MINUTES
OF THE MONETARY COUNCIL MEETING
26 JANUARY 2021

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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 supported the Government's economic policy.

Global macroeconomic and financial developments continued to be driven mainly by the events related to the coronavirus pandemic. While industrial production had been less negatively affected so far by the second wave of the pandemic, services continued to be significantly exposed to the effects of pandemic measures. At the end of last year, industrial production and the volume of retail sales had grown in several Member States of the European Union. However, the introduction and maintenance of increasingly tighter pandemic restrictions had led to a delay in the economic recovery. As a result, there remained an exceptionally high degree of uncertainty surrounding the pace of global economic recovery.

As a whole, investor sentiment in global financial markets had improved recently. Among other things, risk appetite had been driven by the growing use of the coronavirus vaccine, expectations related to the economic policy of the US, the adoption of the EU budget, the Brexit agreement and news about oil markets. At its policy meeting in January, the European Central Bank (ECB) had maintained its loose monetary policy stance. In our region, the Czech and Polish central banks had held interest rate conditions unchanged and the Romanian central bank had lowered its key interest rate. Due to the protracted economic recovery, the world's leading central banks and those in the region were likely to continue to maintain loose monetary conditions over a prolonged period.

The incoming macroeconomic data over the period since the previous policy meeting were consistent with the projection in the MNB's December Inflation Report. Industrial activity had continued to recover recently, with production rising by 1.6 percent in November on an annual basis, while construction output had risen by 5.0 percent in the period. The trend of construction output had been upwards since June. Owing to the government subsidies and measures supporting the credit market, the corporate sector had responded to the challenges posed by the coronavirus pandemic mainly by increasing the proportion of part-time workers. In November 2020, the unemployment rate had fallen compared to the previous month, standing at 4.1 percent, a low level even in international comparison, as well.

Due to the second wave of the coronavirus pandemic, the global economic recovery was taking longer than earlier expected. With the restrictive measures, Hungary's economic activity had weakened again in the fourth quarter of 2020. As a result, the MNB expected that GDP might have contracted by 6.0-6.5 percent in 2020, as a whole. 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 December 2020, annual inflation had been 2.7 percent, core inflation had been 4.0 percent and core inflation excluding indirect tax effects had stood at 3.4 percent. Headline inflation had been unchanged from the previous month and core inflation had risen by 0.1 percentage point. The increase in core inflation had reflected the higher price dynamics of alcoholic beverage and tobacco products. Following higher repricing in the summer months, disinflationary effects had strengthened from September. In line with this, the last period of the year had been generally characterised by lower rate of price inflation. Overall, consumer prices had risen by 3.3 percent on average in 2020.

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. Overall, the changes in indirect taxes were expected to raise inflation by 0.8 percentage point in 2021 and by 0.1 percentage point in 2022. By contrast, 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 was warranted in assessing more persistent inflationary effects.

In 2020, the accrual-based government deficit might have been around 9 percent of GDP, according to the release by the Ministry of Finance, 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. The government deficit might have been around the international average in 2020. The government deficit was expected to fall from this year. After falling steadily since 2011, there had been a sharp, but temporary increase in the government debt-to-GDP ratio in 2020; however, looking ahead, it was likely to shift to a downward path as the economy recovered and the deficit declined. Debt financing had been stable, strongly supported by domestic savings. The capital account surplus was contributing to maintaining Hungary's persistent, 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 as a proportion of GDP had contracted in the years prior to 2020, 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 in 2020, thereby supporting the recovery of economic growth as well. The MNB's balance sheet was of average size in a regional comparison, despite the significant expansion. The MNB would be ready to increase its balance sheet further to manage risks arising from the coronavirus pandemic and to foster the quick and sustainable recovery of economic growth in a targeted way.

The Monetary Council reviewed the central bank instruments affecting longer-term yields. Last year, the MNB's collateralised lending facility had managed to provide the necessary amount of long-term liquidity to the banking sector. With the acute phase of the crisis subsiding, the role of the collateralised lending facility gradually decreased. The government securities purchase programme had strengthened the effectiveness of monetary policy transmission and had contributed successfully to maintaining a stable liquidity position in the government securities market. The stock of government securities in the Bank's balance sheet had increased by over HUF 1,100 billion since May 2020.

In order to use its instruments affecting longer maturities more effectively, the MNB would reallocate liquidity provided under its individual programmes from the collateralised lending facility towards government securities purchases while keeping its monetary policy stance unchanged. In addition, it would be ready to extend its government securities purchases to include government securities with maturities of less than ten years, thereby ensuring continuous liquidity in the government securities market over the middle segment of the yield curve.

The Bank would continue to apply a flexible approach to the amount of its weekly government securities purchases, increasing its direct purchases in the secondary market relative to the past. The MNB would use its government securities purchase programme to the extent and for the time necessary by maintaining a lasting presence in the market, and it continued to consider it as a priority to increase the share of longer maturities within the maturity profile of government debt.

In the Monetary Council's assessment, the FGS Go! played a key role in mitigating the adverse economic effects of coronavirus, as it offered funding with low and reliable rates to the SME sector with more favourable conditions than before and to a wide range of applications. There had been significant interest from companies in the FGS Go! since it had been launched last April. Under the scheme, around 21,500 domestic micro, small and medium-sized enterprises had accessed the favourable funding opportunity until the end of December, in the amount of close to HUF 1,500 billion. 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 during the economic recovery, as well.

At its meeting on 12 January, the Monetary Council reviewed the results of the Bond Funding for Growth Scheme to date and concluded that the Scheme was successful in serving the monetary policy objectives set at its inception. Since the start of the programme, a total of 46 companies had successfully issued 53 bond series, raising nearly HUF 900 billion. In view of the high rate of utilisation and the continued keen interest in the programme, the Monetary Council decided to raise the amount available under the Bond Funding for Growth Scheme from HUF 750 billion to 1,150 billion and altered some conditions of the Scheme. By its measures, the Monetary Council would continue to contribute to increasing liquidity in the corporate bond market. 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, the Monetary Council assessed the central bank programmes and discussed the details of its monetary policy decision. Council members agreed that uncertainty arising from the coronavirus pandemic continued to greatly affect the economic outlook, despite globally improving investor sentiment due to factors such as the start of vaccination and more favourable macroeconomic data received from the European Union recently.

In assessing developments in the Hungarian economy, Council members underlined the continued recovery of domestic industry and the trend growth in construction output over the past few months. It was noted that government subsidies to mitigate the adverse economic effects of coronavirus and measures to stimulate credit market growth contributed to the unemployment rate remaining low in international comparison as well. Despite favourable data, Monetary Council members agreed that a potential increase in risk aversion vis-à-vis emerging markets, the inflationary effects of changes in indirect taxes and future developments in vaccination created significant uncertainty in terms of Hungary's macroeconomic outlook.

Against this backdrop, Council members reaffirmed that in the current uncertain environment, a cautious monetary policy approach was still warranted. Consistent with this, decision-makers decided to leave interest rate conditions unchanged and underlined that it was key to maintain short-term yields at a safe distance from a range close to zero in the current, rapidly changing environment. Several members pointed out that at the end of December 2020, the MNB had provided euro liquidity via foreign exchange swap tenders, meeting strong demand from market participants for foreign currency, thereby cushioning the spillover of tensions in international swap markets to the domestic market. All this had contributed to preserving the stability of monetary conditions and through this to maintaining price stability.

Monetary Council members reviewed the central bank instruments affecting longer-term yields. Decision-makers highlighted that with the acute phase of the financial market crisis induced by the coronavirus pandemic subsiding, now there was ample liquidity in the banking sector. In addition to a stable liquidity position, there had recently been strong demand for government securities at the relevant maturities for the collateralised lending facility. As a result, several members pointed out that the role of the long-term collateralised lending facility was gradually becoming less important. Decision-makers agreed that in order to maintain the effectiveness of the instruments it was justified to reallocate liquidity provided, from the collateralised lending facility towards government securities purchases. The reallocation would only affect future tenders and purchases and it would not change stocks previously accumulated. Council members noted that in the current market environment, the reallocation between the instruments would result in a more efficient allocation, leaving the Bank's monetary policy stance unchanged. In addition, decision-makers also concluded that in parallel with the reallocation, it would be useful to extend the scope of the MNB's government securities purchases to include government securities with maturities of less than ten years, thereby ensuring continuous liquidity in the government securities market over the middle segment of the yield curve. They also agreed that government securities purchases would be more effective if the MNB made a larger proportion of purchases directly in the secondary market in the future. Council members pointed out that the Bank continued to consider it as a priority to increase the share of longer maturities within the maturity profile of government debt. Decision-makers finally reaffirmed that the MNB would use its government securities purchase programme to the extent and for the time necessary by maintaining a lasting presence in the market.

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 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. The MNB had conducted foreign exchange swap tenders providing euro liquidity again at the end of December 2020. In response to the strong demand from market participants for foreign currency liquidity, the Bank had ensured the required foreign currency liquidity in full. In addition, through active market presence, it had successfully cushioned the spillover of tensions in international swap markets to the domestic market, contributing 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	Péter Gottfried, 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:

Péter Gottfried

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 23 February 2021. The minutes of that meeting will be published at 2 p.m. on 10 March 2021.