**Virág Barnabás:**

**When conventional tools need a boost**

**Why Hungary has adopted targeted monetary measures, OMFIF**

*Central banks in an inflation-targeting regime can meet their inflation objectives on a long-term basis only through steady economic expansion. Consequently, policy instruments that generate only one-off price shocks without contributing to steady economic growth do not facilitate sustainable price stability.*

This realisation has contributed to the extension of central banks' mandate in recent years. Inflation targeting has become more flexible and central banks have placed greater emphasis on attaining sustainable growth and financial stability. Experience suggests that, in addition to their general tools, central banks expanded the use of targeted instruments to help attain their broadened objectives in a low interest rate environment. The advantage of targeted tools is that they avoid fragmented monetary channels and the resulting frictions, allowing the central bank to achieve its desired stimulus without impediment. An active central bank role In line with these circumstances, the Magyar Nemzeti Bank has adopted a more active central bank role. The Bank's actions take into account the low inflationary environment, the risks of high indebtedness and the vulnerability of the banking system owing to the large volume of Swiss franc-denominated mortgage loans and the slow recovery. In terms of conventional instruments, the MNB has sought to manage deflationary risks and support economic recovery by a substantial easing cycle, reducing its policy rate to 1.2% from 7% in the period between August 2012 and March 2016. In addition, it applied a number of targeted, unconventional tools to meet the challenges it faced. The MNB's measures included providing cheap collateralised refinancing to banks to back lending to the small and medium-sized business sector, under the so-called Funding for Growth Scheme, reversing the declining trend in corporate lending. The conversion of Swiss francdenominated mortgage loans has improved the economy's shock-absorbing capacity and strengthened the damaged monetary policy transmission mechanism. Interest rate cuts and a programme to improve the economy's self-financing capacity have lowered Hungary's external vulnerability, reducing gross external debt and long-term government securities yields.

Looking ahead, the asset management company established by the MNB based on its macroprudential mandate will improve the efficiency of the credit channel through a reduction in banks' portfolio of nonperforming  real estate loans. These measures provide an effective, long-term stimulus to the real economy, supporting the sustainable achievement of the inflation target. Developing capital markets, in general, provide an important way for central banks to allow companies to access alternative funding. Risk premia can be lowered using central banking measures to reduce the economy's vulnerability and improve the traditional transmission mechanism. Crisis management In contrast with Hungarian practice, along with lower interest rates, central banks have turned to quantitative easing through large purchases of government and other bonds. These crisis management instruments have side-effects, raising stability risks. Showing how these instruments have reached the limit of their value, yield curves have typically flattened out as risk premia diminished. The potential impact of further QE appears to be negligible. In addition, several developed country central banks have introduced negative interest rates, raising questions both in terms of efficiency and bank profitability. Monetary transmission channels have remained fragmented, and bank lending remains subdued. As a result of the international effect of QE by large central banks, bond issuance has boomed in emerging markets, starting to become dominant in a number of emerging economies. However, as a result of the issuance of corporate bonds in large volumes, rollover and renewal risks may take a heavy toll on stability. Furthermore, currency debt increased considerably in several countries due to favourable interest rate spreads, which itself raises the risk of debt repercussions in future years if exchange rates move adversely. Taking into account the fact that the most relevant internationally applied conventional instruments have been exhausted by now, central banks need to be more innovative in dealing with future deflationary shocks. A proper, well-chosen mix of targeted and conventional measures can be more efficient to deal with the challenges posed by the new, low interest rate environment. ▪

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*„A cikk az OMFIF Monthly Bulletin című magazin áprilisi számában jelent meg 2016-ban."*