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Article

## National Bank of Hungary Preview: All eyes on stability

We have seen no material improvement either in the risk environment or in the macro outlook which would make the National Bank of Hungary think about any change. We expect a reinforcement of the hawkish 'whatever it takes' stance, even if we get some positive news about the Rule-of-Law procedure



The National Bank of Hungary in Budapest

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# 13%

ING's call

No change in the base rate

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### The rationale behind our call

Since mid-October, the National Bank of Hungary has been in Phase 3 of its tightening cycle. This means it has used both temporary and targeted measures to ensure both long-term price stability and short-term market stability. In this regard, the effective (marginal) rate is defined as the one-day deposit quick tender.

After the previous rate-setting meeting, Deputy Governor Barnabás Virág highlighted that the central bank needs to see a significant improvement in general risk sentiment to gradually reduce the spread between the base rate (13%) and the effective rate (18%). General risk sentiment is defined as a combination of external (war, global monetary policy, energy, general investor sentiment) and internal risks

(Rule-of-Law procedure, current account imbalance).

As we see no material improvement in these criteria, we expect no change in the monetary policy setup. Regarding the war, the Polish missile incident proved that the geopolitical situation remains very fragile. We can say the same about general investor sentiment as well. When it comes to global monetary policy, we might see the beginning of a slowdown in general tightening as we approach year-end, but as a developing, BBB-rated economy with a free-floating currency, it is too early to make a move on these early changes. Hungary's gas storages are now filled, so the worst-case scenario is off the table, though the energy crisis is still with us and winter is still ahead.

On internal risks, the current account balance has been dragged down by the import of energy goods. After the record trade deficit in August (EUR 1.58bn), the balance in goods showed an improvement in September, posting just a EUR 0.65bn shortfall. The same happened with the monthly current account balance, showing a roughly EUR 0.5bn improvement to EUR -1.1bn from August to September. A small step in the right direction but not enough to label it as a permanent and material change.

Finally, there is the Rule-of-Law debate. The next milestone here is the European Commission's report and recommendation which will be published on 19 November and the following European Commission meeting on 22 November. By the time the NBH's rate-setting meeting takes place (also 22 November), we might see some positive headlines coming from the European Commission regarding the Rule-of-Law procedure. With a green(ish) enough light, Hungary may be able to secure a signature on the Recovery and Resilience Facility just in time so as not to lose EUR 4.6bn of the EUR 5.8bn grant which is at stake should Hungary miss the year-end deadline to have its plan accepted. However, no matter how green this light is, we don't expect the central bank to make a policy change on that very quickly and we expect the NBH to underscore its hawkish "whatever it takes" approach again.

When it comes to macro developments, neither the inflation nor the GDP outlook show a material decoupling from the latest central bank forecast. Core and headline inflation readings moved higher in October and the peak might come only in late 2022 or early 2023. This gives no room for manoeuvre in monetary policy this time. [Real GDP has started to decline on a quarterly basis](#), but as it is just the first leg of the technical recession, Hungary is not out of the woods yet from an inflation and external balance point of view. Moreover, this drop in economic activity was widely expected, including by the central bank.

And yes, despite the 18% marginal rate and the hawkish monetary policy stance in Hungary, the forint has remained volatile. The recent market movements have provided excellent proof that it is not fundamentals, monetary policy intentions or financial processes that decide what happens to a given country's financial assets. In our view, all this confirms that the central bank will continue to maintain a high state of alert and policy flexibility. In our [FX Outlook 2023](#), particularly in our [CEEMEA FX Outlook 2023](#), we said that a material improvement in risk sentiment could translate into a gradual convergence of the effective rate to the base rate, starting as soon as late December. Perhaps even that seems to be too optimistic based on the developments of the past few days. At the moment, it is more than likely that the central bank will change interest rates on its temporary and targeted

measures only at the beginning of next year.

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