MINUTES
OF THE MONETARY COUNCIL MEETING
25 JUNE 2019

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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, but at least twice a month, according to a pre-announced schedule. At the second scheduled meeting each month, members consider issues relevant to decisions on interest rates. 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

The Magyar Nemzeti Bank's (MNB) single anchor was inflation, its primary objective was to achieve and maintain price stability. The factors determining inflation continued to show volatility. Therefore, in assessing the outlook, the Monetary Council paid more attention to the measures of underlying inflation capturing persistent trends. In May 2019, inflation had been 3.9 percent, while core inflation and core inflation excluding indirect tax effects had stood at 4.0 percent and 3.7 percent, respectively. The rise in core inflation excluding indirect tax effects had reflected an increase in the rate of market services and processed food prices.

A dichotomy remained between the factors determining likely developments in inflation. Buoyant domestic demand was boosting, and, from the second half of the year, weakening external activity was likely to restrain the pace of price increase. Consistent with this, core inflation excluding indirect tax effects was expected to rise slightly in the coming months, and then, due to external disinflationary effects, to decline gradually to 3 percent from the end of 2019. The increase of excise duty on tobacco products on a six-monthly basis, which was outside the scope of monetary policy, was likely to raise the consumer price index over the entire forecast horizon. This measure did not cause any second-round effects, consequently, did not influence changes in core inflation excluding indirect tax effects.

The Hungarian economy had grown by 5.3 percent in the first quarter of 2019, mainly driven by market services, industry and construction. On the expenditure side, in addition to household consumption and investment, net exports had also contributed positively to economic growth. Labour demand had remained strong, and the unemployment rate had been close to its historically low level. Based on monthly preliminary data, the current account had remained in surplus in the first quarter of 2019.

Economic growth was expected to slow gradually from the middle of the year, but to remain strong. Subdued economic activity in Europe from the second half of the year was also reflected in the slowdown of growth in Hungary. The Hungarian economy was expected to grow by 4.3 percent in 2019 and by 3.3 percent in 2020. As a result of further dynamic growth in credit markets, the investment rate was likely to continue to rise and stabilise at high levels in the coming years. Regarding long-term, sustainable economic growth, the improvement in competitiveness by structural measures would be given increasing emphasis.

In addition to monetary policy, the new retail government security strategy, the 2020 draft budget and the provisions of the Economy Protection Action Plan to improve competitiveness, were aimed at further strengthening macroeconomic stability and sustainable convergence. The Hungarian Government Security Plus, introduced in June, was expected to raise households' savings rate, in addition to the structural change of their financial assets. Consequently, an increasing share of rapid wage growth was converted into savings instead of consumption, while the promotion of self-financing also helped to reduce Hungary's external vulnerability. Based on the draft legislation for next year, the budget deficit-to-GDP ratio – with a significant amount of reserves – was likely to decline to 1 percent. After 2019, fiscal policy would remain counter-cyclical in 2020 as well. Announced in recent weeks, the Economy Protection Action Plan was expected to gradually improve the competitiveness of the domestic economy. The above measures jointly strengthened macroeconomic stability, reduced external vulnerability, and contributed to maintain a sustainable convergence path.

GDP data for the first quarter of 2019 had exceeded expectations in many cases; however, the outlook for global economic activity had continued to deteriorate in recent months. Monetary policies across the world's leading central banks were increasingly cautious. Consistent with the downside risks related to economic activity in Europe and the euro area, after March, the European Central Bank (ECB) had modified its forward guidance again in June. According to communications from the ECB, the first interest rate hike had shifted to an even later date: interest rates would remain at their present levels at least through the first half of 2020, and beyond. Based on the President's latest indications, a growing number of market agents were pricing in the loosening of monetary conditions. In the case of the Federal Reserve, market agents clearly expected an interest rate cut this year, while the Bank of Japan was likely to maintain its loose monetary policy for a longer period of time than earlier expected.

Sentiment in international financial markets had been volatile in the period since the Council's previous interest rate decision. Risk appetite had been influenced by developments in international trade policies, incoming macroeconomic data and measures taken by the world's leading central banks. Oil prices had decreased significantly in the last month.

To improve the effectiveness of monetary policy transmission, the Monetary Council would launch its corporate bond purchasing programme with a total amount of HUF 300 billion on 1 July 2019. By introducing the Bond Funding for Growth Scheme (BGS), the Council's specific objective was to promote the diversification of funding to the domestic corporate sector. Companies had shown considerable interest in bond issuance since the programme had been announced at the end of March. As a result of the BGS, complementing the Funding for Growth Scheme Fix launched at the beginning of 2019, funding conditions and liquidity of the corporate bond market were expected to improve significantly, offering an effective alternative to funding from banks. The MNB would neutralise excess liquidity arising from bond purchases by using the preferential deposit facility bearing interest at the central bank base rate.

Following the review of macroeconomic and money market developments as well as the Inflation Report projection, the Monetary Council discussed the details of the current monetary policy decision. Several members pointed out that the factors determining inflation continued to show great volatility. Therefore, in assessing the outlook, the measures capturing persistent trends still had to be monitored closely. The decision-makers agreed that inflation was likely to be influenced by positive and negative effects in the coming quarters, as well. Persistently buoyant domestic demand was boosting, and disinflationary effects resulting from weakening external activity were likely to restrain the pace of price increase from the second half of the year. Members stressed that, in addition to these two effects, the increase in the excise duty on tobacco products on a six-monthly basis was likely to raise the domestic consumer price index over most of the forecast horizon. Nevertheless, decision-makers also agreed that second-round inflationary effects could not be expected; therefore, the measure was outside the scope of monetary policy.

The members emphasised that the macroeconomic outlook was characterised by symmetric risks. Stronger wage growth and a more dynamic increase in consumption than assumed in the June Inflation Report baseline projection might result in more robust economic growth and higher inflation. By contrast, increasing risks surrounding economic growth in the euro area might lead to more moderate economic growth and stronger external disinflationary effects.

Members unanimously emphasised that several factors, fundamentally influencing the macroeconomic environment of Hungarian monetary policy, were likely to exert their effects in the second half of the year. In terms of external effects, the extent of the slowdown in the European economic activity and its prospective disinflationary effects in Hungary would be closely monitored in the coming months. Closely related to the developments in the international macroeconomic environment, monetary policy of the world's leading central banks was also changing, which was likely to have an effect on the perception of emerging regions. In terms of economic developments in Hungary, the initial success of the new retail government security (MÁP Plusz) was already visible; however, persistent effects on savings could only be assessed in the coming quarters. Finally, counter-cyclical fiscal policy might influence the cyclical position of the economy and the inflation outlook.

In consideration of the volatile factors determining inflation and the risks emerging at different times which characterise the macroeconomic environment, members agreed that cautious and moderate changes were required. Accordingly, the Council decided to leave the base rate and the interest rate corridor unchanged, and to reduce the liquidity to be crowded out by HUF 100 billion. The Monetary Council reviewed liquidity developments in the interbank market. In this context, members noted that the Council was ready to make changes to the stock of FX swap instruments in a flexible manner to ensure proper interest rate transmission and to mitigate the volatility of interbank rates. Decision-makers emphasised that monetary policy was to face an uncertain and – from both macroeconomic and monetary policy perspectives – fast-changing environment in the coming quarters. Against this backdrop, decision-makers unanimously argued that a data-driven and cautious approach was likely to be warranted over the coming period.

The Monetary Council left the base rate, the overnight collateralised lending rate and the one-week collateralised lending rate at 0.9 percent and the overnight deposit rate at -0.05 percent unchanged. In addition, in June, the Council had reduced the average amount of liquidity to be crowded out for the third quarter by HUF 100 billion, from the former HUF 300-500 billion band to at least HUF 200-400 billion and would take this into account in setting the stock of central bank swap instruments. The MNB was ready to change the stock of the FX swap instrument in a flexible manner to ensure that the interest rate transmission changed in line with the decisions by the Monetary Council, and the volatility of interbank rates remained at low levels.

In its decisions, the Monetary Council focused on the maintenance of price stability. The monetary policy stance would continue to be accommodative, economic agents' financing costs would remain favourable. A dichotomy remained between the factors determining likely developments in inflation. Buoyant domestic demand was boosting, and, from the second half of the year, weakening external activity was likely to restrain the pace of price increase. Regarding the outlook for inflation, data to be received in the second half of the year would be decisive. Of these, the following were of key importance: the spillover of disinflationary effects of slowing European economic activity, changes in monetary policies of the world's leading central banks, the effect of the new retail government security on savings, and the economic consequences of counter-cyclical fiscal policy. The Monetary Council would assess their effects on the maintenance of price stability over the 5-8 quarter horizon of monetary policy. In its monetary policy decisions, the Council applied a cautious approach, relying mainly on the comprehensive projections for the macroeconomy and inflation of the quarterly published Inflation Report. The future developments in the outlook for inflation would be a decisive factor in the necessity of further measures.

Votes cast by individual members of the Council:

In favour of maintaining the base rate, the overnight collateralised lending rate, the one-week collateralised lending rate at 0.9 percent **and** **maintaining the interest rate on the overnight central bank deposit at -0.05 percent:**	9	Gusztáv Báger, Kolos Kardkovács, György Kocziszky, György Matolcsy, Márton Nagy, Bianka Parragh, Mihály Patai, Gyula Pleschinger, László Windisch
Vote against:	0	

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

Gusztáv Báger

Kolos Kardkovács

György Kocziszky

György Matolcsy

Márton Nagy

Bianka Parragh

Mihály Patai

Gyula Pleschinger

László Windisch

The Council will hold its next policy meeting on 23 July 2019. The minutes of that meeting will be published at 2 p.m. on 7 August 2019.