and the Government's policy measures continued to contribute to economic recovery. In the Council's assessment, economic growth of around 3 per cent could be maintained by the Bank's Growth Supporting Programme and the steps taken by the Government to encourage home construction and to facilitate the faster draw-down of EU transfers. Rising incomes, the pick-up in lending and the gradual decline in precautionary motives contributed to a substantial expansion in consumption, which in turn provided considerable support for economic growth.

Sentiment in global financial markets had improved slightly overall since the Council's latest policy decision, mainly driven by expectations and announcements related to the monetary policy stance of the world's leading central banks and news coming from oil markets. In March, monetary conditions in the euro area had been eased further by the European Central Bank. The forint exchange rate had weakened and long-term government bond yields had fallen since the previous policy decision. Hungary's strong external financing capacity and the resulting decline in external debt were contributing to the sustained reduction in the vulnerability of the economy. In the Council's assessment, a watchful approach to monetary policy was still warranted due to uncertainty in the global financial environment.

Market yield expectations had been in line with the Bank's forward guidance. The unconventional, targeted monetary policy instruments introduced by the Bank also facilitated a decline in long-term yields and, consequently, an easing in monetary conditions. Forward-looking money market real interest rates were in negative territory and were declining even further as inflation rose.

In the Council's assessment, there continued to be a degree of unused capacity in the economy and inflationary pressures remained moderate for an extended period. The real economy had a disinflationary impact over the policy horizon. Based on the March Inflation Report projection, the time when the inflation target was met had lengthened as an effect of the persistently and substantially lower cost environment than earlier expected.

In discussing the current decision, members noted that the March Inflation Report provided an opportunity for a comprehensive assessment of developments in inflation and the real economy as well as the external monetary environment. In view of the projection of the March Inflation Report, the Council judged that Hungarian economic growth and the reduction in the economy's external vulnerability continued; however, inflation was significantly below the previous projection and remained below target over the entire forecast horizon. Several members noted that the lower path of inflation in the current projection relative to December, moderate imported inflation and the looser external monetary environment pointed in the direction of a reduction in the policy rate. Some members emphasized that the risks related to the meeting of the medium-term inflation target had risen and persisted for longer, which might increase the probability of the formulation of second-round inflation risks. Council members agreed that, in view of the international monetary environment and the stimulation of economic growth, on the one hand, and underlying inflation developments, on the other, it was both possible and necessary to reduce the base rate in order to meet the inflation target on a sustainable basis. Some members noted that also the stability of the financial system and the reduction in the country's external vulnerability provided enough room to lower the base rate.

Taking these factors into account, all members supported the reduction in the base rate; however, one member proposed a smaller, 10 basis points reduction. In that member's opinion, before making a larger reduction in the central bank base rate, members should wait to see whether the MNB's measures to support growth and the policy easing by the ECB announced recently would have a material impact on corporate lending. The members voting for a 15 basis point reduction in the policy rate argued in favour of launching a new easing cycle. Members shared the opinion that it was appropriate to continue the rate cut cycle as long as the resulting monetary conditions moved into line with the sustainable achievement of the inflation target. In addition, members decided to narrow the interest rate corridor asimmetrically. Looking ahead, the possibility of changing the interest rate corridor further depended on future developments in financial conditions.

Long-term government securities yields had fallen after the announcement of Phase 3 of the Self-Financing Programme and were likely to continue declining as the announced measures were implemented. However, persistently low cost-side inflationary pressure, the slowdown in global growth and the historically low level of inflation expectations had heightened the risk of second-round effects resulting in below-target inflation over a sustained period. In view of the March Inflation Report projection, the Council assessed that the sustainable achievement of the inflation target had made it necessary to implement a comprehensive easing of monetary conditions. This consisted of the reduction in the policy rate and the asymmetric narrowing of the central bank interest rate corridor. As a result, the central bank base rate was reduced by 15 basis points to 1.20 per cent, the overnight deposit rate to -0.05 per cent, i.e. into negative territory, and the overnight lending rate to 1.45 per cent. The Monetary Council remained ready to use every instrument at its disposal to contain second-round inflationary effects. Interest rate cuts would continue as long as monetary conditions became consistent with the sustainable achievement of the inflation target. In addition to the central bank base rate, the Monetary Council would henceforth also decide on the current levels of the overnight deposit and lending rates, that is, the width of the interest rate corridor at its interest rate-setting meetings.

Votes cast by individual members of the Council:

In favour of reducing the base rate to 1.20%:	**8**	Gusztáv Báger, Andrea Bártfai-Mager, Ferenc Gerhardt, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch
In favour of reducing the base rate to 1.25%:	**1**	János Cinkotai
In favour of narrowing the interest rate corridor asymmetrically: reducing the overnight collateralised loan rate to base rate+0.25 percentage points and maintaining the overnight central bank deposit rate at base rate-1.25 percentage points:	**9**	Gusztáv Báger, Andrea Bártfai-Mager, János Cinkotai, Ferenc Gerhardt, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch

The following members of the Council were present at the meeting:

Gusztáv Báger

Andrea Bártfai-Mager

János Cinkotai

Ferenc Gerhardt

György Kocziszky

György Matolcsy

Márton Nagy

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 26 April 2016. The minutes of that meeting will be published at 2 pm on 11 May 2016.