MAGYAR NEMZETI BANK

ABRIDGED MINUTES

OF THE MONETARY COUNCIL MEETING OF 23 JULY 2007

Published: 17 August 2007, 2 pm

Article 3 (1) of the Central Bank Act (Act LVIII of 2001 on the Magyar Nemzeti Bank, as amended) 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. Each month, the agenda of the second meeting includes the potential modification of the central bank base rate. Abridged minutes of the Council's rate-setting meetings are released regularly, before the next policy meeting takes place. The minutes are divided into two main parts. The first part contains a discussion of economic and financial developments, derived from analyses presented by Bank staff to the Council, as well as information which has become available since the previous meeting. Taking into account the findings of the first part, the second part goes on to present the decision makers' assessment of current economic conditions and the factors they consider when deciding on the base rate.

The abridged minutes are available on the MNB's website at:
http://www.mnb.hu/engine.aspx?page=mnbhu_mt_jegyzokonyv

I. Macroeconomic and financial market developments

The Q2 2007 consumer price index and the core inflation developed as forecast in the May inflation report. The core inflation rate, excluding the medical visit fee, excise taxes and the impact of VAT, best reflecting the developments, amounted to 4 percent in the second quarter of 2007, which is a half percentage point decline compared to the previous period.

At the same time the short-based monthly index indicates a slightly less favourable picture. The increase of the annualised one-month core inflation index in June was primarily due to the unexpectedly high rate of rise in the prices of consumer non-durables and processed foods. The fact that – in spite of the strong exchange rate – the inflation of consumer non-durable prices seems to stabilise at a level higher than earlier expected will present a long-term risk. The global increase in food prices and oil prices, too, carries the risk of inflation. It is a favourable development though that the market services inflation continues to fluctuate in the band around 6 percent.

The economic activity on the whole developed as outlined in the inflation report. Though the detailed GDP data published last month showed slightly higher consumption than expected, the data received since then indicate strong deceleration of the economic activity.

The data concerning industrial production show continued deceleration starting in the second half of last year. Both exports and domestic sales contributed to the slowdown of the dynamics. The dynamics of export sales has been moderate since the end of 2006 and is nearly stagnating in the case of domestic sales. The May data fit into the earlier trend though the rate of deceleration was slightly higher than expected.

The international trade in goods developed similarly to industrial production. Compared to the very high, about 20 percent rate of annual growth at the beginning of the year, deceleration was observable during the spring months both in exports and imports. According to the preliminary data, the trend continued in May, the value of the export of goods in euro grew by 12 percent and that of the import of goods by 11 percent compared to May last year.

The economic activity of the retail trade sector, too, continued to decelerate starting from the second quarter of last year. Nevertheless, it deserves attention that the decline in the household demand for consumption in the first four months of 2007 was still less than the estimated decrease of real household income and the demand for consumer loans – typically denominated in foreign currency – achieved the highest level ever. All this is in line with the assumed consumption adjustment efforts by the households.

The average gross income continues to grow at a high rate. The dynamics of regular wages increases. Based on the last months data, the dynamics of total average gross income seems to be stagnating due to the slight adjustment through bonus payments. The difference between wage indexes in the manufacturing industry and in the market services grows wider: while the former seems to be stagnating at about 9 percent (or slightly increases), the latter shows steady increase.

The statistical data concerning the number of staff for institutions have indicated – diminished – decline in the competitive sector since the beginning of the year. It must be noted, however, that the data are affected by considerable methodological uncertainties (e.g. whitening). The latest LFS data are only available in respect of the national economy as a whole. These data indicate slight adjustment in April and May after a decline in the rate of employment and the growth of unemployment in the first quarter.

The foreign investment environment continues to be extremely favourable. The latest macroeconomic data confirmed the prospects of strong global growth and this maintained the investors' demand for risky assets. This resulted in continued bullish trend on the stock markets, a considerable volume of funds flowed into the investment funds on the emerging markets, and there was a revaluation of high yield foreign currencies. Oil prices, too, continued to rise as the concern strengthened that the supply would not be able to satisfy the demand continuously increasing due to the strong economic activity. The Brent crude oil prices went up from a very low USD 50 per barrel at the beginning of the year to around USD 78 per barrel.

From among the risk factors, the high-risk American mortgage loan market continues to exert a negative impact on the investment sentiment. The bankruptcy of certain investment funds and the announcements by large credit rating agencies about assigning or the prospect of assigning lower credit ratings to mortgage loan products resulted in the increase of credit premium in other market segments as well. In addition to corporate lending the premium of sovereign debts rose slightly as well. In spite of the increase of credit premium the developments on the American mortgage market will probably exert only a marginal impact on risk appetite until affecting other markets or household consumption as well of which there is no indication as yet.

Long-term yields stopped rising on the major markets, which exerted favourable effects on the rising markets as well. With the American prime rate remaining unchanged, the markets also expect that the rates will continue to rise in Europe and Japan in the following months. The expected decline of the interest rate differential contributed to the dollar reaching historic lows against the euro.

The currencies in the Central-European region appreciated due to the favourable external environment, however, the rate of forint appreciation was slower than that of the other currencies. The forint fluctuated within an extremely narrow band, around HUF 246/EUR. The rapid decline for two months in the exposure of foreign investors to forint risks stopped in the middle of June.

The reduction of rates by the MC in June was a surprise for the analysts. The reduction of rates had no impact on the foreign exchange market, but at the same time the entire yield curve shifted down. The priced interest rate trend indicated stronger expectations for interest rate reduction. The yield curve is consistent with a 6.75% prime rate by the end of this year and a 6.25% prime rate by the end of next year, which represents a decline of nearly 25 basis points compared to the trend a month ago. Market surveys indicated that analysts, fund managers and currency dealers had a difference of opinion regarding the July interest rates decision. Long-term forint forward yields followed the decline in euro forwards, consequently the long-term premium did not change. Whereas the Hungarian foreign currency bond premium rose in line with the debt premium of other emerging countries.

II. The Council's assessment of current economic conditions and its interest rate decision

Following a discussion of the macroeconomic and financial market developments, proposals were submitted to maintain the base rate or to reduce it by 25 basis points.

The majority of those present held the same view about the latest inflation figures. Though the June inflation data indicated a somewhat downward trend compared to the previous two months, the rate of increase does not exceed the characteristic noise of the data. The inflation in the second quarter, and more specifically the core inflation excluding tax changes, providing a better view of the development of inflation, indicated an overall improvement. The majority held the view that the risk of deviation of the inflation expectations from the target values had considerably declined and that, in all probability, the development of inflation was consistent with the basic trend of the May forecast. Nevertheless opinion was also voiced that the occurrence of new inflation risks cannot be excluded in the future, primarily in connection with raw material and food prices.

The members essentially agreed that it continued to be difficult to assess the developments on the labour market. The changes in the regulatory environment considerably distort the data on wages and employment, therefore it would be misleading to rely only on a single indicator; all available information must be used before making the decision. Several members noted that the fact that special attention had been paid to wage dynamics in the competitive sector over the previous period wrongly gave the impression that interest rate decisions were primarily determined by this indicator. In this regard the members agreed that the Council should indicate the uncertainties connected with labour market data, thus the fact that there is no single indicator which could express the wage cost-related inflation risks.

Several members, voting in favour of maintaining the base rate, emphasised that they saw an opportunity for further reductions of the interest rate in the future, which would become possible due to the considerable decrease of the forint asset premium and the inflation prospects. These members, however, were of the opinion that the interest rate reduction could only be implemented carefully and gradually. According to one of the members, a rapid succession of interest rate reductions can result in an unjustified strengthening of the expectations for interest rate reduction. It was also mentioned that numerous signs indicated that the demand for investments on the emerging markets could decline in the near future. In addition to that the recent and the expected future interest rate raises by the largest central banks will moderate the yield premium of forint assets.

Following the discussion, the Chairman invited the members to vote on the propositions. Nine members voted to maintain the base rate, one member voted for a 25 basis point reduction. Based on the votes cast, the Monetary Council decided to maintain the central bank base rate at 7.75%.

Votes:

In favour of maintaining the base rate at 7.75%:	**9**	Péter Bihari, Vilmos Bihari, Csaba Csáki, Ilona Hardy, Béla Kádár, Ferenc Karvalits, György Kopits, Gábor Oblath, András Simor
In favour of reducing the base rate to 7.50%:	**1**	Tamás Bánfi

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

András Simor, Chairman
Péter Adamecz
dr. Tamás Bánfi
Péter Bihari
Vilmos Bihari
dr. Csaba Csáki
dr. Ilona Hardy
dr. Béla Kádár
Ferenc Karvalits
dr. György Kopits
Judit Neményi
dr. Gábor Oblath

Péter Tabák, Head of Department of the Ministry of Finance, was present as the Government's representative.

The Council will hold its next rate-setting meeting on 27 August 2007. The abridged minutes of that meeting will be released at 2 p.m. on 7 September 2007.