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The Central Bank of the Future is Green – Sustainability and Monetary Policy in Hungary*

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Norbert Kiss-Mihály – Pál Péter Kolozsi:
Monetáris politika a fenntarthatóság jegyében – A Magyar Nemzeti Bank tanulmánykötete a zöld monetáris politikai eszköztár első évéről[1]
(Monetary Policy for Sustainability – A Book of Studies by the Magyar Nemzeti Bank on the First Year of the Green Monetary Policy Toolkit)
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With global temperatures continuously increasing, droughts occurring more and more frequently in recent years and floods, hurricanes and other natural disasters taking place almost on a daily basis, it has become imperative to treat policies addressing the quality and condition of our natural environment as top priorities. Having chased economic growth, GDP and per capita income indicators, humanity has entered a new era: the period of sustainable growth, or at least in terms of the goals.

However, setting the world on the path of sustainable growth requires serious intellectual and material resources. According to World Bank estimates, infrastructure investments amounting to nearly USD 90,000 billion are needed globally to achieve climate targets between 2015 and 2030. Such an investment volume can only be realised if funding is ensured, which necessitates support from banks, banking systems, regulators and central banks. The importance of this issue has also been recognised by the management of the Central Bank of Hungary (Magyar Nemzeti Bank, MNB).

In many respects, sustainable monetary policy and the toolkit for the green monetary policy were developed and introduced in Hungary with outstanding precision and speed, even from an international point of view. The events and observations of the first year of the green turnaround by Hungary's central bank are

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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[1] Available at: https://www.mnb.hu/letoltes/monetaris-politika-a-fenntarthatosag-jegyeben-a-magyar-nemzeti-bank-tanulmanykotete-a-zold-monetaris-politikai-eszkoztar-elso-everol.pdf

described in *Monetary policy for sustainability – A book of studies by the Magyar Nemzeti Bank on the first year of the green monetary policy toolkit*, edited by Norbert Kiss-Mihály and Pál Péter Kolozsi.

The chapter *International developments in green central bank programmes and practices* presents the sustainability measures of the world's largest central banks. As the authors highlight, the increasing number of negative effects of climate change, rising global temperatures and the related natural and material damages have made it clear to central banks that they must play an active role in catalysing sustainable economic development.

The primary goal of the central banks also justifies the necessity of their action. Droughts, fires and floods negatively affect the volume of agricultural production. The deteriorating quality of the air and drinking water, accompanied by an increased risk of quantitative and qualitative starvation, poses challenges in the availability of the workforce. The effects detailed above collectively result in inflationary pressure in the economy.

In terms of the actions initiated by central banks to address climate risks, the Network for Greening the Financial System (NGFS), established in 2017, can be considered a flagship. The organisation had 114 members on 13 April 2022. The rapid increase in the number of members clearly shows the turnaround in central banks' thinking and the advancement of the role of green finances. The MNB was the first Central European participant to join the group in January 2019.

The chapter *Green bond standards as the bases of sustainable financing* provides an explanation of the standardisation process in a market of new, innovative financial instruments. Among investors and issuers, instruments for financing environmentally-friendly activities have appeared in recent years, but the initial state of the market is well represented by the fact that no standardised definition of a green bond has been set, even though more than 14 years have passed since the first issue.

In addition to the world's first Green Bond Principles, established by the International Capital Market Association (ICMA), we can also list the Climate Bonds Standard, the European Green Bond Standard, which was only a draft at the time of preparing the study, the ASEAN Green Bond Standard in the countries of South East Asia, and the Green Bond Endorsed Project Catalogue in China. The market is in serious need of regulations as green bonds had been issued in 58 countries in 33 different currencies by 2021, and based on the market trends, this form of financing is expected to spread and become more and more popular in the future.

The chapter *The Hungarian green bond ecosystem and its related central bank programmes* presents the development in this field in Hungary. It can be stated that in the past years green bonds have become a key element in capital markets. The Funding for Growth Scheme (FGS) played a significant role in boosting the Hungarian bond market. Although Hungarian companies typically raised debt capital in the form of bank loans before 2019, the Hungarian corporate bond market caught up with the countries in the region by 2021. However, the Hungarian market for green bonds was not particularly significant at that time.

The MNB has made great efforts to reinforce the green bond market in Hungary. Up until the end of February 2022, all green corporate bonds in Hungary were issued within the framework of the Bond Funding for Growth Scheme (BGS). In addition, the share of green-rated securities in the central bank's corporate bond portfolio is also outstanding by international standards. The MNB purchased green corporate bonds with a nominal value of HUF 233 billion, accounting for 16 per cent of its total corporate bond outstanding.

The real estate sector, the construction industry and the financial sector are considered to be the most significant issuers of Hungarian green corporate bonds. This situation is beneficial for the achievement of climate goals as both the real estate sector and the construction industry have serious environmental footprints.

The chapter *Emergence of a new market segment: Central bank incentives for the Hungarian green mortgage bond market* explains the contribution of the MNB to developing and strengthening this market. In addition to the favourable indirect environmental effects, green mortgage bonds also represent beneficial, long-term financing for the banking sector. The advantage of this asset class is also emphasised by the green hypothesis. According to this theory, the risk profile of green mortgages is lower than that of similar standard loans. Hence, the increase in the volume of these investment products also reduces the investment risks of the financial actors holding them.

The issuance of Hungarian green mortgage bonds is further supported by the favourable treatment in the Mortgage Funding Adequacy Ratio (MFAR). In this sense, green mortgage bonds and refinancing loans can be weighted at 150 per cent in the MFAR indicator from 2021. This contributes not only to increasing the volume of green mortgage products, it also helps improve the capital position of the sector.

The chapter on the *Green turn of collateral management* presents the incentive and the method of expanding the range of the MNB's eligible collateral with green tools. The importance of this area is also indicated by the fact that central bank loans are only provided in secured forms. Therefore, the scope of eligible tools has a significant effect on what investments the banking system prefers to hold. The framework of collateral management is also influenced by monetary policy, risk management and operational aspects. In Hungary, government bonds account for the main part of the eligible collateral range. Making the tools of eligible collateral greener was also justified by the dynamic development of the green bond market and central bank goals.

As a result, this step by the MNB was also in line with international trends. The People's Bank of China included green bonds in the range of eligible collateral in 2018. Since September 2021, the European Central Bank has rated Sustainability-Linked Bonds (SLBs) as eligible collateral. However, the Hungarian central bank is not just a trend-follower: it was one of the first central banks to introduce the preferential green haircut. In doing so, it took the first steps to implement climate risk considerations in the framework of collateral management.

The chapter *Promoting a green home loan market: the FGS Green Home Programme* presents the central bank measures that were introduced to make the Hungarian housing market greener. The housing market is also an excellent field for implementing green aspects, due to the low energy efficiency of the dwellings, which account for one third of primary energy consumption in Hungary.

In accordance with the monetary policy strategy aimed at sustainability, as one of its first steps, the Green Home Programme (GHP), which was introduced in October 2021, promotes the sustainability of the housing market by providing central bank resources at favourable interest rates that can be applied for the purchase or construction of new, energy efficient dwellings. With the GHP, similarly to the Certified Consumer-Friendly Housing Loans, borrowers are supported with a number of consumer-friendly conditions. Such conditions, for example, maximise the credit assessment time and limit the scope and rate of costs to be imposed; furthermore, a favourable interest rate on the funds gives further motivation to potential borrowers in the rising inflationary and interest rate environment.

The chapter *Green aspects of the government securities purchase programme and a snapshot of Hungarian green government bonds* provides a description of central bank measures supporting the funding of government projects aimed at sustainability. With regard to the turbulence in the financial markets caused by the coronavirus pandemic, the MNB launched a programme for purchases of government bonds in May 2020. As a result, 30-year green bonds issued in April 2021 were purchased in the value of HUF 29.4 billion. This amount represented 31.4 per cent of the total outstanding in December 2021.

The Hungarian Green Bond Framework provides simultaneous support for the funding of sustainable government investments, the stable liquidity of the market of green state bonds and the strengthening of the transmission mechanism of monetary policy.