MINUTES

OF THE MONETARY COUNCIL MEETING

20 JUNE 2017

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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

In the Council's assessment, Hungarian economic growth picked up over the forecast horizon. Some degree of unused capacity had remained in the economy, but this was likely to be gradually absorbed as output grew dynamically. The inflation target was expected to be achieved in a sustainable manner half a year later, from early 2019.

In May 2017, inflation had eased to 2.1 percent. The moderation in inflation had mainly reflected the decline in the price index for fuel, due in part to base effects. Developments in the Bank's measures of underlying inflation had remained stable, in line with expectations. The expansion in domestic employment, the tight labour market as well as increases in the minimum wage and the guaranteed minimum wage at the start of the year 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 and in the corporate income tax rate early this year. In line with the Bank's expectations, there had not yet been any upward pressure on inflation from wages. The rise in global inflation which had started towards the end of 2016 had come to a halt in recent months. In relation to the euro area, the European Central Bank had revised its inflation forecast down for the coming years. Consistent with this, external inflation was likely to remain low for a prolonged period.

The consumer price index was likely to remain around its current level in the summer months and then to rise slowly as the end of the year approached. To a smaller extent, the expansion in household consumption was expected to lead to higher core inflation and, to a greater extent, to a reduction in the trade surplus. Moderate imported inflation and historically low inflation expectations as well as the VAT reductions, announced recently, had been slowing the rise in domestic prices. In the baseline projection, the 3 percent inflation target was expected to be achieved in a sustainable manner half a year later, from early 2019.

The Hungarian economy had expanded dynamically, by 4.2 percent, in the first quarter of 2017 relative to the same period a year earlier. The main contributors to growth had been investment, industry and services, in addition to consumption. Based on available monthly data, Hungarian economic growth was likely to continue in the second quarter of 2017. Industrial production might weaken from its strong performance in the second quarter of 2016; however, the sector's performance was expected to improve in 2017 as a whole. Robust growth in construction was likely to continue in the coming months. In April, the volume of retail sales had continued to expand at a similar rate as at the beginning of the year. Labour demand had remained strong. Employment had risen slightly in the first quarter of 2017 and the unemployment rate had remained at historically low levels. Driven by the continued expansion in household consumption and the strong pick-up in investment activity, domestic demand would play an important role in economic growth. Hungary's current account surplus was expected to fall over the forecast horizon as a result of rising domestic demand. Economic growth this year would also be supported by the fiscal budget and the stimulating effects on investment of EU funding. The Monetary Council expected stable annual economic growth of between 3–4 percent over the coming years, to which the Bank's and the Government's measures to stimulate economic growth contributed substantially.

The Funding for Growth Scheme had ended at the end of March 2017. After it had been phased out, the transition to lending under market conditions was ensured by the Bank's Market-Based Lending Scheme introduced at the beginning of 2016 and extended in May 2017. In consequence, growth in lending to micro, small and medium-sized enterprises might be maintained in the upper half of the 5–10 percent range, deemed necessary for sustainable growth, over the medium term.

Sentiment in international financial markets had been mostly favourable since the Council's latest interest rate-setting meeting. Risk appetite had been mainly influenced by the French elections, the oil price agreement between OPEC members in line with expectations and by expectations related to the Fed's and ECB's monetary policy. In the euro area, market expectations on the interest rate path had shifted down, while the Fed's expected interest rate path had not changed markedly. Risk indicators and developed market equity indices had not changed significantly overall. The amount of liquidity crowded out due to the introduction of an upper limit on the stock of three-month deposits had continued to have a marked influence on domestic money market rates. As a result, the three-month BUBOR had remained at a historically low level. The interbank yield curve had shifted down slightly. Yields on domestic short-term government securities had been little changed, while there had been a decline at the middle and the long end of the yield curve of Hungarian government securities. Three and five-year yields had been around record low levels. Hungary's strong external financing capacity and the decline in external debt were contributing to the sustained reduction in the vulnerability of the economy. Forward-looking domestic money market real interest rates had fallen significantly over recent years and were expected to remain in negative territory for a prolonged period. In the Council's assessment, a watchful approach to monetary policy was still warranted due to uncertainty in the global financial environment.

In the Council's assessment, some degree of unused capacity had remained in the economy, but this was likely to be absorbed gradually as output grew dynamically. Over the forecast period, the inflation target was expected to be achieved in a sustainable manner half a year later, from early 2019.

In discussing the current decision, Council members noted that the June Inflation Report provided an opportunity for an overall assessment of recent developments in inflation, the real economy and the external monetary environment. In view of the June Inflation Report projection, the Council assessed that no event had occurred in terms of Hungarian economic fundamentals and the sustainable achievement of the inflation target which would warrant a change to the current level of the base rate or the interest rate corridor. Members pointed out that the unchanged base rate and maintaining the loose monetary conditions achieved through the change in monetary policy instruments were consistent with the baseline projection in the June Inflation Report, economic data released over recently as well as with the Monetary Council's previous communications and market expectations. Several members mentioned that the increase in global inflation at the beginning of the year had stalled and, based on current forecasts by central banks, inflation might remain below the target in several countries, including in the euro area, Hungary's most important trading partner, for a prolonged period. All this might result in lower imported inflation in Hungary than previously expected. In relation to domestic inflation developments, members noted that historically low inflation expectations and the VAT reductions, announced recently, were leading to a slower rise in the consumer price index. In addition, the effects of the dynamic wage increase had not yet been reflected in underlying inflation. These factors combined might add to downside risks to inflation. Members emphasised that special attention should be given to inflation developments at home and abroad as well as to the potential effects of the global environment on domestic inflation. Several members pointed out that there were both upside and downside risks to the macroeconomic outlook. More moderate global inflation than assumed in the baseline projection and stronger domestic investment activity might lead to a lower inflation path and more dynamic GDP growth, respectively.

In the Council's assessment, the operation of the monetary policy instruments, extended in July 2016, was successful; the limit set on the three-month deposit stock and its potential future change were considered to be integral parts of instruments. Members agreed that the HUF 300 billion upper limit on the stock of three-month central bank deposits as at the end of the third quarter of 2017 ensured that the amount of liquidity crowded out of the deposit facility and thereby the loose monetary conditions achieved were maintained. The Monetary Council intended to ensure that the limit imposed on the stock of three-month deposits exerted its expected effect on monetary conditions efficiently. The Bank managed uncertainties related to liquidity developments in the banking sector using fine-tuning operations introduced in October 2016 and extended with longer maturities in March 2017. The limit was set quarterly. On the next occasion, a decision on its level as at end of the fourth quarter of 2017 would be made in September 2017. Taking these factors into account, all members voted unanimously in favour of leaving the base rate, the overnight deposit rate, the overnight lending rate and the one-week lending rate unchanged.

If the assumptions underlying the Bank's projections held, maintaining the current level of the base rate and loose monetary conditions achieved through the change in monetary policy instruments for an extended period was consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy. In the Council's assessment, downside risks to inflation had increased with the change in the external environment. If inflation remained persistently below the target, the Council would stand ready to ease monetary conditions further using unconventional, targeted instruments.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight central bank lending rate and the one-week collateralised central bank lending rate at 0.90% **and**	8	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Bianka Parragh, László Windisch

maintaininging the overnight central bank deposit rate at -0.05%:		
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

László Windisch

The Council will hold its next policy meeting on 18 July 2017. The minutes of that meeting will be published at 2 p.m. on 2 August 2017.