MINUTES
OF THE MONETARY COUNCIL MEETING
25 AUGUST 2020

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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

In the current extraordinary economic environment, the Magyar Nemzeti Bank's (MNB) mandate was still to achieve and maintain price stability, to preserve financial stability, as well as to support the Government's economic policy. Macroeconomic and financial developments continued to be mostly driven by the effects of the coronavirus pandemic.

The coronavirus pandemic had hit the global economy in a weakened state. In most of the developed countries, real economic performance had declined substantially in the second quarter. Economic activity had entered a new phase of gradual recovery from June; however, several countries' infection curve had started to rise again. The second wave of the pandemic would cause an increase in risks. There remained an exceptionally large degree of uncertainty in judging the time profile of the health emergency and the speed of the global economic recovery.

In the past month, sentiment in global financial markets had been volatile: the dollar exchange rate had depreciated, while long-term yields in developed countries had mostly risen. The Federal Reserve and the European Central Bank had continued their liquidity-providing and asset purchase programmes in the recent period. In our region, the Romanian central bank had reduced policy rates, while decision-makers at the Czech and the Polish central banks had left them at close to zero.

The coronavirus pandemic had hit the Hungarian economy when its fundamentals had been stable and growth had been strong. The economic policy pursued over the past decade had maintained the country's macroeconomic balance and reduced its external and internal vulnerability. Hungary's health defence against the first wave of the coronavirus had been successful. As a result of the economic shutdown, production in most sectors of the national economy had declined. Consequently, Hungarian GDP had fallen by 13.6 percent year on year in the second quarter of 2020. Due to the weaker-than-expected GDP data, a revision of the economic outlook for this year had become necessary, which would be made in the projection of the September Inflation Report. Successful health defence continued to provide an appropriate foundation for the economic recovery.

This year's macroeconomic data were expected to show significant volatility and dichotomy. The effects of the pandemic had been the strongest in data for the second quarter. The recovery had started in May following the trough in April. The significant improvement in economic activity had been reflected mostly in the June data. A pick-up in public investment and an expansion in corporate lending were required for a 'V' shape economic recovery in the second half of the year. In line with the expected slower recovery in the external environment, production in export-oriented industrial sectors might pick up only towards the end of the year.

In July 2020, inflation had stood at 3.8 percent and core inflation excluding indirect tax effects had been 4.1 percent. Incoming data had exceeded expectations. In the period when the economy had been restarted, a faster rise in prices had been mainly caused by changes in the structure of aggregate supply and demand. In specific sub-markets demand had been soaring, while the recovery of disrupted supply caused by the pandemic situation had been slow in others. The effects of the changes in indirect taxes had contributed to the rise in inflation by a further 0.4 percentage points. Changes in fuel and food prices had increased the volatility of inflation while statistical factors constituted unusually stronger measurement uncertainty.

The consumer price index was expected to remain around its current level in the coming months, before inflation stabilised at close to the central bank target of 3 percent as economic activity was brought back to normal. Disinflationary effects of the coronavirus pandemic became even stronger over the forecast horizon. Deteriorating economic activity due to the pandemic was likely to reduce core inflation excluding indirect tax effects through several channels. In addition to a weaker external inflation environment, more muted domestic demand compared to previous years was also increasingly restraining underlying inflation. The Monetary Council monitored closely the persistent inflationary effects as the economy recovers.

As a result of the rising cost of protective economic measures and the reduction of the tax base, the budget deficit in the first half of the year had stood at 5.9 percent of GDP in the first half. The government debt ratio had risen to 71.9 percent of GDP due to a decline in GDP and a higher financing requirement. After the significant rise in government debt, in parallel with the recovery of the economy, the ratio was expected to return to a downward path from 2021. The current account balance was expected to show a moderate deficit this year as well, but net lending remained persistently positive. Hungary’s external debt-to-GDP ratios were expected to decline further.

In a more favourable sentiment in financial markets the forint had appreciated against the euro for most of the period, together with other currencies in the region. After the previous interest rate decision in July, long-term yields and yield spreads had declined; however, in recent weeks the effect of the rise in global yields had also appeared in domestic yield developments.

Decisions of the Monetary Council in spring months had helped to stabilise domestic money market developments while liquidity with favourable conditions, available to all economic agents, supported the recovery of economic growth. The Bond Funding for Growth Scheme (BGS) and the Funding for Growth Scheme Go! (FGS Go!) ensured access for the domestic corporate sector to sustainable, stable and long-term funding and helped the credit market and investment growth to pick up. The MNB had extended the range of potential uses of funds granted under the FGS Go! in early July to allow SMEs to have wider access to funds with favourable conditions under the Scheme and thereby to stimulate the economy.

By launching its government securities purchases programme in April 2020, the MNB had successfully managed to stabilise developments in the government securities market and to reduce yields. After a temporary break, the MNB had made targeted government securities purchases again in the segment of over 15-year maturities from July 2020 to ensure that the base rate cut had its effects on the longer segment of the yield curve as well.

The Monetary Council intended to use the government securities purchase programme to the extent and for the time necessary. The global deterioration in recent weeks in the pandemic situation raised external risks, while expenditures related to economic defence resulted in a higher government financing requirement. To maintain the effectiveness of monetary transmission and the stable liquidity position of the government securities market, the Monetary Council deemed it necessary to increase the amount of weekly government securities purchases, in addition to keeping the long-term collateralised lending facility. The Bank would continue to make purchases in the long segment to support an extension in the maturity structure of government debt.

Following the review of macroeconomic and financial market developments, the Monetary Council discussed the details of its monetary policy decision. Decision makers pointed out that inflation had generally risen in countries of the region. In Hungary, inflation had been in the upper part of the tolerance band, exceeding expectations. Members concluded that upward effects on inflation had appeared during the restart of the economy, in addition to disinflationary effects normally expected during recessions. A pick-up in demand, concentrated in some specific sub-markets, while the slow recovery of disrupted supply caused by the pandemic situation in others, had led to an increase in prices. A number of companies had raised their prices in an effort to compensate for missing income caused by the economic lockdown. The effects related to the restart of the economy had raised inflation by 0.7 percentage points and excise taxes had raised it by another 0.4 percentage points. Decision makers were of the view that inflation would stay around its current level in the coming months; however, inflation developments were surrounded by greater-than-usual uncertainty. In the Monetary Council's general view it was essential to assess the persistence of inflationary effects stemming from the economic recovery and its consequences for the achievement of price stability in the coming months.

Members agreed that the economic downturn in the second quarter had been caused by a combination of several factors. The time profile of the pandemic had mainly affected second-quarter economic data. Furthermore, several members noted that the stronger-than-average decline in the automobile industry and tourism had been restraining the performance of the domestic export sector, reflecting the sharp drop in global demand. Finally, the performance of construction had also lagged significantly behind the previous year's high values. Members pointed out that, due to the time profile of the pandemic, data for the first two quarters of the year should be evaluated jointly. In this regard, the performance of the Hungarian economy had shown a similar pattern to that of the Visegrád region, and it had significantly exceeded EU and euro area averages. Council members agreed that weaker-than-expected second-quarter GDP data made it necessary to revise the outlook for growth this year, which would be made in the September Inflation Report.

Several decision makers underlined that conditions in the labour market were particularly important in terms of the longer-term outlook for growth. The Hungarian unemployment rate continued to be low in international comparison, which contributed to the restoration of real economic performance in the coming quarters. Turning to fiscal developments, members pointed out that the decline in GDP and the cost of economic defence had significantly increased the government financing requirement in the first half. Some decision makers noted that in terms of meeting the government's financing requirement it continued to be of key importance that financing by households, and particularly the MÁP+, had proved resilient to the crisis, which might be a stable source of funding during the remainder of the year.

Regarding the pandemic situation, members concluded that infection curves in a number of countries had started to rise again, with the number of daily new cases in several countries reaching and even exceeding those seen during the first wave. With an increase in external risks, expenditures on economic defence resulted in a higher government financing requirement.

It had become necessary to raise the amount of weekly government securities purchases to maintain the effectiveness of monetary policy transmission and the stable liquidity position of the government securities market. The Monetary Council had already indicated that it would purchase government securities to the extent and for the time necessary. Members agreed that, due to the developments discussed above, it was necessary to raise further the amount of weekly purchases from the current HUF 15 billion. Decision makers underlined the continued importance of lengthening the maturity profile of government debt; therefore, the Bank would continue to purchase government securities at the long segment. Members of the Monetary Council had emphasised that the Bank would sterilise the amount of excess liquidity provided using its short-term instruments.

At its meeting today, the Monetary Council left the base rate and the overnight deposit rate unchanged at 0.60 percent and -0.05 percent, respectively, and the overnight and the one-week collateralised lending rates at 1.85 percent. The MNB would continue to set the one-week deposit rate at the weekly tenders.

In the Monetary Council's assessment, the 0.60 percent base rate supported price stability, the preservation of financial stability and the recovery of economic growth in a sustainable manner. In the current rapidly changing environment, it was key to maintain short-term yields at a safe distance from a range close to zero. The Council continuously assessed incoming data and changes in the outlook for inflation. In the event of a persistent deterioration in the outlook for growth, the Bank would deliver the required additional economic stimulus using its targeted instruments, i.e. the Funding for Growth Scheme Go! and the Bond Funding for Growth Scheme, providing the most direct support to investment.

Votes cast by individual members of the Council:

In favour of maintaining the base rate at 0.60 percent, **In favour of maintaining the overnight collateralised lending rate, the one-week collateralised lending rate at 1.85 percent** **and** **maintaining the interest rate on the overnight central bank deposit at -0.05 percent:**	8	Gusztáv Báger, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, Bianka Parragh, Mihály Patai, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

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

Gusztáv Báger

Csaba Kandrács

Kolos Kardkovács

György Kocziszky

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 22 September 2020. The minutes of that meeting will be published at 2 p.m. on 7 October 2020.