

Sustainability and Financial Issues at the 2022 Annual Congress of the Hungarian Economic Association*

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On 22–23 September 2022, the Hungarian Economic Association (HEA) – founded 128 years ago – held its 60th Annual Congress. This Congress, which was organised in Szeged this time, is one of the most significant annual conferences of the Hungarian community of economists and also the largest. The opening plenary speeches were delivered by *György Matolcsy*, Governor of the Magyar Nemzeti Bank (the central bank of Hungary, MNB), *Laurent Maurin*, Head of the Economics Department of the European Investment Bank, *Sándor Csányi*, CEO of the OTP Bank Nyrt. and *László Windisch*, President of the State Audit Office of Hungary and Member of the Sustainability Section of the HEA.¹ In this report, we give information on the roundtable discussion of bank leaders, the new sustainable economics and the sessions on financing sustainability.

Roundtable discussion of bank leaders

The event was moderated by *Barnabás Virág*, Deputy-Governor of the MNB and Member of the Board of the Competitiveness Section of the HEA, and included a roundtable discussion with senior executives of Hungarian commercial banks. The participants were: *Éva Hegedüs*, President and CEO of GRÁNIT Bank Zrt., Secretary General of the HEA, *Réka Vörös*, Member of the Board of UniCredit Bank Hungary Zrt., Head of the Retail and Small Business Division, *Radován Jelasky*, Member of the Board of ERSTE Bank Hungary Zrt., *Antal Martzy*, Deputy CEO of Hungarian Bankholding, *Pál Simák*, CEO and Chairman of the Board at CIB Bank Zrt. and *László Wolf*, Deputy CEO of OTP Bank Nyrt. and Vice President of the HEA.

In his introductory presentation “*Banking system 2022: In continuous preparedness*”, *Barnabás Virág* stressed that we are preparing for a difficult period, but in the first half of 2022 the banking system was in a better position than it was before

* 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 on the HEA's YouTube page: Opening plenary session: <https://www.youtube.com/watch?v=53T-tV-UW84>

the global financial crisis in all indicators: lending is healthier, the banking system is more resilient and stable. At the same time, the energy price surge, the rising interest rate environment, lower profitability, deteriorating credit portfolio quality, real estate market risks and overvaluation pose serious risks. As a result, credit demand is expected to fall in the latter half of 2022, also due to the tightening of credit conditions and adjustment by borrowers, further slowed by the higher effectiveness of the debt service-to-income ratio. A slowdown in retail lending has already been visible since June 2022. As regards bank deposits, while the interest rate on corporate deposits has steadily followed the increase in the base rate of the central bank, the average interest rate on retail deposits is only two per cent, far below the base rate which is over ten per cent. Retail credit risks are rising and tightening credit conditions should be expected. Consumers in small settlements are more affected. Businesses will have to operate in an environment of multiple risks: on the one hand, energy bills will rise significantly, and on the other hand, the demand side will also tighten, and thus the corporate sector will come under pressure on both the cost and revenue side. However, the magnitude of the cost shocks may vary from sector to sector, and the question is who can pass on the current higher costs to their customers and to what extent. The likelihood of default is expected to increase significantly as a result of the many shocks.

Among the challenges ahead, the *green transition* is to be highlighted. Supporting this transition is of great importance for the banking sector as well. Climate risks may lead to significant losses in the banking sector as well (e.g. in relation to the agricultural sector), but green collateral and credit risks for customers seeking green loans could become lower, and financing the green transition could increase investor demand and reduce borrowing costs. The central bank has been and remains very active in the green transition. The MNB will help the banks to develop dedicated green loan products and differentiate their pricing decisions to take climate risk into account. At the macroeconomic level, a higher share of green energy investments could be a key factor for both the government, the central bank and the banking sector, which will require an increased mobilisation of financing resources.

Finally, he underlined that there is a consensus that it is important to move forward with *digitalisation* as quickly as possible. The good news is that the Hungarian banking system has made steady and significant progress in this area, especially in terms of digital strategies and solutions for management and workforce. However, it is still worth accelerating the digital transition in the product range. Overall, the sector's digital maturity is still only at a medium level and thus future improvements are still needed.

The first topic of the roundtable discussion was the expected path of growth, i.e. whether a temporary, short *recession* or a prolonged, massive recession can be expected in 2023. According to commercial bankers, there is now a state of "calm

before the storm". The biggest problem is inflation and its persistence, which is pushing the economy towards recession in an environment of rising interest rates. Growth is projected to be close to zero in the first two quarters of 2023, followed by a slight increase and a gradual decline in inflation after a peak in the first quarter of 2023. The key questions are: a) how the balance of payments, which may exceed even 8 per cent of GDP, will develop and this will have to be financed; b) whether an agreement with the European Union can be reached as soon as possible; c) when the Russia-Ukraine war will end. Fiscal adjustment may also be needed to preserve the balance. Household consumption is expected to slow down significantly.

Regarding *bank profitability*, it was said that although interest income had increased, profitability had been negatively affected to a large extent by, for example, the extra profit tax, the moratorium, the interest rate freeze, the impairments or the one-off cost of Sberbank as a payment to the National Deposit Insurance Fund. The banks accept that the economic situation is difficult and that they have to share the burden because of their social responsibility, but they believe that their burden should not be increased, and that the banking system should not be overstressed, as it moves along with the economy. *Barnabás Virág* pointed out that the banking system has about HUF 10,000 billion in deposits with the MNB, on which it receives interest of the order of HUF 1,000 billion, contributing significantly to the profitability of the banking system.

It was also discussed that the Hungarian banking system is not cost-efficient compared to European banks. But there is an important breakthrough potential here, because if a bank can be put on a more cost-efficient path, its profit-making capacity can be sustained in the long term. Labour shortages could also be a problem, making operations difficult and even affecting profitability, although this could change next year.

The *pro-cyclical behaviour of banks*, whereby they over-lend in times of economic growth and over-reduce the amount of lending during recessions, deepening the downturn, was also addressed. In the retail *credit market*, mortgage interest rates are above 10 per cent, which puts a heavy strain on household budgets, and therefore demand for credit is expected to fall. Personal loans are less price-sensitive, but there is a sort of wait-and-see attitude in case of home renovations and car purchases, although green renovations are still expected. Overall, this segment is less likely to experience a downturn. As regards corporate loans, it is seen that many firms are postponing or suspending their investments, which means that less investment borrowing is expected and the average maturity of the loan portfolio will be shorter. Exceptions to this may be the green loans that improve energy efficiency with state support. Many companies are doing well without external funding, and lower interest rates would be needed to increase investment loans.

Guarantee institutions can also play an important role, as it is not possible to finance investments on a market basis. Working capital loans, on the other hand, tend to increase as firms try to build up inventories to service their customers. In addition, many firms are reducing their outstanding debt. For the time being, the Széchenyi Programme meets the credit needs of small and medium enterprises at low interest rates. Banks will only grant foreign currency loans to export-oriented firms, as they have foreign currency earnings.

The corporate sector has never had such high *deposits*. The interest rate on these has risen in line with the base rate, as companies have a strong bargaining position. Interest rates on retail deposits, on the other hand, are far below the central bank base rate, except for the latest special products of a few banks. As a reason for this, bank managers stressed that there are savings opportunities available on the market that offer much higher returns than deposits, such as recently issued sovereign debt instruments. The public can always achieve higher returns on alternative investments than on bank deposits. According to the banks, their role is to help their customers navigate the investment options to find the best form for their risk tolerance. They believe that as long as they have to pay a special tax, this acts against raising deposit rates. The consumption habits of the Hungarian population also contribute to low interest rates, as they are attached to deposits, safety and liquidity. It was said that only about 30 per cent of the population is considered financially aware; they have savings and they pay attention to returns. Virág also noted that the lack of competition plays a role in the fact that banks do not raise the interest rates on retail deposits sufficiently.

Regarding *credit risks* in the household segment, the increased utility bills and higher food prices should also be taken into account, especially for those with low incomes. Fortunately, the portfolio is of very good quality, especially in real estate, and the loans are largely fixed-rate, with fewer and fewer people remaining in the moratorium. In addition, the population is prepared for the extra costs that energy price changes will entail, and wages have increased significantly. In terms of corporate credit risks, some sectors, such as hotels or energy-intensive sectors, need particular attention, but the companies engaged in energy production and energy saving are good debtors. For customers in difficulty, the banks are preparing credit relief packages.

The last topic was the issue of *digitalisation*. Banks are constantly digitalising their operations, and the pandemic has given a huge boost to this as well as to the social attitude that people can not only shop, but also bank online. Digitalisation first appeared in the area of payment services, but will continue to spread to all product areas. Digitalisation is also urgently needed in the internal processes of banks, including risk management and lending processes, to make the whole banking system simpler and cheaper. Banks are starting to build an ecosystem

where financial transactions have to be delivered quickly, flexibly and cheaply. There are banks that are building their own IT competencies as a major pillar of digital transformation, and this requires the direct employment of talented professionals who worked for suppliers so far, because the key issue of digital transformation is workforce.

In conclusion, Virág noted that we are facing a very difficult year and a challenging period for the economy, families, companies, banks and decision-makers, but hopefully in a year's time more positive developments can be reported.

New sustainable economics

The session, organised by the Competitiveness Section of the HEA, focused on the book "*New sustainable economics – A global discussion paper*", which was released in May 2022. The main message of the publication is that a sustainability turnaround is needed in all areas of life, but that this requires a fundamental transformation of economic thinking. In order to share ideas and experiences as widely as possible, the central bank has launched a lively dialogue on the subject. This also included a session where renowned economists gave their views on the fundamental issues of sustainable economics.

According to *Gergely Baksay*, MNB's Executive Director of Economic Analysis and Competitiveness, the central bank aimed to make the book easy to read, while also providing an overview of how the institution envisages the future of economic thinking.

In the presentation, it was noted that the second half of the last century has seen extraordinary economic growth in the world, with some Asian countries being particularly successful and making exceptional progress in catching up. But the sustainability of economic growth is becoming increasingly questionable as the main drivers of growth reach their limits. The central bank has identified four main constraints. The first is the *demographic constraint*, reflected in the low birth rate in developed countries. The second one is the *ecological constraint*, as we are currently overconsuming natural resources globally, with some estimates suggesting that we are using up nearly 1.8 Earths worth of resources. The third constraint is *fiscal balance*, as public debt in developed countries has risen to levels not seen since the Second World War. The fourth one is the *productivity constraint*, which is reflected in productivity growth in developed countries that has been slowing for decades and converging towards zero. In addition, the cyclical waves of technological innovation since the industrial revolution also require a renewal of economics.

According to Baksay, sustainability issues raised are not sufficiently addressed in economics. The top five economics journals, for example, published analyses on

environmental sustainability, social inequality and digital money in just under 1 per cent of their articles over the last 10 years. According to the Executive Director of the MNB, a fundamental change, a paradigm shift is needed in economics. The new economics must have a number of characteristics and be based on *sustainability*, as the sustainable use of resources is the key to the survival of our civilisation. It is useful if other disciplines are integrated into economics, i.e. economics itself becomes *multidisciplinary*. In the world of digitalisation, the new economics *looks at communities and networks*. *Knowledge and talent* must be valued as the key drivers of economic growth. In this process, *data* is also a new resource. Revolutionary changes are taking place in the world of *money*, where new technology is also emerging, for example in the form of central bank digital currency.

The participants of the panel discussion agreed on the need to renew economics. *Gábor Bartus*, Secretary of the National Council for Sustainable Development (NCSZ), said that economics is always changing and no strict limit can be set to the individual trends. The main problem he sees is that there is less and less intersection between economic policy and economics. Often decisions are made that have been repeatedly disproved even by the old economics. *Magdolna Csath*, Professor at the Pázmány Péter Catholic University, agreed with the central bank's suggestions, and she emphasised that economics often uses only economic, quantitative measures, while it should not only deal with the economy, but also with qualitative (social, environmental) factors. This new way of thinking should be made part of mainstream economics. She proposed, among other things, that national wealth should be the decisive factor in judging a country's success, rather than GDP. *György Szapáry*, Chief Advisor to the Governor of the MNB, put the issue in historical perspective, showing that the introduction of the euro was also a paradigm shift. In his opinion, the task of economics is to identify the challenges of the future and to try to find answers to them in all cases. In his view, there have always been paradigm shifts in economics. In particular, he highlighted the demographic situation as a major challenge, which, in his view, has cultural and social causes for the declining population in developed countries. *Csaba Lentner*, Professor at the University of Public Service, highlighted the transformation taking place within mainstream economics. Central banks are a central part of this new type of economics, and their role has been significantly enhanced in the last 15 years or so. For example, before the global financial crisis of 2008, the scope of central bank responsibility was too narrowly interpreted, whereas nowadays central bank decisions in a crisis have become more concerned with growth and financial stability as well as inflation.

According to *Magdolna Csath*, competitiveness must be complemented by agility. Competitiveness is a complex system, just like the immune system, whose point is the same: to be able to prepare for unexpected situations. Resilience has to be

built up for which agility and the ability to react quickly are essential. It is all based on data and data analysis so that we can make projections based on past data. To assess a given event, it is not enough to look at a scenario; a more open approach is needed. For example, the feasibility of an investment needs to be looked at in the long term, not only the investment itself, but also possible alternatives.

György Szapáry explained that Americans think very much like Europeans on economic issues. In his opinion, the IMF has always tried to achieve both balance and growth in the countries it has supported, but this has almost never been achieved. He sees the increase in public debt as a new challenge. Since the 2008 crisis, the ratio of countries in Europe that exceed the Maastricht debt criteria has increased significantly. In a rising interest rate environment, where risks and premiums are also rising, a high public debt may not be manageable and fiscal intervention becomes necessary, but this is made more difficult by the fact that European countries are currently facing several crises at the same time, including migration and the energy crisis.

Csaba Lentner said that if Hungary wants to catch up with the average level of development in the EU, it must invest in knowledge. In the foreseeable future, the Hungarian economy can only catch up if it shows a significant economic growth surplus above the EU average, based on education. For the time being, he says, Hungarian universities can meet the graduate labour needs of large companies, but this is not the case for the SME sector. This means that the share of graduates and skilled workers must be increased. Universities are undergoing a transformation; operation in the form of a foundation has proven that where the owner is closer to the management, performance comes more to the fore.

Gábor Bartus explained that, in his opinion, we are a long way from representing the desired level of sustainability in economic policy. He argues that in the developed countries the identification of the problem and the setting of relevant targets is appropriate, but the choice of instruments is not always good and achievement of the targets is mostly unsuccessful. The NCSO report, published in 2013, is reviewed every two years and it was found that progress towards implementation is slow, despite the agreed strategy. But this is not unique to Hungary – similar problems can be identified in the EU in general. In his opinion, there are areas where deterioration can be observed. One of these in Hungary is resource productivity, which has weakened over the last decade. We are using more and more resources to produce a unit of GDP, i.e. along with high economic growth, we are increasingly overusing natural resources.

In *György Szapáry's* opinion, we will only be able to tap the potential of the economy if we focus on education. Higher education is also very important, but the gateway to it is public education, which needs to be developed in Hungary.

The number of people applying for teacher training is falling, and only 70 per cent of graduates are employed in the profession. A career in teaching can be made more attractive if earnings prospects improve. In addition, the teachers are overloaded and there are few of them, and so less time is spent on one child.

Speaking about the innovation performance of the Hungarian economy, *Magdolna Csath* said that the only way forward is to make the most of everyone in education and to think systemically. However, education is only one side of the coin, because the knowledge acquired can only be put to good use if the well-educated young persons can find jobs in the labour market. The economist said that when looking at the input and output side of innovation performance, the latter is more of a problem. The very low number of patents, the lack of innovative employment and the lagging status of sustainable ecological products all show that improvements are needed. According to the expert, innovation should not be interfered with from above, but rather the environment should be made supportive.

The final question of the session was how to bring environmental sustainability to the forefront of economic thinking. According to *Gábor Bartus*, crises can bring about great change, although given the current circumstances, he does not wish for more crises for anyone. For example, the direct effect of the current energy crisis is that demand for solar panels has never been so high. So the rising energy prices as a price signal also affected people. In all cases, it is extremely difficult to make a change happen, but incentives can play a great role. On the other hand, if the price signal is too strong at the same time, it also carries a social risk.

Financing issues of sustainability

A presentation by *Csaba Kandrács*, Deputy Governor of the MNB, opened the session “*Financing issues of sustainability*” on the afternoon of 22 September. The opening lecture, titled: “*Financing sustainable economy – The road to sustainability*”, placed the financing issues of the sustainability transition in the context of current global economic challenges.

Among the ideas raised in the presentation, it is worth highlighting that the issues of sustainability and energy efficiency gained momentum in the current turbulent economic environment burdened by the energy crisis. Following the COVID-19 crisis, the world economy faces disruptions in energy and food markets with dwindling reserves. With energy security now a priority in most European countries, the energy crisis could be a catalyst for a sustainability turnaround by forcing the necessary action. This is possible because increasing our energy security and achieving climate neutrality require almost identical steps. Reducing the use of fossil fuels could thus reduce Hungary’s exposure and vulnerability as well as its greenhouse gas emissions. It is also worth mentioning that the latest study

by McKinsey, a consultancy firm, argues that climate neutrality can be achieved in Hungary by 2050, but that this would mean a substantial additional cost of EUR 150–200 billion. It should be remembered that investing in the transition is also a business opportunity and can support economic growth. According to the analysis, a large amounts of investments could not only boost GDP growth but also create new jobs for the Hungarian economy. The Vice President also reminded the audience that the tightening monetary policy environment does not mean a scaling back of the central bank’s green measures, but only a change in focus. The current period is therefore an excellent time for scientific workshops, for example.

This was followed by a presentation by *Balázs Dobos*, Deputy State Secretary for Business Development at the Ministry of Culture and Innovation, focusing on the government’s sustainability plans for business development. The Deputy State Secretary underlined that the government’s sustainability targets are of course guided by the EU targets, which aim to achieve climate neutrality at the EU level by 2050. In the green transition, domestic SMEs face both structural and acute challenges. The presentation focused more on the structural problems, which were typically already present in the period before the COVID-19 crisis. Among these the productivity of the domestic SME sector, which is below the EU average, and the need to increase exports and enter new markets due to the open economy have to be highlighted. Meeting the technological challenges of a fast-paced global world is difficult, and the digitalisation efforts have already taken up considerable resources. Addressing these challenges is essential for the sustainable development of domestic businesses. The Deputy State Secretary mentioned that in many cases, the sustainability expectations placed on businesses appear on the demand side. KPMG’s 2021 international CEO perceptions survey shows that 58 per cent of executives have already faced higher stakeholder expectations for increased reporting and transparency. These expectations are first formulated for large companies, but the process quickly spills over through the supply chains to SMEs as well. The presentation identified three directions for government intervention: promoting operational sustainability, expanding financing opportunities and supporting customer and regulatory compliance.

The panel discussion was closed by *Richárd Végh*, CEO of the Budapest Stock Exchange (BSE), who also chairs the Sustainability Section of the HEA. In his presentation, he argued that sustainability and capital markets go “hand in hand”, as ESG² has in fact now become a corporate competitiveness issue. The ESG approach has been present in capital markets for years, mainly as a risk management tool for investors. Responsible investment management should therefore include the consideration of sustainability aspects, which recent experience shows is increasing in frequency. In the view of the BSE’s CEO, this trend is a wave that no company can

² ESG: Environment, Social and Governance

avoid, so it is worth being prepared to comply. Végh pointed out that the number of investors committed to responsible investment principles and the volume of assets under their management is growing exponentially, so it is expected that in a few years it will be very difficult to find investors in the capital markets for companies that do not comply with ESG principles. The legislative framework to support the sustainability transition is continuously evolving, with an important element being the common taxonomy, which aims to develop a common set of concepts, common indicators and a technical framework for data reporting. The BSE aims to develop ESG awareness in the domestic market through ecosystem development and knowledge sharing. The BSE's vision is to create a domestic ESG hub with the involvement of financial system stakeholders and representative organisations.

The introductory presentations were followed by a roundtable discussion on the corporate and banking side of green finance. The discussion was moderated by *Rita Szalay*, Managing Director of ESG Capital; the panellists were *Gergely Pókos*, Managing Director of the OTP Bank's Green Programme Directorate, *Péter Tőreki*, Head of MOL Group Funding, and *Attila Vajda*, Managing Director of Vajda Papír Kft.

The discussion was prompted by the idea that in recent years we have been hit by several crises, sometimes in succession, sometimes in parallel. The economic slowdown caused by the COVID-19 pandemic and the shutdowns was followed by a war-related energy crisis and damage to supply chains. But behind all this, the negative impacts of climate change on the economy, the environment and the population still remain. The companies represented in the discussion naturally face very different challenges. For the MOL, maintaining security of supply is of paramount importance, while at the same time continuously reducing oil exposure to Russia and achieving independence. *Péter Tőreki* also stressed the importance of foresight and anticipation. In the case of the MOL, several items were already pre-financed in the much more favourable interest rate environment, which puts the company in a more favourable position. The participants agreed that although demand for green assets has been steadily increasing, the green premium or "greenium" has effectively disappeared from financial markets in recent years. According to *Gergely Pókos*, this is a temporary situation caused by the current poor economic outlook. However, the green premium is not the only attractive factor for green financing, as the need to meet ever more stringent and growing sustainability criteria is also pushing companies in this direction.

With regard to the challenges and opportunities related to the green transition, *Attila Vajda* highlighted the importance and role of self-produced renewable energy in reducing costs and achieving sustainability goals for manufacturing companies. According to *Gergely Pókos*, when it comes to sustainability solutions, it is always worth thinking about what we can do today. What is the practical solution that is tangible and can work today? In his view, the practical green solutions are

currently related to energy supply, energy efficiency and transport, which are worth considering for everyone, both in the corporate and residential sectors. At the moment, everyone is trying to wade through the forest of regulations to get a good ESG rating, as an outstanding rating can give a company a competitive advantage. However, caution is advised with regard to some ESG ratings, as the consensus is that in this segment “wild west” conditions partly still prevail, with some rating agencies issuing ESG ratings without dialogue or consultation and without having all the necessary information. In addition to the environmental pillar, other aspects of ESG—social and corporate governance—highlighted by the panel included healthy lifestyle programmes, integrity and transparency, increasing the proportion of female employees and managers, and cooperation with non-profit and charitable organisations.

The above sessions are available on the HEA YouTube channel (in Hungarian).³

³ Roundtable discussion of bank leaders: https://www.youtube.com/watch?v=VB_GWPM3N_U, New sustainable economics: <https://www.youtube.com/watch?v=gom1SI8BZg>, Financing issues of sustainability: <https://www.youtube.com/watch?v=sFHBLCoXbXs>