

National Bank of Hungary Review: Pandora's box remains closed

The National Bank of Hungary left the base rate unchanged in November, as expected. The Monetary Council refrained from giving any new message or instructions to the markets, other than to emphasise its long-standing careful, stability-oriented approach. So the game of patience continues



6.50%

Key interest rate

No change

As expected

Interest rates remain unchanged after the November meeting

The picture could have been very different. Economic activity has surprised on the downside, as

has inflation. External balances are still healthy and the fiscal situation hasn't shifted to a significantly pro-inflationary stance. This should be a perfect recipe for easing. But financial market instability has spoiled the party. The vulnerability of the forint keeps the door shut on the possibility of easing.

Under these circumstances, the outcome of the November meeting was crystal clear (see our [NBH preview](#) for more details). The National Bank of Hungary lived up to expectations and kept its key interest rate on hold at 6.50% in November. The central bank also left the interest rate corridor unchanged, with a range of +/- 100bp around the base rate.

Market instability limits the playing field

As usual, Deputy Governor Virág assessed the macroeconomic situation at the press conference. There were two main messages. On the one hand, economic activity disappointed in the third quarter, but this is related to factors outside the monetary policy area of influence. Namely, agriculture, external demand, investment activity (linked to the fiscal situation and inflation fears). The central bank has thus sent a clear message: it can't and won't solve the problems of the economy. The only way the National Bank of Hungary can help is to anchor inflation expectations and achieve price stability in a sustainable manner.

On the other hand, while the central bank welcomed the downside surprise in headline and core inflation in October and acknowledged the improvement in the near-term inflation outlook, longer-term pro-inflationary risks emerged. The main ones were forint depreciation, the acceleration of food and fuel inflation and the forthcoming tax changes. The overall quantitative impact of these developments will be assessed in the December Inflation Report.

Against this backdrop, hawkish messages clearly dominated the macroeconomic assessment. The same can be said of the financial market story. The growing dichotomy between the US and the eurozone, the (expected) divergence between the Fed and the European Central Bank, the associated risk aversion and capital outflows from emerging markets, and the further escalation of geopolitical risks all justify a patient, careful and stability-oriented approach.

Some positive aspects of Hungary were clearly highlighted on a comparative basis with other emerging markets (generally strong fundamentals), while on the negative side change in FX positioning was highlighted. The short positions of foreign participants increased, but at the same time the stabilising behaviour of the domestic sector (real money players) mitigated the weakening of the forint. However, the central bank can't rest on its laurels, as it is closely monitoring the factors behind the weakening of the forint and the changes in the sectors (swaps, interest rates, etc.). Thus, the sensitivity of exchange rate stability remains a key factor in upcoming monetary policy decisions.

Find value in saying nothing

The Monetary Council will maintain a data-driven stance, focusing on the well-known three factors that have proven to be the basis for the monthly decisions. The inflation outlook, Hungary's risk perception (via fiscal and external balances) and financial market stability will determine the fate of interest rates.

The cautious, patient and stability-oriented approach will also be maintained. In the Council's assessment, geopolitical tensions, volatile financial market developments and the risks to the

outlook for inflation warrant further pause in cutting interest rates.” While this is clearly a hawkish message, it is also in line with previous forward guidance.

What is most telling is the absence of one thing: talk of rate hikes (or reference to other liquidity tightening measures). The central bank's main message is to keep monetary conditions tight, with interest rates on hold for an extended period if necessary. As we expected, the Monetary Council didn't want to open Pandora's box and put itself in the crosshairs of investors.

The only stunner arrived during the Q&A session of the press conference, when Deputy Governor Virág admitted that the Council had voted by a large majority to keep rates on hold. And no, the dissenting vote wasn't for a hike, but for a cut. A cut that wasn't officially an elaborated option on the table. A nice touch at the end of a rather deliberately dull rate-setting meeting.

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