

## National Bank of Hungary Preview: Ensuring market stability, no matter what

The National Bank of Hungary held an emergency meeting on 14 October, switching to a 'whatever it takes' approach. We expect the central bank to maintain this new modus operandi to ensure market stability. In our view, this out-of-the-box thinking will continue to support the forint



The National Bank of Hungary in Budapest

# 13%

ING's call

No change in the base rate

## The rationale behind our call

The National Bank of Hungary decided to make an [extraordinary intervention to ensure market stability](#), defending the forint. In this new, extremely flexible monetary policy setup, the key instruments have become the overnight deposit quick tender with an 18% interest rate, and the one-day FX liquidity-providing swap tenders with a 17% interest rate.

Though there is room to hike rates further if needed, as the upper bound of the interest rate corridor was moved up to 25%, the initial market reaction shows that current interest rate levels may be enough to enforce the NBH's political will.

Against this backdrop, we can't see any material changes to the system when the Monetary Council meets on 25 October. We think the central bank will repeat its strong message regarding its willingness to ensure market stability, whatever it takes. In addition, the NBH will make sure to echo its primary objective, which is fighting inflation and ensuring price stability.

What could help the central bank's job is the coming recessionary period in the Hungarian economy. High inflation and high interest rates will dampen domestic demand, reducing the import needs stemming from consumption and investment over the next two to three quarters at least. This will help to improve the current account balance which has put additional structural pressure on the Hungarian forint via a massive deterioration. The recent trend-like decrease in global commodity prices might also help the slow rebalancing of external financing needs.

The latest measures by the central bank will also help this by providing FX to the main energy importers. This is basically a targeted, indirect FX intervention using the bank's FX reserves. We see the recent level of FX reserves as providing ample room for this action. The central bank's FX swap lines with major central banks and regional peers will provide an additional cushion in this operation. On top of this, transfers related to the 2014-2020 EU budgetary period are coming through and given the seasonality of the flows, we expect a significant improvement in the capital account during the fourth quarter of 2022.

However, these positive impacts will take time to affect market stability, thus we see the central bank as maintaining its recent stance for the foreseeable future. This means that we expect the overnight deposit quick tender to remain the key instrument, alongside the one-day FX swap tender. Regarding the level of interest rates, we see the NBH as maintaining recent levels until both the global and the country-specific risk environment improves materially.

## What to expect in rates and FX markets

Last week's emergency rate hike sent the IRS curve inversion to new record levels and unsurprisingly stopped our expected curve normalisation. We see this situation as a fresh start for our earlier view of a steepening curve. At the short end of the curve, we see a safe situation at the moment due to the return of the forint to late September levels. At the same time, we expect the long end to continue to be moved higher by rising core rates. Of course, for this view to hold, we need to keep a close eye on the forint, which seems crucial for additional rate hikes. With the NBH's recent moves, the risk of further hikes decreases, which is beneficial for our steepening view. However, we can't say this with high conviction due to the FX sensitivity of short-end rates, and on top of that, we see liquidity problems in the market.

Hungarian government bonds (HGBs) have richened again against the IRS curve. In asset swap

(ASW) terms, HGBs look expensive, which could be supported by the positive budget outlook and secured issuance numbers. On the other hand, these two markets seem to have been disconnected for some time, creating two separate markets. Overall, given global conditions in the form of negative sentiment and rising core rates, HGBs might remain under pressure in the short term. However, this could be changed by some positive news flows regarding the Rule-of-Law debate.

The Hungarian forint has returned to late September levels after last week's emergency rate hike. In our view, the strengthening in recent days has been driven by favourable regional conditions in the form of falling gas prices and friendly EUR/USD levels as well. Considering that HUF remains sensitive to global risk aversion, we can't rule out some periodic correction. For the time being, however, the forint should remain supported and enjoy this moment of peace created by recent central bank actions and global conditions.

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