The Hungarian central bank's 3 Ps

Pragmatism, persistence, patience: Three key words ruling the actions of the National Bank of Hungary. The bank left its monetary policy setup unchanged in May and it seems pleased with the effectiveness of the toolkit it put in place

György Matolcsy, Governor of Hungary's central bank

0.90%

Hungary Base Rate

O/N depo rate: -0.05%; O/N repo rate: 1.85%

As expected

What the central bank said and did

The Hungarian central bank practised patience in its May rate-setting meeting leaving interest rates unchanged. Interest on overnight and one-week collateralised loans was left at 1.85%, while the overnight deposit facility rate stands at -0.05% with the base rate sitting in the middle of the interest rate corridor at 0.90%. The Monetary Council also sees the 0.9% level of the 1-week deposit rate as appropriate.

In its press release, the NBH highlighted that the effects of Covid-19 were reflected in macro data for Hungary. However, the Monetary Council remains optimistic that the economy will show persistence and it's expected to rebound quickly, preserving its growth advantage versus the eurozone. The central bank sees inflation remaining stable around its 3% target, while inflation expectations remain anchored. All in all, the NBH is transmitting confidence, which doesn't stop at the macro environment.

The NBH outlined that the steps taken by the bank have helped decrease market volatility, improve liquidity, stabilise the forint and support the flattening of the yield curve. The latter was mainly due to the early successes of the government bond purchase programme, according to the NBH.

Speaking of which, the Monetary Council highlighted what we echoed several times, that the QE programme is a financial stability tool, a "crisis management instrument", which is intended to be used for the period and necessary extent. In our view, this means that the bond-buying programme will remain with us for a while. The NBH won't buy at any price and any size, but rather use this as an ad-hoc tool, showing patience and pragmatism. The latest auction reflects this approach.

What we make of it all

The NBH is still trying to play 'economy psychologist'. It painted a relatively optimistic picture about how quickly Hungary will be able to turn around that ship which was steered away by Covid-19. In contrast with our expectation, the NBH did not make any groundwork for an upcoming downward revision to the economic outlook. QE will remain with us, but as we expected, the NBH won't use this at any time, rather using it as a safety net if things go wild.

Also, the recent 'no change' from the NBH should contribute to HUF stability. While the mix of a stable HUF and the expected decline in CPI should eventually lead to some reversal of the prior FX stabilising hikes, if done in a gradual way with CPI in check, then HUF should not come under pressure. Indeed, in 2019 and early 2020 the HUF was under heavy pressure as markets perceived the NBH policy as being too loose for the inflation dynamics. That was evident in the HUF real rate, the lowest in the EM space at the time. Now, even after accounting for the recent fall in Bubor, HUF no longer stands out on the real rate side (both CZK and PLN show more negative real rates). With markets already pricing further Bubor declines, modest cuts in the 1-week depo shouldn't be overly detrimental for HUF (especially as it looks that the NBH still refrains from aggressive QE).

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Disclaimer