

Monetary and Statistics Department
Monetary Policy and Strategy Division

While the FED continues to raise rates, the ECB – given the euro's rally against the dollar – is leaving its rates unchanged. A strengthening exchange rate led the National Bank of Slovakia to lower its rates. The Hungarian central bank cut its rates, too. The RBNZ is trying to rein in the growth of the New Zealand economy (driven chiefly by housing investment) by tightening monetary policy. In Spotlight we look in more depth at the situation around the amendment to the Hungarian Central Bank Act, which could undermine the MNB's independence.

1. Developments in the last three months and expected future information

	Inflation target ¹	Latest inflation	Current basic rate	MP meeting date/rate change/ expectation ²	Next MP meeting/ expectation ³	Other expected events
Euro area (European Central Bank, ECB)	<2.0%	2.2% (Nov 2004) ⁴	2.00%	7 Oct/0.00 4 Nov/0.00 2 Dec/0.00 /→	13 Jan 3 Feb 3 Mar /→	3 Mar: new interim forecast to be published
Sweden (Sveriges Riksbank)	2.0%	0.8% (Oct 2004)	2.00%	13 Oct/0.00 8 Dec/0.00 /→	27 Jan 14 Mar /↗	15 Mar: publication of IR ⁵
United Kingdom (Bank of England, BoE)	2.0%	1.2% (Oct 2004)	4.75%	6–7 Oct/0.00 3–4 Nov/0.00 8–9 Dec/0.00 /↗	12–13 Jan 9–10 Feb 9–10 Mar /↗	16 Feb: publication of IR, including new forecast
Hungary (Magyar Nemzeti Bank, MNB)	3.5%	6.3% (Oct 2004)	10.00%	20 Sep/0.00 18 Oct/-0.50 22 Nov/-0.50 /↘	20 Dec 17 Jan ⁶ 21 Feb ⁶ /↘	21 Feb: ⁶ publication of IR, including new forecast
Poland (National Bank of Poland, NBP)	2.5%	4.5% (Oct 2004)	6.50%	28–29 Sep/0.00 26–27 Oct/0.00 23–24 Nov/0.00 /↗	21–22 Dec 25–26 Jan 22–23 Feb /↗	
Slovakia (National Bank of Slovakia, NBS)	n/a	6.3% (Nov 2004)	4.00%	23 Sep/0.00 29 Oct/0.00 26 Nov/-0.50 /↘	21 Dec 28 Jan 25 Feb /→	MP meeting dates: situational report on monetary developments to be issued
USA (Federal Reserve System, Fed)	n/a	3.2% (Oct 2004)	2.00%	21 Sep/+0.25 10 Oct/+0.25 /↗	14 Dec 1–2 Feb /↗	
New Zealand (Reserve Bank of New Zealand, RBNZ)	2.0%	2.5% (3Q2004)	6.50%	28 Oct/+0.25 9 Dec/0.00 /→	27 Jan 10 Mar /→	10 Mar: new forecast to be published

¹ inflation target valid for the current period

² the direction of the expected change in rates in the past quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey)

³ provisional meeting dates. The direction of the expected change in rates in the coming quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey)

⁴ Eurostat's flash estimate

⁵ Inflation Report

⁶ estimated date – exact calendar not yet published

2. News

[ECB speaks out against strong euro](#)

ECB President Jean-Claude Trichet made repeated verbal interventions in November against the euro's growing strength against the dollar, describing it as "brutal" and "unwelcome". His comments had only a temporary effect, however, and so the calls for market intervention by the ECB are growing louder. Given the Fed's restrained stance, it is unlikely that it would back any ECB intervention.

[BoE reforms its money market operations ...](#)

The BoE published a study in November proposing changes in the way it conducts monetary policy. The objective of the reforms is to ensure flexible, efficient and transparent monetary policy-making. The main change is a switch from daily two-week-maturity repos to weekly one-week-maturity repos. This would mean that instead of the current twenty or so auctions a month, only four or five would be held, one of which would always end on the date of the Monetary Policy Committee meeting. This change is intended to reduce the difference between market rates and the rates announced by the bank and to decrease the possibility of risk-free profit.

[... and axes its banking services](#)

As part of an earlier announced measure to concentrate more on its core purposes – monetary policy and financial stability – the BoE is to withdraw from providing financial services (keeping accounts and settling transactions) to commercial and state customers such as government departments, building societies and other companies. The BoE envisages this happening in around two years' time. Apart from BoE staff, the sole exception will be Huntingdon Life Sciences, an animal testing company, which will continue to bank with the BoE. High street banks are refusing to provide services to this company after being targeted by animal rights extremists.

[Magyar Nemzeti Bank defends its independence ...](#)

An amendment to the MNB Act tabled by the Hungarian government and passed by parliament has introduced several measures that could undermine the MNB's independence. See the *Spotlight* section for more details.

[... and sets target for 2006](#)

In the context of the amendment to the MNB Act, it is interesting to note that at the start of November the MNB and the government jointly set a new inflation target for the end of 2006 of $3.5\% \pm 1$ percentage point. The new target is at the same level as the 2003 and 2004 targets, but 0.5 percentage point lower than the 2005 one.

[National Bank of Poland publishes monetary policy guidelines for 2005](#)

The NBP has been publishing such guidelines – intended primarily to set out the central bank's objectives for the coming calendar year – since 2000. For the first time the new Monetary Policy Council drew up the guidelines for next year. For this reason they contain an interpretation of the inflation target published in *Monetary Policy Strategy beyond 2003* ($2.5\% \pm 1$ percentage point). The guidelines state explicitly, among other things, what sort of shocks monetary policy will react to, and when it will react only to their second-round effects and when to their primary effects as well. It also specifies the current monetary policy transmission lag (5–7 quarters) and generally emphasises forward-looking monetary policy.

[National Bank of Slovakia changes Board line-up](#)

At the end of September, the Slovak government appointed four new members to the NBS Bank Board. Mr Peter Ševčovic and Mr Ladislav Balko took up their new posts at the start of October and Mr Martin Barto began at the start of December. Mrs Milena Koreňová will assume her duties at the start of January. As Slovakia plans to join the euro area in 2009, the appointments are unlikely to lead to any major change in the NBS's monetary policy system.

[Riksbank alters its management method ...](#)

In October, the Riksbank's Executive Board decided to change the way the bank is managed. The Board members' current responsibility for running individual departments within the bank was giving rise to excessively close links between the Board members and their departments, leaving them without enough scope to focus on their work on the Riksbank's central policy areas, namely monetary policy and the payment system. The Board therefore decided to replace this responsibility for running departments with responsibility for specific tasks, such as the publication of the Inflation Report and Financial Stability Report and the preparation of background material for the Board's monetary policy decisions. The day-to-day operations of the bank will be managed by a management group consisting of heads of departments. The chairman of this management group will be the head of the General Secretariat, Mats Galvenius.

[... and refines its Financial Stability Report](#)

The Riksbank can be described as a pioneer in the financial stability area. In 1997 it was the first central bank to publish a separate publication devoted to this issue, and it was one of the first to put in place new procedures to deal with financial crises. This year the Riksbank voluntarily subjected its Report to an independent assessment, culminating in ten specific recommendations. These include more detailed analysis of the nonbank financial sector (most notably the insurance sector), macroeconomic developments in neighbouring countries and analysis of the effect of public policy on the vulnerability of the financial system.

More and more central banks are publishing financial stability reports (FSRs). Two banks issued their first FSRs in October alone (the [NBS](#) and the [RBNZ](#)). The Czech National Bank published its first such report in January 2004.

[China puts brakes on economy by raising rates](#)

The People's Bank of China (PBC) raised interest rates in October, the first change in nine years. The measure is aimed at reining in economic growth, which is close on 10% at present. The step meanwhile prompted speculation that the next step might be a relaxation of China's fixed exchange rate, as the expected subsequent appreciation would depress economic growth. However, PBC representatives say that the move towards a more flexible yuan will proceed only gradually. The most recent step in this direction was a decision to increase the ceiling on the amount of currency people can take out of China from 6,000 yuan to 20,000 yuan.

[Romania opts for more flexible exchange rate](#)

The National Bank of Romania (NBR) decided at the end of October to limit its interventions in the forex market and to stop publishing its exchange rate appreciation forecast. This decision is in line with the NBR's overall strategy to switch to inflation targeting in mid-2005 and with the gradual liberalisation of Romania's capital account. The NBR believes that a continuing real appreciation trend will foster a further fall in inflation.

3. Spotlight: Magyar Nemzeti Bank defends its independence

Since October the Hungarian central bank has been facing a threat of reduced independence. An amendment to the MNB Act tabled by the government and passed by parliament has introduced several measures that could undermine the MNB's independence.

Events leading up to the proposed amendment

The first signs of a rift between the government and the central bank emerged in the early autumn, just days after the appointment of the new government. First, Finance Minister Tibor Draskovics made remarks criticising central bank policy. Then the Hungarian parliament rejected the MNB's report on measures taken in 2002 and 2003. And then the bank came under heavy criticism from Prime Minister Ferenc Gyurcsany. The ruling party has thus taken quite an outspoken stance on the MNB, accusing it of harming the Hungarian economy through inadequate economic policy co-ordination and monetary policy inflexibility. The conflict between the socialist government and the MNB had been bubbling away since 2002, but was kept under control by the previous independent premier, Peter Medgyessy.

The gist of the amendment

The conflict resulted in a government bill to amend the MNB Act. The Hungarian parliament began debating the bill on 20 October and passed it in slightly revised form on 22 November. At the end of November the President sent the amendment back to parliament to be rewritten, but did not ask the Constitutional Court to review it. This has opened the door for the ruling party to approve it again, at which point it will enter into force. Parliament can be expected to pass it by the end of this year.

The proposed amendment to the MNB Act is the fifth since May 2002, a fact which, according to the MNB, in itself endangers monetary policy stability. The amendment contains several provisions that can be interpreted a loss of part of the MNB's independence from the government.

The main bone of contention is a change in the way the MNB's Monetary Council members are appointed. The number of members is to be increased from seven to nine to nine to eleven, and the way in which they are appointed (and dismissed) is to change. Previously, the Governor was nominated by the Prime Minister, while the three Deputy Governors were ex officio members and the five other members were nominated by the Governor after consultation with the Prime Minister. Following the changes, the Governor will still be nominated by the Prime Minister, but there will be only one ex officio member. Four members will be nominated by the Governor (with the Prime Minister having a right of veto) and the remaining three to five by the Prime Minister (without the Governor having a right of veto). The appointments themselves will be made by the President, who, as previously, will not have the power to reject those nominated.

The government's role in appointing the Council does not in itself endanger the bank's independence, as a similar approach is applied in other countries (for example, four members of the BoE's MPC are appointed by the Chancellor of the Exchequer). But the circumstances and arguments used to justify this change give rise to concerns that the new rules will undermine the MNB's independence. Above all, the government's argument that it is unhappy with the decisions of the current Council is, according to the MNB, directly at odds with the domestic and European legislation requiring Council members to be independent. The MNB is also concerned about the high number of Council members proposed, which could impair the Council's decision-making efficiency. Under the amendment's transitional provisions, which allow the government to appoint new Council members before the term of office of the current Deputy Governors elapses, the number of members could rise to as many as 13.

The amendment also gives one Deputy Governor the privileged position of responsibility for monetary policy. The MNB views this as unconstitutional, as under the constitution the MNB, represented by the Council, is collectively responsible for defining and implementing monetary policy.

The Council members' independence is further impaired by the fact that the amendment requires them to submit a wealth declaration within 30 days of being elected and every year thereafter. This duty is linked to the Act on the Legal Status of Public Sector Workers, which gives the Prime Minister and his office considerable powers to obtain information on assets. The MNB says that this is inconsistent with the Data Protection Act.

The ECB's position

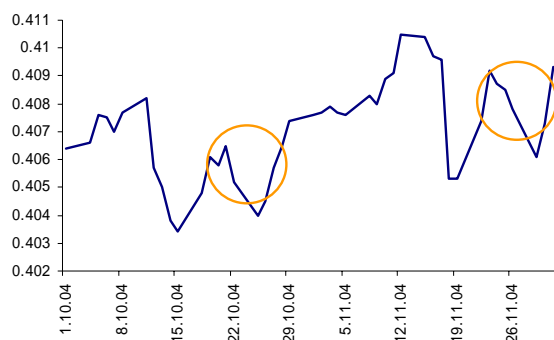
The Hungarian finance ministry requested a consultation with the ECB in line with EU law. The resulting ECB opinion can be summed up as follows. First, the ECB states that the law in its present form is sufficient to ensure independent monetary policy. Second, the ECB sees no need to separate the executive management from the Monetary Council, i.e. it does not accept the argument used by the Hungarian government to support its proposal. Third, the ECB warns against harming the MNB's credibility, something that would occur if the present Council members were dismissed before the end of their term of office. The ECB also says that the Council members should be appointed at different times, not "en bloc", so as to maintain continuity in the membership of the Council.

The ECB's opinion was worded rather vaguely, so it is little wonder that the finance ministry and the MNB interpreted it differently. The finance ministry welcomed that the ECB had no reservations about the amendment's main points and that it believed the central bank's independence would not be affected, while the MNB felt that the ECB's opinion confirmed that the Act needed no revision. Some of the ECB's comments are partially reflected in the approved version of the Act.

The response of the financial markets

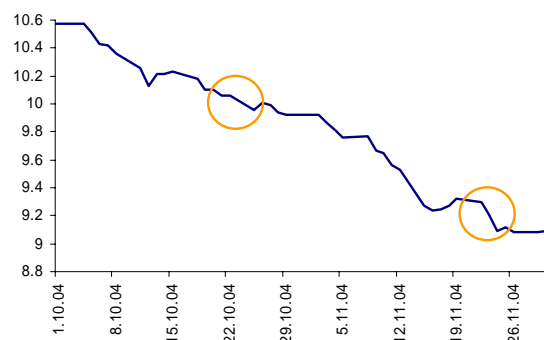
The events surrounding the approval of the amendment to the MNB Act had only short-lived effects on the exchange rate and interest rates, as swings in one direction were always followed by corrections. This is clearly visible in the following charts, in which the period following the start of the debate on the new law and the period following its adoption by parliament are highlighted.

Chart 1: The forint



Source: Bloomberg

Chart 2: One-year interest rates



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info@cnb.cz