FROM THE PANDEMIC TO THE RESTART

CRISIS MANAGEMENT MEASURES OF THE MNB

2021 June

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Extraordinary crisis, historic measures

In early 2020, coronavirus became a global pandemic, forcing governments and central banks to introduce historical scale crisis management measures. The global economic impact of the pandemic was unprecedented. Therefore governments greatly increased their budget deficit, thereby supporting the economy, while central banks provided liquidity to all players in the economy and fostered economic recovery as the pandemic is calming down.

The Hungarian economy was hit by the coronavirus pandemic with a strong immune system, owing to the economic policy measures introduced in the previous decade. Hungary's financial system faced the 'invisible enemy' in a resilient and stable position thanks to the steps taken by the Magyar Nemzeti Bank.

The coronavirus pandemic has caused a triple crisis: economic, health and psychic, the latter caused by fear. Financial crisis similar to 2008/2009 has been avoided by strong, proactive and preventive economic policy measures.

The MNB responded to the shocks caused by the coronavirus in a timely, targeted, flexible and appropriate manner:

- *The MNB immediately stabilised markets at the beginning of the pandemic.*
- *Since the appearance of the coronavirus pandemic, it has provided one of the largest amount of funds to economic operators relative to GDP in international comparison, to overcome difficulties.*
- *To make everyday life easier and protect people's health during the pandemic, steps taken by the MNB encouraged transactions without physical contact.*
- *Later, it decided to introduce measures promoting economic recovery and pave the way for economic growth.*

As vaccination progresses, the focus may now be shifted to restarting the economy, before focusing on restoring economic balances. In the 21st century, rapid economic growth is not satisfactory, a development path needs to be taken that is sustainable over the long term from a financial, environmental and social perspective as well.

The past 18 months in numbers

The **MNB** provided liquidity
of **HUF 9311 billion** to economic actors
until the end of May 2021:

18 percentage points

The MNB's balance sheet to GDP ratio rose by 18 percentage points

500 HUF bn

The MNB supported the budget by paying HUF 500 billion in dividends

2200 HUF bn

Government securities purchases for over HUF 2,200 billion until the end of April 2021

2800 HUF bn

Liquidity of over HUF 2,800 billion to almost 40,000 SMEs under the FGS Go! scheme until the end of May 2021

Strong growth in lending in 2020:

a rise of 9.4 per cent and 14.5 per cent in the corporate and household segments, respectively.

9.4%

CORPORATE

14.5%

HOUSEHOLD

At the MNB's proposal, the Government introduced the payment moratorium

left around HUF 1600-1700 billion with households and the business sector by the end of 2020 and is expected to leave approximately HUF 700-800 billion with borrowers by the end of June 2021.

1600–1700 HUF bn

(2020)

700–800 HUF bn

(by the end of June 2021)

91%

91% of **card payments** were conducted without physical contact,

as the MNB initiated to raise the limit of contactless card payment without PIN.

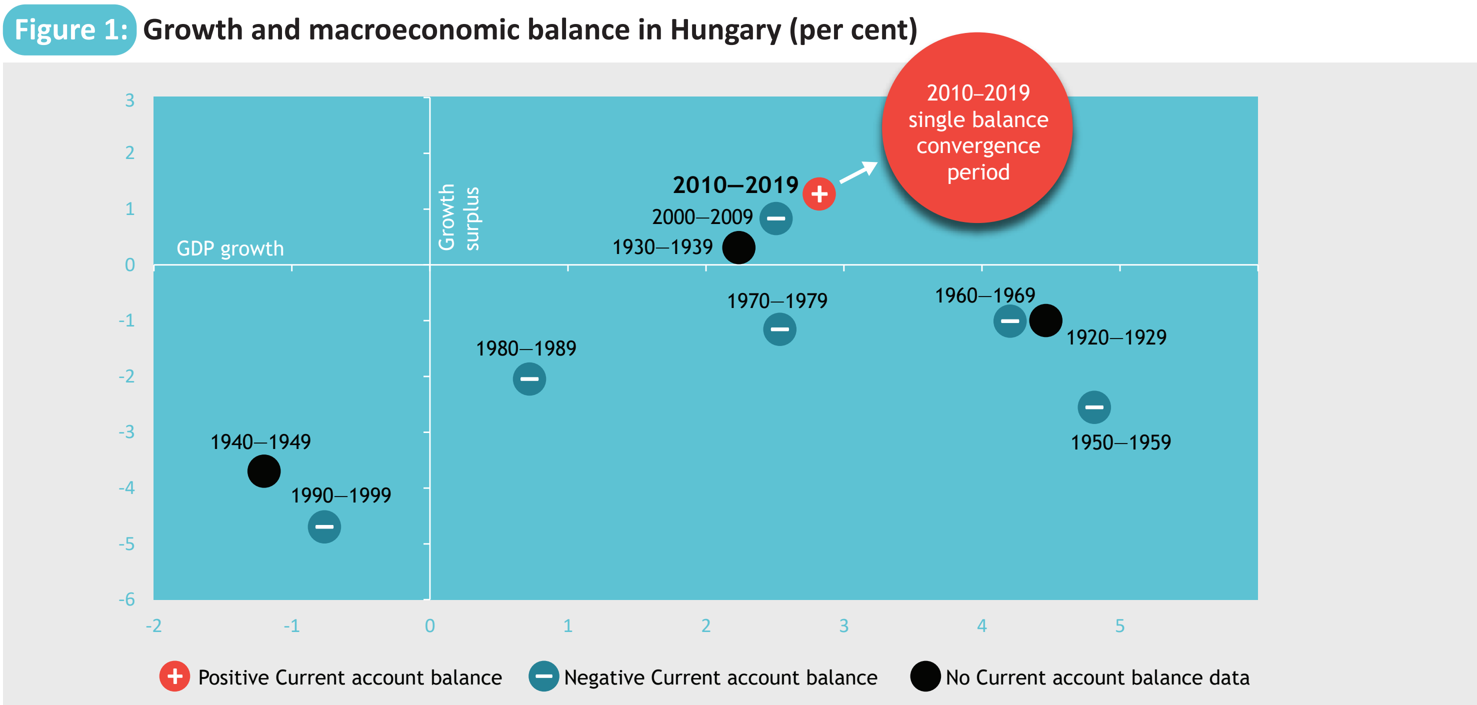
1. Thanks to the success of the formula of balance and growth, Hungary was hit by the COVID crisis with a strong immune system

From an economic perspective, the past decade has been the most successful in the last century.

In the past 100 years, this was the first time when the formula of economic growth and balance was implemented and sustained persistently. The key to the success was the labour market reform and thus the approximation of full employment. At the beginning of the century, the reform of the budget and the tax system and the implementation of the Széll Kálmán plans were launched in this spirit, and this was also supported by the turnaround in monetary policy and lending that unfolded from 2013. By 2019, the Hungarian employment rate, which had been at the bottom of the rankings, had risen to the top of the region and above the EU average. Economic growth was more than 2 percentage points above the EU average, while the country's balance indicators also improved. Hungary's level of economic development rose from 66 to over 73 per cent of the EU average, overtaking Poland and Slovakia again.

The improvement in the balance position of the Hungarian economy was reflected in all key indicators. The MNB achieved unique success in meeting the inflation target: there were only four months in 2017–2020 when inflation was outside the 3 per cent ±1 percentage point tolerance band. The Government and the Hungarian Banking Association jointly, phased out household FX loans and the Bank improved the power and efficiency of financial supervision. The regulation of the banking system also underwent a major change, leading to much better, and in certain cases even certified, products for customers, while banks' capital position and resilience improved. The budget deficit steadily fluctuated around 2 per cent, government debt contracted considerably, while the share of FX debt shrank below 20 per cent. At the same time, all external balance indicators improved significantly, confirming the stability of the country. As a result, the Hungarian economy was hit by the coronavirus pandemic with a strong immune system.

Figure 1: Growth and macroeconomic balance in Hungary (per cent)



Source: MNB calculation based on Maddison and Eurostat.
Note: Historical growth surplus relative to Austria.

2. Financial stability was successfully maintained

Since 2013, the central bank's measures have made the operation of the financial system much healthier than before. This means more predictable and safer products for customers, and a more crisis-proof operation for banks. This new system has performed well in the past little over one year, **as the Hungarian financial sector faced the coronavirus pandemic with much greater resilience than it did the previous crisis.** The central bank also responded well to short term challenges.

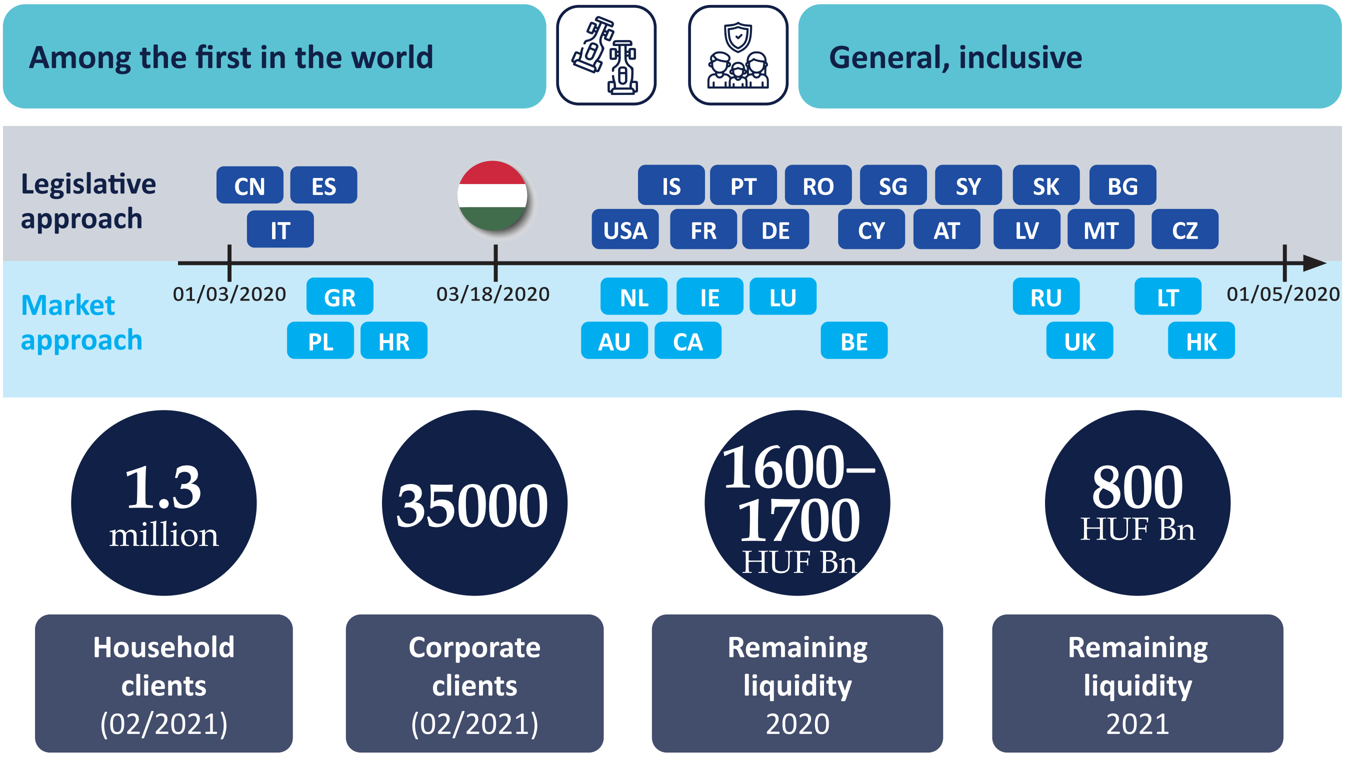
In response to the new risks arising in the coronavirus pandemic, the government and the MNB immediately introduced measures to maintain lending:

- **Capital requirements:** The temporary easing of capital requirements and the call for postponing dividend payments enabled banks to continue lending, despite the potential increase in losses. The MNB's measures more than doubled the free capital stock available for boosting lending activity.
- **Liquidity requirements:** The MNB temporarily tightened the domestic liquidity and financing requirements targeting FX funding risks, which ensured an appropriate level of stable funding in a turbulent environment in a pre-emptive manner.
- **Moratorium:** In line with the MNB's proposal, the moratorium on loan repayments introduced by the government eased the liquidity shortages of households and companies alike, and supported the continuation of consumption and investments, since the start of the first wave of the pandemic. In February 2021, some 1.3 million retail customers and 35,000 firms took advantage of the moratorium, representing 50 per cent of eligible household loans and around 34 per cent of eligible corporate loans that were disbursed until 18 March 2020. As a result, around HUF 1,600–1,700 billion remained with households and companies for consumption, investment or even saving until the end of 2020, and HUF 700–800 billion until June 2021 due to the extension of the programme.

Stability paid off, allowing the banking system to lend even during the crisis that occurred due to the pandemic.

In 2020, the outstanding corporate credit stock increased dynamically, by 9.4 per cent in annual terms, while the household loan portfolio recorded an even faster annual growth rate of 14.5 per cent, which was exceptional in the whole EU.

Figure 2: **Main features and effects of the payment moratorium in Hungary**



Source: IMF, ESRB, websites of national authorities, MNB.

3. The MNB responded at the right time and with massive firepower, thereby supporting the rapid economic recovery

The Magyar Nemzeti Bank faced several challenges, as the stability of the markets had to be preserved, economic stimulus measures were necessary to help the recovery, and new challenges surrounding its primary objective, price stability, also had to be addressed. This required an even more complex, targeted and flexible monetary policy response than before. The central bank had made this possible with well-considered policies in earlier years. The MNB responded to the negative impact of the coronavirus pandemic by using a wide range of instruments at its disposal, employing tools already used before the coronavirus pandemic and also new, targeted ones.

The MNB responded to the money market and real economy shocks caused by the coronavirus pandemic in a timely, targeted, flexible and appropriate manner.

First, the central bank immediately had to stabilise markets:

- **By expanding the scope of eligible collateral,** the MNB increased the liquidity potentially available to the banking system by some HUF 2,600 billion.
- **Consistent with the MNB's recommendation, the Government declared a loan repayment moratorium on the debt of companies and households,** which helped address debtors' temporary difficulties.
- **Since launching its government securities purchase programme in May 2020, the MNB has purchased government securities for more than HUF 2,200 billion,** thereby contributing to the stability of the government securities market. By decreasing yields, the government securities purchase programme of the MNB increased the government's room for fiscal manoeuvre, which could be used in the containment of the pandemic.
- **Besides the government securities purchase programme, the central bank also provided a large amount of long-term funds to the banking system,** which also helped maintain banking activities.

Later, in addition to its immediate liquidity-providing and market-stabilising steps, the MNB also decided to introduce other measures promoting economic recovery and laying the foundations for economic growth. This was partly because many Hungarian firms were facing difficulties due to the coronavirus pandemic, which posed new challenges:

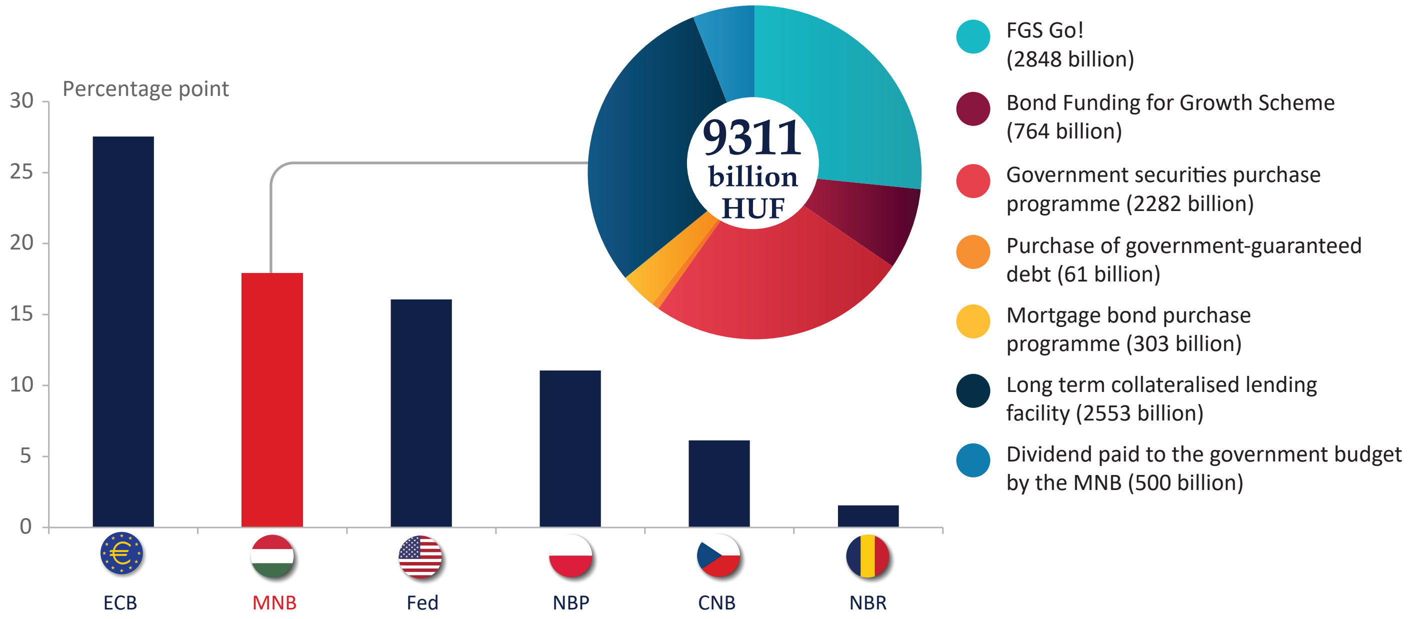
- **In the summer of 2020, the central bank cut the base rate twice, altogether by 30 basis points, to 0.6 per cent.** The interest rate cuts help the rapid recovery of Hungarian economic growth.
- **Also as part of the phase promoting economic growth, on 20 April 2020 the MNB launched the latest addition to its Funding for Growth Scheme (FGS),** FGS Go!, with an allocated amount of HUF 1,500 billion. Due to the great interest seen since the scheme was launched, the MNB has increased the allocated amount of the FGS Go! to HUF 3,000 billion in several steps. From the increased amount, about 40,000 small and medium enterprises have already used over HUF 2,800 billion for operation, modernisation and growth.
- **Thanks to** the MNB's **Bond Funding for Growth Scheme (with an allocated amount of HUF 1,150 billion increased in two steps), the liquidity of the corporate bond market expanded considerably during the coronavirus pandemic,** therefore companies now consider raising funds from the bond market

as a genuine alternative to financing from bank loans. Almost 60 companies used the BGS fundraising opportunity.

- **The central bank also paid dividends of HUF 250 billion to the budget twice** to contribute to the tackle of the coronavirus crisis and to successfully restarting the economy.

Overall, the MNB has remained committed to maintaining price stability even during these very difficult times, and it has successfully achieved its primary objective. The trend seen since 2017 was not interrupted in 2020, despite the coronavirus pandemic, and the consumer price index stayed within the central bank's tolerance band almost during the entire year. In 2020, average annual inflation was 3.3 per cent, therefore the central bank has successfully maintained price stability in Hungary. **Since the appearance of the coronavirus pandemic, the Magyar Nemzeti Bank has provided one of the largest amount of funds to economic actors relative to GDP by international comparison, to help them tackle the economic difficulties caused by the coronavirus pandemic.**

Figure 3: Change in the balance sheet total of leading and regional central banks relative to GDP between January 2020 and May 2021, and the MNB's liquidity-providing programmes



Source: websites of central banks, Eurostat.
Note: In the case of the Polish, Czech and Romanian central banks, data from March were used for 2021.

4. A big step towards a contactless economy

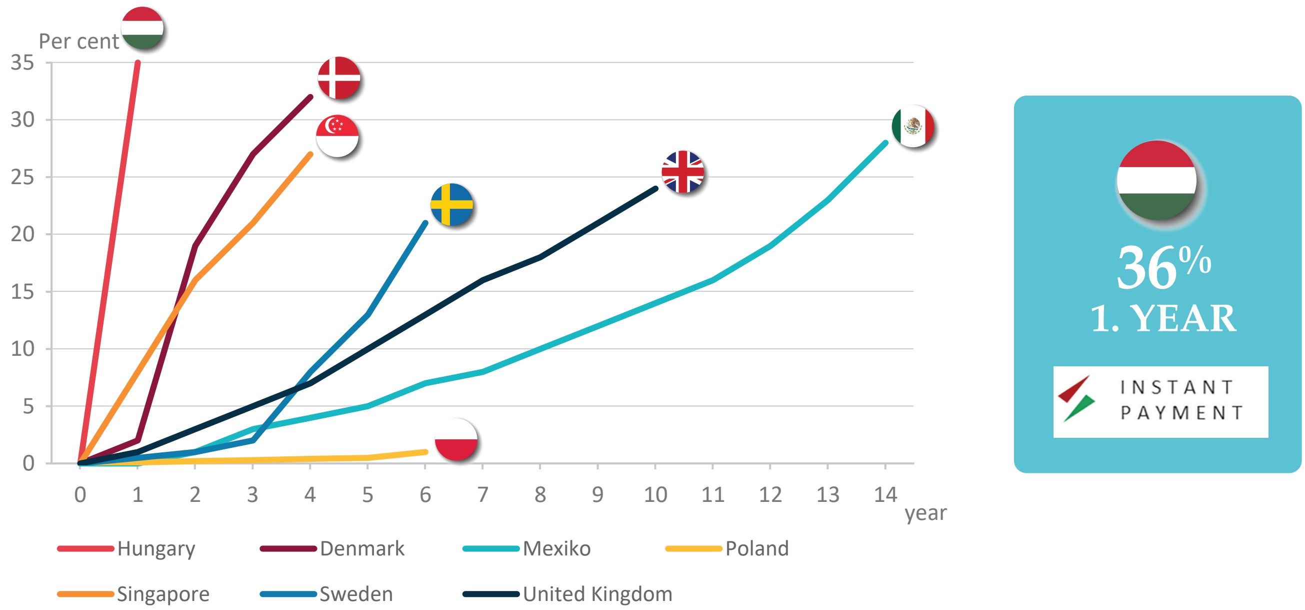
4.1. Payments: Raising the payment limit requiring a PIN code and introducing the option to use instant payment

In order to ensure that payments without physical contact can be made in as many cases as possible, the MNB initiated the raising of the HUF 5,000 limit for contactless payments without a PIN code to HUF 15,000. During the pandemic, people went shopping less frequently than usual, but they purchased at a higher value than before. In addition, in payment situations, there has been an increased need to reduce physical contact for example as regards using cards rather than cash, preferably without entering a PIN code. The change in shopping habits meant that some of the purchases that had been under HUF 5,000, in particular card purchases, shifted to higher value categories, mainly to the HUF 5,000–15,000 range. As the limit was raised to HUF 15,000 as proposed by the MNB, the share of contactless card payments not requiring a PIN code jumped by almost 30 percentage points to over 90 per cent.

At the MNB's initiative, the instant payment system was successfully launched on 2 March 2020, which provided a convenient and safe way of making payments during the pandemic.

As a result, payments without physical contact can be conducted by instant payment in addition to card. At the initiative of the MNB, in a way that is unique in the world, all banks were required to join the instant payment system, so more than one-third of the credit transfers to be settled instantly right after the launch. Instant payments were introduced at the best possible moment, as all bank customers had access to the fast and innovative method of payment during the pandemic, which was thus quickly embraced by people. The number of low value transactions increased by 7 per cent in Q1, by 10 per cent in Q2 and Q3, and by 15 per cent in Q4, when the second wave of the pandemic hit, as compared to the same periods in the previous year. Accordingly, some of the low value transactions conducted using cash may have been permanently diverted to the instant payment system, probably because of the pandemic.

Figure 4: Share of instant payments within credit transfers in the years following the launch



Source: ECB, MNB.

4.2. Recommendations for banks to operate by reducing physical contact as much as possible

Although the MNB expects banks to ensure that customers are serviced during the pandemic, taking into account the curfew, it urged banks to use digital solutions that affect customers. In line with the MNB's guidance, institutions have to strive for electronic communication and urge their customers to use digital channels for bank transactions. The MNB provides temporary relief for taking out retail mortgage credit during the proclaimed pandemic: notarisation may be waived before disbursement, electronic official certificates are recommended to be accepted, some administrative tasks related to borrowing are encouraged to be conducted without personal contact, and when certain conditions are met, the on-site inspection during the appraisal of the real estate serving as collateral can be performed retrospectively.

The MNB also continuously monitors banks' practices regarding the payment moratorium and consumer information, taking action against bad practices and warning consumers.

5. What can the Hungarian economy expect? Complete recovery instead of post-covid syndrome!

The economic impact of the pandemic was unprecedented, but the Hungarian economy proved to be resilient against the crisis. Economic output declined by 5.0 per cent in 2020, which was less than the drop in the EU average. The virus attacked the most important pillars of the growth in the previous period. Due to Hungary's huge exposure to the car industry and the significance of tourism, which was the most badly hit by the lockdowns, it caused a larger slump in the first half of last year. Nevertheless, the increased output of the sectors not directly exposed to the lockdowns (information and communication) mitigated the economic downturn. In spite of the recession seen last year, the Hungarian investment rate remained high by international comparison, partly on account of the FDI inflows, and credit markets also remained healthy thanks to the MNB. All this and the high vaccination serves as a solid basis for a rapid recovery (Table 1).

Table 1: Macroeconomic indicators in Hungary (per cent)

INDICATOR NAME	2020	RANK IN THE EU (2020)	EXPECTATION FOR 2021
GDP growth	-5.0	15.	6.2
Investment rate (% of GDP)	27.3	3.	27.9
Growth of corporate loan portfolio held by credit institutions	9.4	4.	7.8
Unemployment rate	4.1	5.	3.9
Change in wages and salaries	4.2*	4.	9.6
Growth of household loan portfolio held by credit institutions	14.5	1.	11.0
Household consumption growth	-2.3	5.	4.6

Note: The projection for 2021 is based on the June Inflation Report. The growth rate of corporate loan is based on the loans outstanding to the entire financial intermediary system.
*Based on national accounts data.
Source: Eurostat, HCSO, MNB

The Hungarian recovery is assisted by household consumption and the stability of the labour market. The Hungarian unemployment rate remained one of the lowest in international comparison, which was supported by the well-functioning financial markets and the targeted central bank and government programmes (payment moratorium, wage subsidies). Wage growth in Hungary was among the highest in Europe, with wages and salaries increasing by 4.2 per cent. As a result, household consumption diminished less than the EU average in 2020 (Table 1).

In 2021–2022, Hungary is expected to complete the fastest economic recovery in the past 100 years. The stability of the labour market, the high investment rate, the high household savings rate and rising loan stock all suggest that the Hungarian real economy has a substantial recovery potential from a supply,

demand and financing perspective as well. Due to the potential of the economy to recover fast, GDP is expected to grow by 6.2 per cent in 2021, with an increase of 5.5 per cent in 2022, followed by an expansion of 3.5 per cent in 2023. Thanks to the solid fundamentals and the strong growth, by the third quarter of this year Hungarian economic output may be as high as before the crisis.

After restarting the economy,
the focus has to shift back to restoring balance.

This is because the formula for sustainable growth has not changed, growth and balance go hand in hand when it comes to convergence. In the past decade, Hungary, having lagged behind, once again became one of the top performers in the region, but the example of the Czech Republic and Malta shows that convergence can be continued even when the EU average is closer. A sustainable convergence path can only be achieved when competitiveness is improved in a comprehensive manner. **In the 21st century, rapid economic growth does not suffice, a development path needs to be taken that is sustainable in the long run from a financial, environmental and social perspective as well.**

6. Crisis management by the MNB from an outside perspective

*”**The IMF is satisfied with the Hungarian crisis management.** During the virtual discussions focusing on the examination of how the coronavirus crisis was managed, the delegation found that the Hungarian authorities responded to the crisis in a fast and decisive manner.”*

*”**The Hungarian economy was hit by the current pandemic with solid foundations, and the authorities responded appropriately to the crisis’,*** the delegation of the International Monetary Fund (IMF) found during its annual review. Besides its positive attitude, the organisation also made recommendations for Hungary for the period ahead.”

IMF

”We welcome the set of instruments announced by the Government and the Magyar Nemzeti Bank today, and we believe it contributes significantly to mitigating the negative impact of the state of emergency and to promoting the economic recovery after that. **It has to be underlined that the Government and the Magyar Nemzeti Bank took important decisions in a timely and appropriate manner.”**

Hungarian Banking Association
07/04/2020

”The government handled the crisis well. Thanks to this, the economic downturn is not as large as foreseen, and family support programmes and SME credit programmes promote growth. **The Magyar Nemzeti Bank performed exceptionally well. The Funding for Growth Scheme, the Bond Funding for Growth Scheme, the liquidity-providing programmes and the easing of the capital buffer requirements all had a positive impact on lending.”**

Sándor Csányi,
Chairman & CEO of OTP

*”**I am satisfied with the MNB’s performance, it did everything it could fast.*** They basically enabled the state to spend without any constraints for some time.”

Viktor Zsiday,
Investor/Portfolio Manager, Citadella Fund

Magyar Nemzeti Bank