

National Bank of Hungary Review: Risk environment must improve

The National Bank of Hungary repeated its “whatever it takes” stance at its November rate setting meeting. Interest rates remained unchanged. The short-term focus remains on market stability until a trend improvement in risk perception occurs. Asset prices remain in the grip of non-monetary decisions, but we remain constructive in our views



The National Bank of Hungary in Budapest

Central bank maintains its "whatever it takes" stance

Similar to the late October rate setting meeting, the widespread market expectation has been met. This means no change in the monetary policy set-up. The central bank did not touch the interest rates in late November. This leaves 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.

As a second layer to the monetary policy, the central bank continues to use its tools to tighten the liquidity conditions. In line with that, the NBH decided to hold yet another 2-month deposit tender

on 30 November. This shouldn't come as a surprise with the previous long-term deposits (worth HUF2.6tn) maturing on 1 December. Moreover, during the last month of the year, the NBH will again hold FX swap tenders providing euro liquidity and discount bill auctions with maturities extending beyond the end of the year. For the latter, the central bank will use a fine-tuned framework, possibly raising the demand in those central bank bills, draining more liquidity.

The third layer of the monetary policy mix is provided by the temporary targeted measures introduced in mid-October. We don't expect any change in this framework in the remainder of the year. 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 set-up.

The forward guidance was updated in a way in that it reflects a possible trigger regarding the implementation of the exit strategy from this third phase. The NBH focuses on sustained shifts in financial market conditions, and it will use its instruments introduced in mid-October until a trend improvement in risk perceptions occurs. In our view, this means that the central bank will take its time to assess the market outcome of a possible positive end to the Rule-of-Law debate and won't immediately react with its monetary policy set-up.

Regarding the state of the economy, the Monetary Council noted the negative quarter-on-quarter GDP growth in the third quarter and expressed its view about a further slowdown ahead. When it comes to the inflation, we agree with the central bank's view here as well, that inflation is expected to peak in the coming months, but the normalisation of price pressure will be a slow process.

FX and rates markets reaction

The Hungarian IRS curve normalised significantly since the last emergency rate hike in mid-October, in line with our steepening view and our intention is to maintain this view. Looking at the 2-10y spread, the short-end leg has fallen from levels above 16% to below 12% and we should see further normalisation if the forint remains under control, but of course the scope to go lower is already limited for the weeks ahead. On the other hand, the long-end leg is being dragged down largely by the global rally which we believe is only temporary in nature and expect a correction soon. Thus, overall we maintain a steepening bias with an eye on the forint and global conditions.

On the Hungarian Government Bond (HGB) side, the Ministry of Finance and Debt Management Agency are in a very comfortable position at the moment with essentially a done issuance for this year and enough cash buffer to allow it to avoid adverse market conditions. We expect fiscal policy to consolidate next year, which, while not wowing the crowds, still paints the best picture in the CEE. But for now, we see that the EU story is more about FX trades and the FI market is still struggling with liquidity issues and high volatility. Therefore, we see better value in other countries in the region for now, but believe HGB's time will come next year and we remain constructive in our views.

When it comes to the Hungarian forint, we see it to rather moved by non-monetary events and shocks in the short run. The next milestone is the upcoming Ecofin meeting on 6 December, when – based on the already published agenda – we expect a positive outcome. This means a reduced temporary freeze of Cohesion Funds and a signed RRF Plan, in our view. The latter would mean that Hungary will be able to avoid the worst-case scenario, losing access to €4.6bn in grants from the RRF (the funds can be used until 2026). This clearly positive outcome might free up the potential in HUF as it will clear some grey clouds regarding net external financing of the country. However, the

market reaction to the latest cap measure remains to be seen. The government rolled out a deposit rate cap for institutional investors, which is a wild card for the markets. This could raise some questions about the general tightness of monetary conditions, limiting somewhat the upside potential in HUF. Nevertheless, we still see EUR/HUF at around 400 by the end of the year.

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