National Bank of Hungary Review: Financial and price stabilities in focus

Hungary's central bank appears to be maintaining its 'whatever it takes' stance at Tuesday's rate-setting meeting. Main interest rates remain unchanged, while the effective rate will be defined on the one-day deposit quick tenders in the foreseeable future

The entrance to the National Bank of Hungary in Budapest

We couldn't really expect any fireworks from the Hungarian central bank at its regular rate-setting meeting following the 14th of October's 'big bang' After the extraordinary intervention which led to a 500bp effective rate hike, the central bank did not touch the interest rates this time around. This leaves the regular overnight deposit rate at 12.5%, the base rate at 13% and the overnight repo rate at 25%.

[Extraordinary intervention by the National Bank of Hungary]

The central bank closed the first phase of tightening raising the base rate to 13%. According to the latest assessment, keeping this level for a prolonged period will help in reaching the inflation target over the monetary policy horizon. The second - ongoing - phase of the tightening is to squeeze the excess liquidity with the longer-term deposit rate and the new reserve requirements. In parallel with that, financial stability risks called have brought about a third phase: the use of an extremely flexible toolkit with the combination of one-day deposit quick tenders and one-day FX swap tenders.

In this regard, the effective rate will remain defined by the one-day deposit quick tender, which now sits at 18%. The central bank stands ready to use this tool with the recent level of interest rate as long as necessary to preserve financial stability and reach price stability over the monetary policy horizon.

The Monetary Council still sees several external risks (war, global monetary policy, energy crisis, general investor sentiment) and internal risks (Rule-of-Law procedure, current account imbalance), which warrant the prolonged use of this new, highly flexible monetary policy setup. In our assessment, this means a reinforcement of the "whatever it takes" approach.

As a new message, Deputy Governor Virág highlighted that the central bank needs to see a significant improvement in the general risk sentiment (defined by the combination of the above-mentioned elements of external and internal risks) to gradually reduce the spread between the base rate (13%) and the effective rate (18%).

Regarding the state of the economy, the Monetary Council sees signs of a marked reduction in domestic demand which will significantly improve the current account imbalance going forward. In parallel with this impact, dropping global energy prices might also help to have a quicker-than-expected rebalancing process in the current account. This should lift some pressure from the financial markets.

Though coming months will bring further accelerating food price rises, inflation is expected to reach its peak soon as the pricing power of corporates is fading with dropping aggregate demand. Cost side pressures will ease as well with sliding shipping and energy costs, according to the latest view of the Monetary Council.

In our view, the most important part of the new forward guidance is that the central bank "*continuously assesses economic and financial market developments and will continue to use the instruments introduced in mid-October as long as it is warranted by the maintenance of market stability and developments in risk perceptions*".

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