MAGYAR NEMZETI BANK

10 February 2003

Statement by the Monetary Council

Disinflation is expected to come to a halt in 2003.

In the judgement of the Monetary Council, developments since the publication of the previous Report may lead to higher-than-expected inflation in 2003. The Bank currently forecasts inflation in 2003 to be above the target band set earlier and to be in the upper range of the band in 2004. Given the current macroeconomic outlook, prices are expected to increase at an annual rate of around 5% in December.

The factors affecting inflation are slower growth and higher wage increases, lower-than-expected fiscal correction and rising oil prices.

Unfavourable developments in global economic activity and the related slower annual growth in GDP, expected to be around 3.5%, constitute downward pressure on inflation. By contrast, wage growth, faster than the improvement in productivity, exerts inflationary pressure. Due to the composition of fiscal deficit reduction, the contractionary impact on demand will contribute to disinflation less strongly than expected. In addition, crude oil prices have increased considerably.

Disinflation is expected to resume in 2004.

In the Bank’s projection, inflation may fall to a level around 4% by end-2004. Furthermore, disinflation may gain renewed momentum as fiscal policy is to implement further significant measures next year to contract demand, consistent with the path designated by the Government's medium-term economic policy programme (PEP). The Bank also expects that, forced by the higher wage growth and slower economic activity in 2003, firms will set wages in 2004 in a more disciplined manner. The global economic outlook appears to be less favourable than forecast earlier. Accordingly, GDP growth is expected to remain at roughly 3.5% in 2004. In the Monetary Council’s assessment, the balance of risks to inflation in 2004 is on the downside, as international oil prices are likely to return to earlier levels.

The Bank's instruments available to foster disinflation are limited. Therefore, holding wage increases under control and fiscal rigour will have a greater role to play in reducing inflation.

The repercussions of the failed speculative attack launched to enforce a revaluation of the central parity are influencing monetary conditions.

Significant amounts of speculative capital flowed into Hungary on 15–16 January, with the purpose of enforcing a revaluation of the currency's central parity. However, Magyar Nemzeti Bank successfully countered the speculative attack. As the after-effects of the incident, the Bank anticipates lasting abundance of market liquidity, which, in turn, points to a weaker forint exchange rate.

Due to constraints implied by the exchange rate band, the Council accommodates an inflation rate of around 4% in December 2004. Achieving this requires no tightening of monetary conditions.

Fiscal policy has restricted abilities to adjust over the short-term, and monetary policy has no power to speed up disinflation, due to the constraints implied by the exchange rate band. Therefore, the Monetary Council perceives a need to interpret the inflation target set for 2004 in the context of monetary policy's limited latitude. Accordingly, the Monetary Council accommodates an around 4% rate of inflation at end-2004. Thus, there is no need to change the current monetary conditions.