

# Hungary Watch: MNB moves to orthodoxy

The MNB increased key interest rate by 185bp to 7.75% and gives up its perplexing double-rate system. Rate hike cycle lasts until the rise of the monthly inflation reading does not stop. In our view this means 9.75% terminal rate in October. HUF nervousness calmed down and EURHUF moved below 400, but it is not a game-changer for the HUF.

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The MNB has decided to give up its double-rate system on its recent rate setting meeting (28 June) and to increase the base rate by 185 basispoints from 5.9% to 7.75%. Accordingly, on the next 1-week deposit tender (30 June) we will see a 50bp rate hike (from 7.25% to 7.75%) to close the gap between the two instruments. This is the orthodox shift in monetary policy most market players were demanding earlier (including us). Nevertheless, the MNB claimed that it keeps the 1-week deposit facility and therefore the possibility to change it anytime if it is necessary (i.e. any Thursday), though the change will be followed by a similar change of the base rate in the next rate setting meeting. The HUF strengthened upon the news: EURHUF moved from 402 to 398.

The MNB also communicated that it will continue the rate cycle until the rise of the monthly inflation reading lasts. While the MNB did not mention the pace of the monthly rate hikes, we expect 50bp rate hikes going forward. According to our forecast, inflation is going to peak in Hungary in September at 13% yoy (the data is going to be published on 11 October) and the first monthly inflation data that may display the break of the rising trend is the October inflation statistics (to be published on 9 November). If our logic proves right, then we will see another four rate hikes, 50bp each (July, August, September, October) before we reach the terminal rate at 9.75%. Of course, there is certain risks around this scenario (with regards both to our inflation trajectory and to our assumption on the pace of the rate hikes).

The MNB also announced its key forecasts from the upcoming June Inflation Report (to be released on 30 June). MNB's new GDP forecast is 4.5%-5.5% for 2022 (vs. 2.5%-4.5% in the March Inflation Report) 2%-3% for 2023 (vs. 4%-5% previous) and 3%-4% for 2024 (unchanged forecast). In our reading the 2022 forecast does not calculate with the possibility of a European energy crisis, though MNB's 2023 forecast fits our baseline scenario (2% GDP growth in 2023). As far as the inflation outlook is concerned, MNB has raised significantly both 2022 and 2023 forecast: from 7.5%-9.8% to 11%-12.6% (2022) and from 3.3%-5% to 6.8%-9.2% (2023). We forecast 11% (2022) and 8% (2023) – pretty much in line with the MNB. Nevertheless, the MNB keeps its optimism for 2024 (2.5%-3.5%) versus our 5% call. Apart from the 2024 outlook (which is still far away) the new MNB forecasts are realistic ones.

Altogether, we evaluate today's decisions as an important step towards an orthodox monetary policy direction. This helps the credibility of the Hungarian monetary policy and gives some support to the HUF. However, there are other major drivers of the HUF

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which remain intact (war in Ukraine and its negative consequences; lack of agreement on EU funds between the European Commission and the Hungarian government; general vulnerability of the Hungarian economy due to its high public debt-to-GDP ratio and high energy dependency on Russia versus peers). Accordingly we expect the HUF to stabilize around the current levels versus the EUR – potentially and inch below 400 and not above.

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