ABRIDGED MINUTES OF THE MONETARY COUNCIL MEETING OF 24 MAY 2016

Time of publication: 2 p.m. on 8 June 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, 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, following this date background materials 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 abridged minutes are available on the MNB's website at:
http://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

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

In the Council's assessment, Hungarian economic growth will continue following a temporary pause. A degree of unused capacity remains in the economy, and therefore the domestic real economic environment continues to have a disinflationary impact. Inflation remains persistently below the Bank's target.

The annual inflation rate and core inflation both rose in April 2016. The Bank's measures of underlying inflation continued to indicate moderate inflationary environment in the economy. Persistently low global inflation is restraining the increase in domestic consumer price inflation. Domestic inflation expectations are at historically low levels. Whole-economy wage growth accelerated early this year, which in turn is likely to gradually raise core inflation through rising household consumption. Inflation remains below the 3 per cent target over the forecast period, and is expected to approach it in the first half of 2018.

The Hungarian economic output grew more moderately than expected in the first quarter of 2016 relative to a year earlier. GDP decreased compared to the end of the previous year, reflecting strong one-off effects. The slower drawdown of funding from the EU relative to recent years caused a sharp slowdown in construction output, while temporary factory shutdowns led to a fall in industrial production. By contrast, retail sales continued to expand further in March, and have on balance grown at a stable rate in recent months. Parallel to the rise in the employment rate, the unemployment rate continued to fall. Economic growth is likely to exhibit strongly contrasting developments during the year as a whole. The Council expects growth to pick up notably in the second half of the year following moderate dynamics in the first half. The unwinding of one-off factors, as well as steps taken by both the Bank and the Government to support growth result in the economy picking up again. On the whole, the Growth Supporting Programme, the expansion in home construction and the faster drawdown of EU transfers help maintain a growth rate of around 3 per cent.

Moderate growth early this year is expected to result in the output gap opening up temporarily; however, looking forward, the expansionary impact on demand of next year's draft budget is likely to speed up the closure of the gap. Rising incomes and the pick-up in lending will contribute to the expansion in consumption, which in turn provides a considerable support to economic growth in the coming years.

Sentiment in global financial markets has deteriorated slightly since the Council's latest interest rate-setting decision, mainly driven by weaker-than-expected macroeconomic data from the US and the euro area and news coming from oil markets. In line with a reduction in global risk appetite domestic long-term government bond yields have risen since the previous policy decision. Hungary's strong external financing capacity and the resulting decline in external debt are contributing to the sustained reduction in the vulnerability of the economy. The international rating agency Fitch has upgraded Hungary's long-term government debt rating to investment grade. This step is expected to contribute to further improvement in the risk assessment of the economy. In the Council's assessment, a watchful approach to monetary policy is still warranted due to uncertainty in the global financial environment. Forward-looking money market real interest rates are in negative territory and are declining even further as inflation rises.

In the Council's assessment, there continues to be a degree of unused capacity in the economy and inflationary pressures remain moderate for an extended period. The real economy has a disinflationary impact over the policy horizon. If the assumptions underlying the March Inflation Report projection hold, inflation is expected to approach the 3 per cent target in the first half of 2018.

In discussing the current decision, the members of the Monetary Council reviewed international and domestic factors corroborating the rate cut and the closing of the cycle. Several members underlined that Hungary's risk assessment would improve as a result of the upgrading by Fitch Ratings. Examining domestic macroeconomic factors, several members emphasised that growth in the first quarter had been below expectations as a result of one-off effects, and upswing is expected again in the second half of the year, supported by central bank and government measures. The stronger than expected whole-economy wage growth observed early this year points to a gradual increase in core inflation through rising household consumption. Recent wage data suggest that the risk of second-round effects resulting from an excessively low level of inflation expectations has diminished. The budget aims at stimulating demand to a greater extent than assumed earlier; therefore, it may play an increasing role in the closing of the output gap. Some Council members underlined that international developments, such as the low international inflation and interest rate environment, the ECB's monetary policy steps, the strengthening Fed interest rate hike expectations as well as the Brexit, warrant a more cautious monetary policy approach. Second-round effects and other, inflationary effects point to maintaining the 0.9 per cent base rate level. In addition, several Council members emphasised the importance of communication in terms of strengthening central bank credibility and that forward guidance influences market reactions.

Taking all this into account, all but one Council member supported the reduction of the base rate by 15 basis points. In addition, with one vote against, the Monetary Council decided to leave the overnight loan spread at 25 basis points and the overnight deposit rate at an unchanged (-0.05 per cent) level. In one Council member's opinion, the central bank base rate has already reached the lowest level that can be sustained in a stable manner and can ensure the achievement of the inflation target over the forecast horizon. The members of the Monetary Council believe that the decision is in line with the Bank's previous behaviour and communication as well as with the overall market expectations, thus contributing to the Bank's credibility and predictability. With this step, the Monetary Council also decided to close the base rate cut cycle, although several members pointed out that fine-tuning of the monetary policy may become necessary, which justifies further analysis of the application of monetary policy instruments and that of non-conventional ones in particular.

In the Council's assessment, with the 15 basis point reduction the 0.9 per cent level of the policy rate ensures the sustainable achievement of the inflation target and a corresponding degree of stimulus to real economy. The Council has left the overnight deposit rate unchanged at -0.05 per cent and lowered the overnight lending rate by 15 basis points to 1.15 per cent. Based on available information, the inflation outlook and the cyclical position of the real economy point to maintaining the 0.9 per cent base rate for an extended period.

Votes cast by individual members of the Council:

In favour of reducing the base rate to 0.90%:	8	Gusztáv Báger, Andrea Bártfai-Mager, Ferenc Gerhadt, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch
In favour of leaving the base rate at 1.05%:	1	János Cinkotai
In favour of reducing the overnight central bank lending rate to 1.15 per cent and maintaining the overnight central bank deposit rate at -0.05%:	8	Gusztáv Báger, Andrea Bártfai-Mager, Ferenc Gerhadt, György Kocziszky, György Matolcsy, Márton Nagy, Gyula Pleschinger, László Windisch
Vote against:	1	János Cinkotai

<u>The following members of the Council were present at the meeting:</u>

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 21 June 2016. The abridged minutes of that meeting will be published at 2 p.m. on 13 July 2016.