MINUTES
OF THE MONETARY COUNCIL MEETING
18 JULY 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 from early 2019.

In June 2017, inflation had eased to 1.9 percent. The moderation in inflation had primarily reflected the decline in the price index for fuel, due in part to base effects. Core inflation had risen to 2.4 percent. 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. Global inflation had started to rise at the end of 2016, but had moderated in recent months. Price indices of the external environment and particularly that of the euro area were likely to remain low for a prolonged period.

The consumer price index was likely to remain near its current level over the remainder of this year. 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 rate cuts, announced for next year, 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 from early 2019.

According to recent monthly data, Hungarian output growth had continued in the second quarter of 2017. Industrial production had risen significantly in May; and the sector's performance was expected to pick up in 2017 as a whole. Robust growth in construction was likely to continue in the coming months. In May, the volume of retail sales had picked up. Labour demand had remained strong. Employment had been broadly unchanged during the spring of 2017 and the unemployment rate had remained at historically low levels. Driven by the continued expansion in household consumption and the strong growth in investment activity, the increase in domestic demand would continue to play a central role in economic growth. Hungary's current account surplus was expected to fall over the forecast horizon in response to 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 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 in early 2016 and extended in 2017. At the tender held in the second phase of the Scheme in July, commercial banks had raised their lending commitment by one-third. This would ensure that growth in lending to SMEs was maintained in the upper half of the 5–10 percent range, deemed necessary by the MNB for sustainable economic growth.

Sentiment in international financial markets had been calm for most of the period since the Council's latest interest rate decision. Risk appetite had been influenced mainly by expectations related to the Fed's and the ECB's monetary policy. Market expectations on both the ECB's and the Fed's interest rate path had shifted up. Overall, risk indicators had been unchanged and developed market equity indices had fallen. 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 steepened. Yields on short-term government securities up to one-year maturity had been little changed, while there had been an increase at the long end of the yield curve of Hungarian government securities. Three and five-year yields were near 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 from early 2019.

In discussing the current decision, the Council judged that no event had occurred since the previous rate decision 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, the Monetary Council's previous communications as well as with markets' and economists' expectations. All members noted that downside risks continued to be identified primarily due to the external environment. Members pointed out that special attention should be given to global inflation and financial market developments, as well as to current and expected future monetary policy of developed country central banks, in particular the ECB and the Fed.

At its meeting in June 2017, the Council had set a HUF 300 billion upper limit on the stock of three-month central bank deposits as at the end of the third quarter of 2017, in order to preserve the amount of liquidity crowded out of the deposit facility, and thereby to maintain the loose monetary conditions achieved. The MNB had 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 set on the three-month deposit stock and its potential future change were considered to be integral parts of instruments. The Bank continued to aim to maintain loose monetary conditions and provide a corresponding degree of support to the economy through money market rates. 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 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, the external environment continued to pose a downside risk to inflation. 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 collateralised central bank lending rate and the one-week collateralised central bank lending rate at 0.90% **and** **maintaininging the overnight central bank deposit rate at -0.05%:**	8	Gusztáv Báger, Ferenc Gerhardt, Kolos Kardkovács, György Kocziszky, Márton Nagy, Bianka Parragh, Gyula Pleschinger, László Windisch
Vote against:	0	

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

Gusztáv Báger

Ferenc Gerhardt

Kolos Kardkovács

György Kocziszky

Márton Nagy

Bianka Parragh

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 22 August 2017. The minutes of that meeting will be published at 2 p.m. on 6 September 2017.