

National Bank of Hungary: Stakes raised with new measures

The National Bank of Hungary moved the base rate by +100bp to 11.75%, as expected. The newly announced measures to reduce the excess liquidity will help to improve the monetary transmission. Thus the way is up in short rates and the forint could maintain a strengthening trend, in our view



The National Bank of Hungary in Budapest

11.75%

Hungary's base rate

+100bp

As expected

Central bank announces new tools to complement decisive tightening

There was a particular consensus in the market about the outcome of the August rate hike

decision by the National Bank of Hungary. The central bank lived up to the expectations, delivering a 100bp rate hike in the interest rate complex. With that, the base rate now sits at 11.75% with the 1-week deposit rate to be raised to this level on Thursday as well. Though the central bank continued its “decisive” tightening, not the rate hike which makes the latest meeting a hawkish one.

The NBH announced the introduction of three measures to help the monetary transmission via the (expected) significant reduction of excess liquidity.

1. The central bank will raise the required reserve ratio set for the banking system. The recent ratio is 1% and it will be raised to 5%. However, besides this mandatory element, there will be an option for banks to keep an even higher reserve, so practically a two-tier system will be introduced. What is also new and a really strict (or hawkish) element that by the new regulation, there will be a minimum daily reserve set at 5% in contrast with no daily minimum set in the recent system.
2. Additionally, central bank discount bill auctions will be announced and held regularly. It is the same path what we saw with the introduction of the reverse FX swaps as an ad-hoc, then a quarterly, then finally as a daily tool.
3. The most interesting or we can say out-of-the-box measure that the NBH will introduce is a long-term deposit instrument in order to sterilise liquidity in the banking system at longer maturities than currently. Although this tool comes with a caveat in a rising interest rate environment, we are eager to see the details and we expect a floater-type deposit. This tool could provide a nice alternative to the short-dated government bills which are still in extreme demand in the market (with an 8% yield while the base rate was at 10.75%). With this new tool, the NBH can relieve some pressure from the short-dated bonds, improving the transmission of interest rates, moving short-end yields higher.

The actual impact of the new measures won't show up from one day to another, but according to the central bank's expectations, the new set of actions might be able to halve the excess liquidity from around HUF10tn to HUF5tn. The goal is quite ambitious, and we have to see the details to assess the plausibility of it. However, this new set of measures shows a strong commitment by the National Bank of Hungary to tackle inflation and the “we are ready to use every tool” slogan now becomes a reality.

In general, we've got what we expected from the August rate setting meeting and the outcome is in line with our preview and broader view. We affirm our call that the NBH will probably lower its step sizes in the next meetings as the just announced new measures will slowly but surely improve the monetary transmission. We see the gradual slowdown in the tightening cycle end in a 14% terminal rate with the last hike probably coming in December 2022. At the same time, as with inflation, we see upward risks in the case of interest rates as well. This could not just mean a higher terminal rate, but an extended rate hike cycle into 2023.

FX and rates markets reaction

The hawkish NBH rate hike resulted in a strong bear flattening and a new record level in the inverse IRS curve, as we expected. We anticipate further front end gains and flattening for the coming days before the dust settles. However, the NBH hiking cycle is about to peak while the market boosts hawkish stance expectations. The priced in terminal rate has moved to 14.50%, above our forecast. Unless we see additional pressures on the forint or inflation, the curve should start to normalise later, i.e. steepening.

The hawkish market reaction has made Hungarian government bonds (HGB) a bit more expensive again in ASW terms, but we will retain our bearish bias. We believe yields should catch up with the core segment, plus today's upward shift in the IRS curve has once again pushed the bar a bit higher. Moreover, the sell-off within the Central and Eastern Europe region is still not over and the supply side is also supporting further cheapening. Thus, we continue to like HGB asset-swap (ASW) cheapeners.

As we expected, the forint has received positive support, but the long-term effect of the measures announced today is questionable and it is necessary to wait for details. Nevertheless, the forint should benefit from this decision in the coming days in any case. In the second half of September, however, we expect attention to return to the EU funds negotiations.

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