

## Hungary: Countdown to tightening reaches one

Core inflation ex-tax has just reached the 3% target, suggesting monetary policy normalisation is coming very soon, but not next week. We have one semi-serious and two strong arguments favouring a wait-and-see approach



### Inflation reached the target ...sort of

As the NBH's latest press release suggested, the Monetary Council is going to start policy normalisation as soon as core CPI ex-tax reaches or exceeds the target. With this measure having reached 3% (2.988% for the sake of accuracy) in January, mainly on market services, it has become clear that the NBH will start the tightening soon ...but not at its next rate setting meeting next week (26 February) as – being semi-serious here – we are still, in fact, below the target.

### External factors could affect the inflation forecast

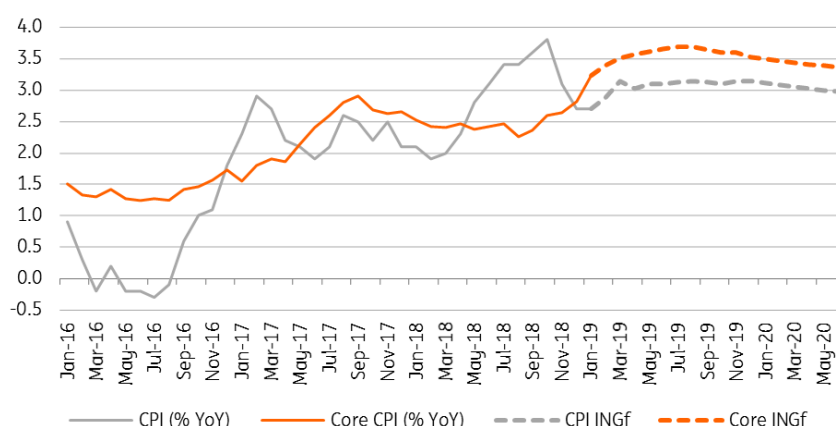
The global environment could potentially affect economic activity as well as core inflation, which is on the monetary policy horizon. If moderate growth prevails in Europe, especially in Germany, it implies downside risks for underlying inflation in Hungary. As the ECB also seems less likely to start policy normalisation in 2019, based on the latest comments by ECB prominents, it suggests that

the NBH is likely to wait until the next Inflation Report. The upcoming new staff projection in March might have an bearing on the velocity of the tightening cycle, but won't influence the starting point, in our view. This is based on the fact that the NBH emphasised that domestic underlying inflation is far more important from a monetary policy point of view, than what the ECB will or won't do.

## The NBH can't wait for long

We see the core CPI ex-tax rising clearly above the target in February, to reach 3.2% YoY. Moreover, it could go as high as 3.5% YoY by mid-2019. Against this backdrop, the NBH must start its tightening cycle, even if some of the downside risks come true. Failing to start at least in March will damage the central bank's credibility. So why wouldn't we call for an immediate start of the tightening cycle besides the outdated inflation forecast of the NBH? Because another factor will play a significant role in the expected hold in February, calling for a one-month delay: the ability to use the available tools for tightening.

## ING inflation forecasts (% YoY)



Source: NBH, ING

## The role of crowded-out liquidity is essential

At the next opportunity, in March 2019, the Council will decide on the amount of liquidity to be crowded out and will take this into account in setting the stock of central bank swap instruments.

The normalisation will consist of two components simultaneously, according to our understanding. First, a shift in the interest rate corridor (or only a hike in the overnight deposit rate, as we forecast) and, second, a reduction in the amount of the FX swaps portfolio providing HUF liquidity. FX swaps are the essential instruments setting the excess liquidity in the banking sector, so a reduction in this will decrease the 'crowded-out liquidity'. However, the Monetary Council can decide on the amount of liquidity to be crowded out only at the next opportunity in March 2019. This technical issue increases the chance of a February wait-and-see meeting and an action-packed March meeting.

## Summary

We believe that we are only one month away from the start of the Hungarian monetary policy tightening. The soft 3% core CPI ex-tax, the latest developments in the external

environment, thus the outdatedness of the December NBH Inflation Report and staff forecasts and the missing availability of adjusting the crowded-out liquidity in February all call for a one-month delay. The 26 February rate-setting meeting could simply be the prologue for an action-packed March gathering.

## Author

### Peter Virovacz

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).