MINUTES

OF THE MONETARY COUNCIL MEETING

15 DECEMBER 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

The primary objective of the Magyar Nemzeti Bank (MNB) was to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserved financial stability and supports the Government's economic policy.

Global macroeconomic and financial developments continued to be driven mainly by the events of the coronavirus pandemic and the news related to the development of the vaccine. Following a decline in the second quarter of 2020, the performance of the world's large economies had showed a significant correction in the third quarter. However, due to the second wave of the pandemic and the increasingly tighter pandemic restrictions introduced, the economic recovery had been delayed. As a result, there remains an exceptionally high degree of uncertainty surrounding the pace of global economic recovery.

Sentiment in global financial markets had improved recently, reflecting favourable news related to the development of the vaccine, an improvement in the economic outlook and the prior adoption of the European budget and the recovery fund. Nevertheless, risk indicators had remained at a high level. At its policy meeting in December, the European Central Bank (ECB) had left policy rates unchanged, but further easing measures had been announced. The ECB had decided to increase the envelope of the Pandemic Emergency Purchase Programme (PEPP) by EUR 500 billion to a total of EUR 1,850 billion, and eased the conditions of its TLTRO III programme. In addition, the ECB would also conduct additional longer-term refinancing tenders to provide the banking system with the necessary amount of liquidity. In our region, the Czech, the Polish and the Romanian central banks had held their policy rates unchanged at low levels. Due to the protracted economic recovery, the world's leading central banks and those in the region were expected to maintain loose monetary conditions over a prolonged period.

After reaching a low point in April and May, domestic economic activity had undergone a significant correction. In the third quarter of 2020, Hungary's GDP had risen by 11.4 percent relative to the previous quarter but had fallen by 4.6 percent from its level a year earlier.

In general, the global economic recovery was taking longer than earlier expected due to the second wave of the coronavirus pandemic. With the restrictive measures, Hungary's economic activity was likely to weaken again in the fourth quarter of 2020. As a result, overall GDP was expected to decline by 6.0-6.5 percent in 2020. Economic activity might begin to normalise from the second quarter of 2021 as the coronavirus vaccine became widely available. Hungary's GDP was expected to rise by 3.5-6.0 percent in 2021 and by 5.0-5.5 percent in 2022.

In November 2020, annual inflation had been 2.7 percent, core inflation had been 3.9 percent and core inflation excluding indirect tax effects had stood at 3.3 percent. Following higher repricing in the summer months, disinflationary effects had strengthened from September. More subdued price growth primarily had reflected changes in market services, fuel and food prices. Based on incoming data, the inflation rate was likely to be somewhat lower, at 3.4 percent, in 2020 relative to the September projection.

Pricing decisions were expected to continue to exhibit high volatility in the coming quarters. As a result of an increase in excise taxes on tobacco products at the beginning of 2021 and base effects, the consumer price index was expected to stand at around 4 percent temporarily in the spring months of 2021. Tax effects resulting from the new administrative measures were expected to raise inflation by 0.4 percentage point in 2021 and by 0.1 percentage point in 2022. In terms of underlying inflation, a prolonged economic recovery was likely to cause disinflationary effects to be persistent. In addition to the moderate external inflation environment, weak domestic demand also pointed to a slowdown in price growth. Overall, inflation was likely to be 3.5-3.6 percent in 2021 before returning to around the central bank target in 2022. The time profile of the pandemic and the expected economic recovery might continue to result in volatile pricing patterns; therefore, an exceptionally cautious approach is warranted in assessing more persistent inflationary effects.

In 2020, the government deficit was likely to rise to 8-9 percent of GDP due to the costs of protection against the coronavirus pandemic, the measures taken under the Economy Protection Action Plan and declining tax revenue resulting from the slowdown in economic growth. However, the government deficit in 2020 was likely to be around the international average. From 2021 the government deficit was likely to decrease. After falling steadily since 2011, the government debt-to-GDP ratio was expected to rise temporarily in 2020; however, it was likely to shift to a downward path from 2021 as the economy recovered and the deficit declined. The capital account surplus was contributing to maintaining Hungary's stable, positive net lending position. As a result, net external debt was expected to decline further in the coming years.

In the Monetary Council's assessment, the increase in risk aversion vis-à-vis emerging markets continued to pose the greatest risk in terms of the outlook for inflation. It was the MNB's clear intention to prevent the current uncertain global market environment from causing an increase in upside risks to inflation.

The central bank balance sheet had contracted in recent years, creating sufficient potential to address economic challenges in a sustainable manner. In response to the adverse economic effects arising from the coronavirus pandemic, the MNB had expanded significantly the central bank balance sheet, thereby supporting the recovery of economic growth as well. The MNB's balance sheet could still be considered of average size in regional comparison, despite a significant expansion this year. The MNB would be ready to increase the size of its balance sheet further to manage risks arising from the coronavirus pandemic and to foster the quick recovery of sustainable economic growth.

The government securities purchase programme had contributed successfully to maintaining a stable liquidity position in the government securities market and strengthened the effectiveness of monetary policy transmission. The stock of government securities in the Bank's balance sheet had increased by over HUF 900 billion since May 2020. The MNB continued to use the government securities purchase programme and to settle for a lasting market presence in the secondary government securities market. The MNB would use the programme to the extent and for the time necessary. The Bank applied a flexible approach to the amount of its weekly purchases, concentrating its purchases on longer maturities.

In the Monetary Council's assessment, the FGS Go! played a key role in mitigating the adverse economic effects of coronavirus, as it offered cheap funding with reliable rates to the SME sector with more favourable conditions than before and to a wide range of applications. There had been significant interest by companies in the FGS Go! since it had been launched in April. Under the scheme, over 17,000 domestic micro, small and medium-sized enterprises had accessed the favourable funding opportunity until the end of November, in the amount of close to HUF 1,200 billion. During the economic recovery, it was of key importance for the Monetary Council to provide the amount of funding necessary for the continuous operations of SMEs and the realisation of their investment projects, which also fostered the recovery of economic growth.

By the end of November 2020, over 260 companies had registered for the Bond Funding for Growth Scheme. By the end of the period, 40 companies had successfully issued 46 bond series, raising nearly HUF 800 billion. The MNB would continue to sterilise the resulting surplus liquidity issued under the programmes in full, using the preferential deposit instrument.

Following the review of macroeconomic and financial market developments as well as the Inflation Report projection, the Monetary Council discussed the details of its monetary policy decision. Council members concluded that this year had posed unprecedented challenges from an economic history perspective, but also pointed out that the economic outlook for next year was more favourable, primarily due to two factors. First, the fundamentals of the Hungarian economy were strong, besides the Hungarian Government's and the Magyar Nemzeti Bank's coordinated measures to protect the economy had successfully mitigated the adverse economic effects of the pandemic. Second, the expected wide availability of the vaccine against coronavirus pointed to a normalisation of economic activity from the second quarter of 2021.

Global macroeconomic and financial market developments had recently been driven by events related to the coronavirus pandemic and the news about the development of the vaccine, as well as the prior adoption of the European budget and the recovery fund. In this context, several decision makers noted that sentiment in global financial markets had improved, but risk indicators had remained at a high level.

Discussing recent inflation developments, decision makers agreed that disinflationary effects had strengthened from September, mainly related to food, fuel and market services. Council members pointed out that pricing decisions were likely to continue to be highly volatile in the coming quarters. They noted that the consumer price index was likely to be around 4 percent temporarily in the spring months of 2021, as a result of the increase in the excise tax on tobacco products at the start of the year and base effect of fuel prices. In this context, however, several decision makers highlighted that those effects were not the consequences of underlying inflation. Turning to developments in underlying inflation, decision makers agreed that the delay in the economic recovery was likely to lead to the persistence of disinflationary effects. In addition to the moderate external inflation environment, weak domestic demand also pointed towards a slowdown in price growth. Members stressed that uncertainty around the time profile of the pandemic and the economic recovery might result in volatile pricing patterns again, as seen in the summer months. Council members therefore were unanimous in arguing that maintaining a cautious monetary policy approach was warranted in assessing the outlook for inflation.

Decision makers were of the view that it was of key importance to preserve the Hungarian economy's growth potential to restore sustainable economic growth, which required that the demand and supply sides of the economy both recovered. Members thought that private and public investment projects were equally important for economic activity to restart; therefore, a funding that is widely available must be ensured to companies in order to maintain the positive trends in investment. Decision makers were of the view that a condition for this on the side of the central bank was to maintain a favourable financing environment and to provide the amount of funding necessary for the continuous operation of companies and the realisation of their investment projects. Council members agreed that Bond Funding for Growth Scheme and Funding for Growth Scheme provided adequate funding for investment projects. Decision makers reaffirmed that the Bank continued to support the restoration of sustainable economic growth.

Members agreed that the MNB's government securities purchase programme was successful: it contributed to maintaining a stable liquidity position in the government securities market, strengthened the effectiveness of monetary policy transmission while supporting the lengthening of the maturity structure of government debt. Decision makers noted that the Bank continued to apply a flexible approach to the amount of its weekly purchases.

In members' assessment, the expansion of the central bank balance sheet so far and the provision of around HUF 5,800 billion of liquidity had successfully supported the mitigation of the negative economic effects of the pandemic; therefore, the Monetary Council was ready to support the restoration of sustainable economic growth by further expanding the central bank balance sheet. To summarise, Monetary Council members attached importance to maintaining a lasting presence in the government securities market and to continuing the programmes supporting investment.

At its meeting today, the Monetary Council had 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 weekly tenders, in response to the increase in risk aversion vis-à-vis emerging markets. The Bank would maintain the difference between the base rate and the one-week deposit rate as long as warranted by inflationary risks.

It was a key priority for the MNB that short-term rates in every sub-market and at all times should develop consistently with the level of short-term rates deemed optimal by the Monetary Council. Therefore, the MNB would conduct foreign exchange swap tenders providing euro liquidity at the end of December as at the end of September. The Bank would hold the four announced tenders with no quantitative limit, and it still might use its international master repurchase agreements to finance them. Measures taken at the short end of the yield curve would contribute to preserving the stability of monetary conditions and through this to maintaining price stability.

In the Monetary Council's assessment, the monetary conditions established at the short end 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 MNB remained committed to maintaining price stability during the coronavirus pandemic. Consequently, the Council continuously assessed incoming data, closely monitored the persistence of inflationary effects resulting from the restoration of the economy and the possible inflationary effects of financial market developments. If warranted by a change in the outlook for inflation, the MNB would be ready to use the appropriate instruments.

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:**	9	Gusztáv Báger, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, 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

György Matolcsy

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 26 January 2021. The minutes of that meeting will be published at 2 p.m. on 10 February 2021.