National Bank of Hungary Review: Keeping the gunpowder dry

The National Bank of Hungary repeated its “whatever it takes” stance at its last rate setting meeting in 2022. Moreover, it added a bit more hawkish flavour to its forward guidance, possibly due to the upgraded 2023 inflation outlook. The reinforced hawkishness might help EUR/HUF visit the sub-400 area in 2023

The National Bank of Hungary in Budapest

"Whatever it takes" stance remains with a hawkish twist

The National Bank of Hungary decided to maintain the monetary setup as it is when it gathered for the last time in 2022. This means no change in the regular overnight deposit rate at 12.50%, the base rate at 13% and the overnight repo rate at 25%. According to the Monetary Council’s assessment, maintaining the current level of the base rate for a prolonged period is consistent with the achievement of the price stability objective over the monetary policy horizon.

Although the policy setup behind the central bank’s “whatever it takes” hawkish approach did not change, the Monetary Council was able to add a little bit more hawkish flavour to its communication. The most important change in the forward guidance that “the Council is constantly assessing incoming data and developments in the outlook for inflation and is ready to take appropriate actions if risks increase". Despite the central bank identified a balanced risk sentiment, it gives more probability to risks which might push inflation higher than expected.

Mainly this type of uncertainty led the central bank and its staff to present an unusually wide range for its inflation forecast in 2023. After a significant upward revision to its short-term inflation outlook, the NBH sees inflation somewhere between 15.0-19.5% year-on-year on average next year. If incoming price pressure data during next year will prove that the full-year reading might be closer to the upper band, we think the NBH will need to reinforce its hawkish stance with some measures mainly affecting (e.g., tighten further) the forint liquidity in the banking sector.

The Monetary Council remains hopeful that the Hungarian economy will be able to muddle through next year with a positive real economic activity thanks to the export sector. We are a bit less optimistic as we expect a 0.1% GDP growth vs the NBH's 0.5-1.5% forecast in 2023. Despite the improved export outlook and the expected narrowing of the current account deficit, the NBH decided to continue to meet foreign currency liquidity needs to reach a market balance related to the energy account, and protect HUF against volatility from this source.

The central bank also pointed out that recent developments in the current account balance or in the EU funds or global inflation are not nearly enough to think about changing tight monetary conditions. The Monetary Council wants to see a trend improvement in risk perceptions, thus it adopts a patient approach. This strengthens our view that temporary, targeted measures and the 18% marginal rate will remain with us through the first quarter of next year. By then, we might see the much-needed trend improvement in local and global risks, reducing risk aversion and improving market sentiment adequately to start approaching the 18% marginal rate to the 13% base rate with gradual steps.

FX and rates markets reaction

The market reaction after the end of the press conference suggested that the market took the NBH's commitment to keep rates high for longer seriously. The entire IRS curve went up with a steepening bias. However, the already high levels at the short end of the curve, in our view, will not allow a significant upward movement, while record inflation in the coming months will also not allow a significant normalisation. Higher inflation caused by the lifting of fuel caps should already be priced in. Thus, market focus should shift to NBH rate normalisation later in the first quarter of 2023 and we should see a significant move down in the short end of the IRS curve. Our steepening view thus remains unchanged after the December rate setting meeting.

The recent meeting strengthened the positive direction of the forint in our view. NBH managed to maintain or even strengthen the hawkish market sentiment, which should at least keep the current momentum of the forint. In addition, the NBH extended the programme of providing hard currency to energy importers for the next months, which is another positive news for the forint, delaying some of the selling pressure on the domestic currency. Beyond the NBH meeting, conditions are also positive for the forint at the global level. Gas prices, which have been driving CEE FX again in recent days, are heading lower and implied rates in Hungary, on the other hand, are again near record high levels providing a shield for potential selling pressures. Overall, we thus remain bullish on the forint and expect further appreciation towards 400 EUR/HUF by year-end and below this level next year.

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