NBH review: Liquidity is king

Unlike most CEE central banks, the central bank of Hungary did not embark on QE but rather introduced emergency liquidity measures. As this is an on-demand tool and at the cost of 0.90%, it does not mean it will flood the market with too much liquidity. It is not overly negative for HUF either

Hungary's parliament building in Budapest

- The central bank revised its growth outlook downwards to the 2-3% range in 2020 and to 4-4.8% in 2021, based on different scenarios. We see this outlook to be optimistic, but it explains why the NBH was not ready to deploy its main weapon.
- The NBH kept interest rates unchanged. Even with this decision (and considering what other CEE central banks delivered), the NBH base rate and interbank rate (Bubor) remains the lowest in the CEE. On the other hand, it took further liquidity measures to ease tensions in funding markets caused by Covid-19, but it isn't a QE.
- It's rather an on-demand emergency liquidity measure, a long-term (3-6-12m and 3-5y) collateralised lending facility. Though powerful in a sense of it being unlimited, there is a soft floor of 0.90% on the interest rate charge ("the interest rate may not be lower than the base rate"), which is above the level of 1y, 3y and 5y HUF IRS. As there is no limitation on how the commercial banks can use this extra liquidity, it can support the HGB market or incentivise fixed-rate lending.
- As an on-demand tool, its function doesn't look as it is aiming directly to flood the market

with liquidity like FX swaps did up until now. Other than this, an extra HUF 250bn extra liquidity is coming from the cut to RRR. Albeit the targeted band of the crowded-out liquidity remains unchanged at HUF300-500bn, the NBH emphasised that it's also a minimum level. As forward guidance, the NBH remains in data-driven mode and despite this it will still rely on the Inflation Reports, a change in the monetary policy can come anytime if the situation warrants.

FX

We see the EUR/HUF reaction to the announced set of measures as excessive and not justified. As this is not QE but rather an on-demand emergency funding (at a non- negligible cost of 0.90%) it does not necessarily follow the market will be flooded with excessive liquidity (above and beyond what we are used to). Also, compared to its CEE peers, the NBH steps during the Covid-19 crisis have lagged the dovish steps from the NBP, NBR and CNB (where all central banks cut rates and embarked / are to embark on QE). This should be, at least in relative terms, perceived as HUF positive.

Domestic debt and rates

We expect the central bank's NBH measures to indirectly rather than directly help HGBs. Indirectly in a sense that emergency liquidity measures announced should limit scope for the periods of HGBs sell-offs and deleveraging we have seen in HGB market over the past weeks. From this perspective, the liquidity risk premium in HGBs should recede and be positive for the bond market. We don't look for a direct help as (a) this is not QE; (b) it remains to be seen how much will banks tap the emergency liquidity at 0.90% as it is above 1y, 3y and 5y HUF IRS, meaning that the extra liquidity may not necessarily flood the market. But as liquidity risk premium was the risk to HGB in past weeks (and led to the pronounced sell-offs), we see today's measures as positive for HGBs.

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