MINUTES
OF THE MONETARY COUNCIL MEETING
21 JULY 2020

Time of publication: 2 p.m. on 5 August 2020

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. Based on the projection in the June Inflation Report, Hungarian economic performance in 2020 was likely to be more subdued than earlier expected, while the outlook for inflation had shifted downwards persistently.

The coronavirus pandemic had hit the global economy in a weakened state. As a result of the measures taken to prevent the spread of the pandemic, in the second quarter real economic activity had declined, while unemployment rates had risen worldwide. From the beginning of May, economic activity had restarted gradually as the restrictive measures had been eased; however, the number of new cases had grown at an increasing pace in several countries in the past month. 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.

The outlook for growth in the global economy had deteriorated significantly. Disinflationary effects had strengthened. Sentiment in global financial markets had been volatile in the past month. The Federal Reserve and the European Central Bank had continued their liquidity-providing and asset purchase programmes in the recent period. In our region, decision-makers at the Czech and the Polish central banks had left policy rates close to zero.

The coronavirus pandemic had hit the Hungarian economy when its fundamentals had been stable and growth was strong. The economic policy pursued over the past decade had maintained the country's macroeconomic balance and reduced its external and internal vulnerability. In the first quarter of 2020, Hungarian GDP growth had slowed to 2.2 percent year on year. However, the Hungarian economy's growth surplus compared to the euro area had far exceeded the value of around 3 percentage points achieved in recent years. Hungary's defence against the first wave of the coronavirus had been successful, which provided appropriate foundation for the economic recovery.

This year's macroeconomic data were expected to show significant volatility and dichotomy. The effects of the pandemic were likely to be the strongest in data for the second quarter. The recovery, started in May following the trough in April, was expected to continue in June. After a significant decline in GDP in the second quarter, a recovery of economic growth was expected from the third quarter. A pick-up in public investment and an expansion in corporate lending were required for a quick 'V' shape economic recovery in the second half of the year. The moratorium on instalment payments of loans contributed HUF 2,000 billion to maintaining purchasing power and preserving jobs by the end of the year overall. 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. Overall, Hungarian GDP might grow at a restrained pace in 2020. Economic growth was expected to be 0.3–2.0 percent in 2020, 3.8–5.1 percent in 2021 and 3.5–3.7 percent in 2022.

As a result of the cost of protective economic measures and the slower nominal GDP growth, the budget deficit in 2020 is likely to rise compared to previous years but to remain low in international comparison. The government debt ratio is expected to rise temporarily; then, with the quick recovery of the economy, it is 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.

Due to the coronavirus epidemic, strong disinflationary effects had appeared in the Hungarian economy as well. Following a temporary rise at the beginning of 2020, the consumer price index had quickly returned into the central bank tolerance band, before declining to its lower bound in May. In June 2020, inflation had risen to 2.9 percent, and core inflation excluding indirect tax effects had remained unchanged on the previous month. Higher consumer price inflation primarily had reflected a rise in the price index for fuel, partly due to base effects. Incoming inflation data had been in line with the MNB's expectations.

The coronavirus pandemic had led to significant fluctuations in food and oil prices in global commodity markets, thus high volatility in domestic inflation was expected to persist. Due to these volatile items, inflation was expected to rise temporarily in the coming months, before stabilising again around the 3 percent central bank target as these effects fade. Weakening economic activity caused by the coronavirus pandemic reduced 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. Due to strong disinflationary effects, core inflation excluding indirect tax effects would fall below 3 percent: it was expected to stand at 3.3–3.5 percent in 2020 and at 2.6–2.7 percent in 2021.

Domestic financial market conditions had shown a mixed picture since the Council's previous interest rate decision. As in the case of emerging market currencies, the forint had depreciated against the euro during the period. In the government securities market, yields at maturities of up to 5 years had fallen and those at longer maturities, in particular over 10 years, had risen.

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 the domestic corporate sector to access sustainable, stable and long-term funding, and 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.

Following the review of macroeconomic and money market developments, the Monetary Council discussed the details of its monetary policy decision. The decision makers pointed out that the recovery of the Hungarian economy had started in May, which had continued in June. Council members emphasised that strong investment activity was essential for a quick economic recovery in the second half of the year, the key to which was a pick-up in public investment and an expansion in corporate lending.

Council members agreed that in the first protective phase of the pandemic, the MNB had managed to adequately stabilise Hungarian money market developments and to provide the required amount of liquidity by implementing targeted measures. After that, a period of recovery had started in June. Members were unanimous in arguing that in this phase, it was key to support the recovery of economic growth in addition to the preservation of financial stability, which was essential to achieve the inflation target in a sustainable manner, in the present situation. In the context of applying a cautious approach, the Council had reduced the policy rate in two steps. Council members agreed that the resulting 0.6 percent base rate supported price stability, the preservation of financial stability and the recovery of economic growth. The decision makers emphasised that, at 0.6 percent, the base rate was at a safe distance from the range close to zero and it remained important to preserve this. In the members' assessment, a similar shift was warranted in short-term yields as in the base rate in the current macroeconomic environment.

In the Monetary Council's assessment, it was of key importance from a monetary policy perspective that the effect of interest rate cuts should have had its effect on the longer segment of the yield curve, as well. The Council agreed that monetary transmission could be improved most effectively by reallocating between instruments affecting longer-term maturities. Decision makers emphasised that to achieve all the above, it was warranted to gradually reduce the amount of the long-term collateralised lending facility, and government securities should have been purchased in limited quantities in the segment of over 15-year maturities. Several members underlined that targeted purchases also had a favourable effect on the maturity structure of government debt.

In the decision makers' assessment, a data-driven and cautious approach was still necessary in course of the monetary policy decisions in Hungary. Council members were unanimous in believing that in case of the materialisation of downside risks affecting economic growth, the economy might be further stimulated most effectively through targeted instruments supporting corporate funding i.e. the Funding for Growth Scheme Go! and the Bond Funding for Growth Scheme.

At its current policy meeting, to maintain price stability and to support the restoration of economic growth, the Monetary Council had reduced the base rate by 15 basis points to 0.60 percent. The Monetary Council had left the overnight deposit rate at -0.05 percent and the overnight and the one-week collateralised lending rates at 1.85 percent unchanged. The MNB would continue to set the one-week deposit rate at the weekly tenders.

The effects of the interest rate cut in June had appeared persistently in the shorter segment of the yield curve. However, it was of key importance from a monetary policy perspective that the effect of the base rate reduction should have had its effect on the longer segment of the yield curve as well. Therefore, to improve monetary policy transmission, the Monetary Council had decided to reallocate between its instruments affecting longer-term maturities, i.e. its long-term collateralised lending instruments and government securities purchases. Consequently, the Bank would purchase limited amounts of government securities in the segment of over 15-year maturities. In addition to improving the transmission of monetary policy, this measure was intended to support an extension in the maturity structure of government debt. The Council continued to consider the government securities purchase programme as a safety net, which it intended to use if and to the extent necessary.

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 reducing the base rate to 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 25 August 2020. The minutes of that meeting will be published at 2 p.m. on 9 September 2020.