National Bank of Hungary Review: Not fooled by promises, waiting for proof

The National Bank of Hungary remains cautious, waiting to see proof of a permanent improvement in the big picture of risks. In our view, recent communication makes clear that the central bank won't change its stance in March and will possibly wait until June to start a gradual pivot

The National Bank of Hungary in Budapest

The National Bank of Hungary left the interest rate complex unchanged at its February rate setting meeting. The regular overnight deposit rate remained at 12.50%, the base rate at 13.00% and the overnight repo rate at 25.00%. Even though at face value it looks like nothing has changed, our impression is that the central bank still means business when it comes to fighting against inflation and was able to sound a bit more hawkish.

We see two key takeaways from the February rate setting meeting. First, the central bank won't be fooled by promises and outliers. The Monetary Council wants to see a permanent improvement in every aspect which matters in the decision-making process. Both internal and external risks need to fade, which means months of data. This refers to inflation, the current account balance as well as to global monetary policy situation, market stability and yes, even regarding EU funds.

This leads us to the second takeaway. In our assessment, the main goal of the central bank was to make sure that no one believes that a monetary policy pivot is close. The messages of the statement, the tone of the press conference, and the upcoming changes to the reserve requirement system all suggesting, that even with a window of opportunity provided by an updated staff projection at the March rate setting meeting, hard evidence will be far and few between to ignite any discussion about a dovish turn.

Speaking about the changes to the reserve requirement, the central bank announced yet another twist. The reserve system will be tiered from 1 April, alongside with the decision made in January, that the daily mandatory reserve ratio will be doubled to 10%. With the tiering, the central bank decided to pay no interest on the reserves up to the 2.5% threshold, while paying the base rate on 7.5% of the reserve base. Moreover, up to an extra 5% threshold (which is optional above the mandatory 10% reserve ratio), the central bank will pay the interest rate of the quick deposit tender (now at 18%). This will incentivise the stakeholders volunteering to take higher reserves reducing losses made by the first tier 0% rate.

Although mathematically speaking the whole reshape of the reserve system might have a minor downward impact on the weighted average of the interest rate complex, we see this as a hawkish change. The main reason is that the central bank will further squeeze the liquidity in the system, keeping upward pressure on interbank rates. Furthermore, with the changes effective from 1 April, monetary policy will not just sterilise its own liquidity impact coming from the high interest rate environment but will reduce liquidity in net nominal terms.

In general, the outcome of the February rate setting meeting significantly increased the probability that we won't see any change in the monetary policy setup until the June rate setting meeting, in our view. The updated forward guidance echoes this as well as the central bank is focusing on the "persistence of the recent improvement in risk perceptions" and in our interpretation this persistence means multiple months.

Author

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

Disclaimer