Extraordinary intervention by the National Bank of Hungary

The National Bank of Hungary has held an extraordinary meeting in which it announced changes to the monetary policy toolkit with immediate effect. The decisions will help stabilise the FX market and ease pressure on the forint

The National Bank of Hungary in Budapest

The changes

The Monetary Council reviewed the latest economic and financial developments and decided to introduce several changes to the monetary policy setup:

- The central bank raised the overnight collateralised lending rate from 15.5% to 25.0% and suspended the one-week collateralised loan with effect from 8:45 a.m. CET on 14 October.
- From today, the National Bank of Hungary (NBH) is announcing a one-day (T/N) foreign exchange swap instrument and overnight (O/N) deposit quick tenders on a daily basis at higher interest rate levels than before.
- According to the pre-recorded announcement by deputy governor Barnabás Virág, the interest rate of the T/N swap instrument has been set at 17%, while he announced an 18%

interest rate for the first O/N deposit quick tender.
- In addition, the central bank commits to directly meeting major foreign currency liquidity needs arising from covering the energy import, over the coming months.

Our assessment

In our view, this can be seen as an emergency rate hike using a tactical weapon. While the structural interest rate environment was practically unchanged – except for a technical 950bp hike in the O/N repo – this new O/N quick tender provides a temporary, highly-effective tool that ensures rapid and flexible implementation of tighter monetary policy conditions in turbulent times.

Even if the NBH won't use this tender permanently (e.g for weeks or months), the threat that there is a tool where short-term interest rates can be moved quickly and can be hiked in an extreme manner if needed can impact investors' decisions regarding sub-markets, like the FX market. The 25% upper bound of the interest rate corridor gives ample room for manoeuvre, posing a threat of an even higher O/N deposit quick tender interest rate than the recently announced 18%.

The National Bank of Hungary still sees the inflation peak coming soon and while the coming months will bring some further acceleration in inflation, these will come from one-off impacts. On the other hand, there are some signs of a cooling demand-driven inflation as well. In this regard, an intervention with a regular tool (i.e. emergency hike in the base rate) would be counterproductive over the monetary policy horizon.

What we've been facing recently is short-term market turbulence and reacting with targeted measures will probably bring more positives to the table than negatives. In contrast, using a blanket-type decision impacting the real economy in the long run would have much more negative consequences, with at least a questionable positive impact regarding the financial market stability. Such a decision would impact, for example, the current account balance in the long run (improving it via a recession causing a marked drop in domestic demand and import), while the problem with the current balance is rather a "here and now" issue.

The energy bill has been responsible for the widening current account balance in Hungary lately. To give an immediate helping hand, the new commitment to directly meet major foreign currency liquidity needs, arising from covering the energy import, looks like another well-targeted instrument. This will help in weathering the darkest months of the energy crisis. After the winter months, we expect an improvement in the energy balance in the current account, thus erasing some structural pressure on the FX market. Moreover, in a recessionary environment, the current account balance will improve in non-energy respect as well, improving the outlook in net external financing needs further.

In practice, this option is an indirect and targeted FX intervention, giving the opportunity for market players to convert foreign currency off-market. According to the chart shown by the NBH, the monthly current account deficit arising from the energy bill is around €1.5bn on a monthly basis. The recent currency reserve (ex-gold) is at €30.8bn, but as the central bank is having active swap lines with other central banks (including a €4bn framework with the ECB), it should be more than enough to give coverage during a short period of time. Not to mention that as soon as Hungary closes the Rule-of-Law debate with the EU (we expect a positive decision by mid-December), there will be a further structural improvement in the aspect of net external financing needs and FX reserves.

Although this decision by the National Bank of Hungary will add a bit more complexity to the monetary policy setup, we see these measures as adequate answers to the temporary challenges which the local financial markets are facing. Moreover, based on the new forward guidance, the NBH stands ready to intervene using every instrument in its monetary policy toolkit to ensure market stability besides its primary objective of price stability. In this regard, we expect the Hungarian forint to stabilise at first, and with the new liquidity measures reaching full impact we see HUF gradually strengthen with a major boost coming with a positive EU decision close to the year-end.

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