Barnabás Virág

Deputy Governor - The Central Bank of Hungary

Monetary policy in the thunderous 2020s: navigating in a continuously evolving global economy to win the decade

Dear Chairman Wright,

Ladies and Gentlemen,

Distinguished Guests,

The previous Hungarian EU Presidency took place in 2011, when the global economy was emerging from a period of crisis – much like it is today as we try to find our way back to a sustainable growth path.

After a successful period in the second half of the 2010s, came a challenging decade. Our days are defined by a multicrisis, but our future depends on what we have learned in the past and in the present. **What was the past that shaped our present?**

The aftermath of the Great Financial Crisis determined the 2010s globally; however, years of the Great Moderation had continued bringing stable growth and low inflation. In these years, the CEE region had a successful catching-up story.

- **The CEE region showed a significant catching up to the Western European countries.** The average growth rate during the 2010s in the CEE country group was nearly double that of the EU as a whole at 2.9 percent in contrast with the EU's growth rate of 1.6 percent. Over the decade, CEE countries were the growth engines of Europe, generating around 20-25 percent of the EU's growth. Strong economic performance came hand in hand with low interest rate conditions, decreasing debt-to-GDP ratios, as well as low and stable inflation near or even below target levels, averaging 1.8 percent over the decade (while average inflation in the EU was only slightly lower at 1.5 percent in the same period).
- **In Hungary, we had to deal not just with the global and European challenges, but with our internal vulnerability problems too. The 2010s began with restoring balance in the economy.** A coordinated fiscal and monetary policy response was needed to address systemic risks in the banking system, as in the case of phasing out foreign currency loans in the household sector. For this, we had to implement many targeted reforms and turnarounds, which successfully paved the path of catching up with Europe.

What is the present like, which now defines our world and the years ahead? The 2020s has a completely different character than the 2010s. The Great Moderation has been replaced by the era of the Great Tension – although I prefer the term Great Transitions which includes opportunities as well as challenges. The first three years of the current decade have been dominated by unprecedented shocks, namely the coronavirus pandemic and the related economic consequences, the terrible Russia-Ukraine war, the energy crisis and other tectonic shifts in the geopolitical landscape. This multicrisis has left its mark on the regional developments.

- **The lessons of the previous years laid the foundation for a successful crisis management.** The resilience, or the immune system of the economies was stronger when the coronavirus pandemic hit the economies than it was at the outbreak of the GFC. The prompt, well-coordinated fiscal and monetary policies helped the quick recovery and enabled us to weather the storm with a strong labour market, resilient bank balance sheets, growing real wages and sound economic fundamentals, keeping the main pillars of growth intact.
- **After re-opening the economies, the age-old enemy of central banks, inflation re-appeared and rose to double-digit levels in several countries.**
- **The inflationary shockwave was a major challenge for the world, an even greater one for Europe, and greater still for the CEE region. Gravity works in the economy as well: countries closer to the conflict zone in Ukraine were hit harder by the war's economic ripple effects.** The CEE region was particularly affected due to high energy intensity and the jump in risk premium because of the geographical proximity to terrible war in Ukraine. Average CEE CDS spread

compared to EU more than doubled, while between June 2021 and January 2024, the accumulated inflation in the CEE region was nearly double than in the Western-European countries (28.2 and 15 percent, respectively).

- ***It was clear that we had to avoid the outcomes of stubbornly high inflation like in the 1970s.*** If there is one takeaway from the inflationary episodes of the 1970s, it is that if central banks do not stay disciplined and maintain positive real interest rates for an extended period, inflation will keep coming back.

- ***The CEE region was the frontrunner in monetary tightening as a response to rapidly growing inflation. It was obligated to be fast and decisive, because we recognised the inflationary patterns of the 1970's.*** The decisiveness and the targeted approach of the central banks paid off: the national central bank's actions played a key role in taming inflation. As a result of central banks' swift response to the inflation surge and their commitment to tight monetary policy we are now approaching price stability both globally and in the CEE region, including Hungary.

- **This decade has redealt the cards also in terms of economic growth.** Increasing geopolitical tensions and the world becoming more divided have led to fragmentation in global value chains and shocks in energy prices. After prospering years, Central Europe[1] has shown significant slowdown: until now, average growth dynamic in the 2020s has been by 1.5 percentage points lower than in the 2010s. Although the growth rate of the CEE region has slowed down considerably, it still exceeds the growth of the Euro Area, therefore the catch-up continues.
- **Compared to the decade of 2010, banking systems of the 2020s are significantly more stable and resilient, both globally and regionally.** European banks significantly improved their profitability. In the 2010s the average RoE in the EU was 2.4 percent, while in the 2020s it was 9.1 per cent in the EU member states. In the 2010s the average ratio of NPLs was 8.6 per cent in the EU, meanwhile, average NPL ratios fell to 3.2 per cent in the EU member states in the 2020s. Nowadays, European banking systems are characterised by healthier loan portfolios, and sounder balance sheets. This is partly due to the implementation of macroprudential rules and the favoura-ble labour market developments. Our decade is full of challenges; however, European banks have so far proved shock resilient, and are also better prepared for the upcoming challenges than they were a decade ago.
- **The main goal of dynamic catching up remains the same as before.** To achieve this, policies must be tailored to the character of the decade. Key terms include competitiveness, efficiency and productivity, the focus should be placed on these areas.

What does the <u>future</u> hold?
However central banks have performed successfully globally in the thunderous first years of this decade, inflation casts a long shadow. Legacy of high inflation still leaves a mark on economic performance. Our mission, the sustainable achievement of price stability, remains unchanged. The constantly evolving global economy with high degree of uncertainty will probably stay with us in the following years. Let me now briefly introduce the **four** most important lessons that shall guide us in the current era of challenges.

1) Remain commited

- The appropriate monetary tightening can prevent inflation from transitioning to a high-inflation regime. The decisiveness and the targeted approach of the central banks will pay off: the national central bank's actions play a key role in curbing inflation.
- Central banks must react immediately and decisively to surging inflation. The lesson of history is that price stability is a precondition for a sustainable economic growth, so restoring and maintaining it is crucial.

2) Prepare for the unexpected

- We must build buffers for unexpected situations. In turbulent times ensuring financial market stability is also key, and for this, we need room for manoeuvre. In a volatile environment, financial market stability is also necessary to achieving and maintaining the primary objective of price stability. Maintaining sovereignty in the energy sector, in finances and having adequate level of foreign reserves also strengthens the immune system of our economies, which in turn becomes more resilient against future shocks.

3) Be credible with clear communication

- Role of central bank communication has strongly increased. In times of more frequent supply shocks, the role of shaping expectations is more important than ever because effective anchoring inflation expectations can prevent second-round inflationary effects.
- In this decade, credibility has become the principal capital of central banks. Clear communication are playing a crucial role in anchoring inflation expectations. Economic performance can be restored only if there is confidence and belief in the future return of stability.
- Central banks can mostly contribute to stronger credibility by achieving and maintaining price stability and proving their strong commitments to this mandate.

4) The future is green and digital: be proactive

- Central banks can and must facilitate a faster and smoother green transition – and thereby can contribute the transition period being shorter. The MNB also undertook a pioneering role in supporting the green transition of the economy with several instruments, e.g. the legal mandate of the MNB includes the promotion of environmental sustainability since 2021.
- Moreover, digitalisation can open a new era in the history of money, e.g., through central bank digital currency (CBDC). This topic is actively researched nowadays by central banks around the world. According to the BIS survey on central bank digital currencies, 80 central banks from the 86 asked were engaged in CBDC work in 2023.
- Remaining at the topic of digitalisation: as cybercrime threatens digitalisation, we must fight for a protected cyberspace because trust can only be founded on safety.

Finally, I cannot emphasize enough the importance of our primary mandate. Despite a constantly evolving global economy, our principal mandate remains the same, to achieve price stability in a sustainable manner. In response to the decade of challenges, resilience is key, and central banks must remain innovative. The main takeaway of the 2020s is that in our highly volatile environment, there is no trade-off between growth and inflation: without price stability, there is no sustainable growth. Restoring a low and stable inflation environment is crucial in order to continue catching up.

We have to stay committed to our core principles of stability and sustainability while supporting sovereignty, competitiveness and cooperation. But also keep in mind that the future will be "green" and "digital". The green transition and digitalisation also support the competitiveness of the economy through improvement of energy efficiency. As a result, we have every chance to emerge victorious from the current decade of challenges.

1. Central European countries: Czech Republic, Hungary, Poland, Slovakia