MINUTES

OF THE MONETARY COUNCIL MEETING

17 DECEMBER 2013

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 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://english.mnb.hu/Monetaris_politika/decision-making/mnben_mt_jegyzokonyv

THE COUNCIL'S ASSESSMENT OF CURRENT ECONOMIC CONDITIONS AND THE INTEREST RATE DECISION

In recent months, the consumer price index, including the Bank's measures of underlying inflation, had been at historically low levels. Low underlying inflation reflected the combined effect of weak domestic demand, declining inflationary pressures in external markets and the gradual adjustment of inflation expectations. In addition to the decline in underlying inflation, the reductions in regulated prices, implemented in a series of steps this year, had also contributed significantly to the development of a low inflation environment. Looking forward, loose labour market conditions and the adjustment of inflation expectations were likely to lead to moderate wage growth, which in turn might contribute to the maintenance of the low inflation environment. Based on the Monetary Council's assessment of the above factors, inflationary pressures were likely to remain muted over the medium term on the whole, with inflation expected to move into line with the target by the end of the forecast period. The low inflation environment might help the Bank's inflation target to better anchor the nominal path of the economy. One member of the Council, however, noted that there were some expectations of a modest rise in inflation in the coming 3 to 5 quarters, mainly driven by a pick-up in domestic demand.

In the Council's judgement, Hungarian economic growth might continue in a more balanced pattern than previously. Rising exports were likely to play a role as a source of growth, supported among other factors by an increase in market share due to the establishment of new production capacities in the automobile industry, in addition to the recovery in external activity. Moreover, domestic demand was expected to strengthen in the coming years. Whole-economy investment was likely to pick up further, bolstered by the increasing use of EU funding. Corporate investment was expected to grow, driven by the positive economic outlook and the easing of credit constraints due to the Bank's Funding for Growth Scheme. However, household consumption was likely to grow only gradually, even despite the increase in real income. Propensity to save was expected to remain high, reflecting the ongoing reduction in debt accumulated during the years prior to the crisis and the slow improvement in credit conditions.

The external surplus of the Hungarian economy was likely to increase further this year, reflecting a rising surplus on goods and services partly due to the improvement in the terms of trade, the expected moderate decline in the income account deficit and the increasing use of EU transfers. On the forecast horizon, Hungary's external financing capacity was expected to remain high and the trade surplus to stabilise at its current level, while the net amount of EU transfers, although falling slightly, was likely to exceed the level of previous years, due to the new budget cycle of the EU. With the external financing capacity remaining high, the external debt ratio was likely to fall further, which in turn would reduce the country's vulnerability. Two Council members, however, noted that the interest rate differential between forint assets and other countries of the CEE region with a more favourable risk profile had narrowed sharply, which might pose risks.

The productive capacity of the economy continued to be lower than optimal, with the output gap remaining negative. The negative output gap might close at the end of the forecast horizon, mainly driven by the performance of the export sector and the revival of investment. On the other hand, household consumption was likely to strengthen only gradually and, consequently, real economic factors were expected to continue to have a disinflationary impact, although to a declining extent.

On the whole, the global financial environment had been supportive in the past quarter. However, sentiment had been volatile, due to uncertainty about the future of unconventional measures used by global central banks, which warranted an even more cautious approach to domestic monetary policy. Some members noted that until the time of the Council meeting the US Fed had not decided on a withdrawal from monetary easing; and the European Central Bank had indicated that it would maintain its current policy stance and would even move towards further policy easing. For those members, these developments suggested that the financial environment would remain supportive.

In the Council's judgement, there continued to be a significant degree of unused capacity in the economy, and inflationary pressures were likely to remain moderate over a sustained period. Global financial markets continued to be volatile. A sustained and marked shift in perceptions of the risks associated with the Hungarian economy might influence the room for manoeuvre in monetary policy.

In line with the projection in the December issue of the Bank's *Quarterly Report on Inflation*, the Council judged that further policy easing was likely to be required in order to deliver price stability in the medium term, but members' views were divided about the magnitude of easing. Two members were of the view that the marked narrowing of the interest rate differential of forint assets and other countries of the region might pose risks, while the steepness of the yield curve for Hungarian government securities might signal that the Bank had neared the end of its easing cycle, and therefore those members proposed an even smaller reduction in interest rates than had been the case earlier. One member noted that because there were some expectations of a modest rise in domestic inflation in the coming 3 to 5 quarters and the monetary transmission mechanism in Hungary affected price-level movements at shorter horizons, the current level of interest rates was appropriate to ensure that inflation remained below the target. However, in view of recent developments in inflation, for several other members a reduction in the pace of the current cautious monetary easing was not warranted, and those members thought that the 20 basis point reduction in interest rates was consistent with the projection in the *Report*. In addition, they stressed the continued supportive international environment, which also required maintaining the size of individual interest rate cuts. However, those members voting for a 20 basis point reduction agreed that a reduction in the pace of policy easing could be warranted in the future.

After the discussion, the Chairman invited members to vote on the propositions. Seven members voted in favour of a 20 basis point reduction in the base rate and two members voted for a 10 basis point cut.

Considering perceptions of the risks associated with the economy as well as the improvement in the pace of economic growth, further easing of monetary policy may follow, but moving in smaller steps could be warranted in the future.

Votes cast by individual members of the Council

In favour of reducing the base rate to 3.00%	**7**	Ádám Balog, Andrea Bártfai-Mager, Ferenc Gerhardt, Csaba Kandrács, György Kocziszky, György Matolcsy, László Windisch
In favour of reducing the base rate to 3.10%	**2**	János Cinkotai, Gyula Pleschinger

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

Ádám Balog
Andrea Bártfai-Mager
János Cinkotai

Ferenc Gerhardt
Csaba Kandrács
György Kocziszky
György Matolcsy
Gyula Pleschinger
László Windisch

The Council will hold its next policy meeting on 21 January 2014. The minutes of that meeting will be published at 2 p.m. on 5 February 2014.