

Hungary Watch: Liquidity tightening replaces interest rate hikes

Yesterday, the MNB raised rates by 125 basispoints (against the market consensus of 100 basispoints), while indicating that the interest rate hike cycle has come to an end, and that any further tightening will come through reducing liquidity and facilitating monetary transmission. Our previous scenario was for rate hikes to peak at 13.75% in Q1 2023, which we are now revising, although we maintain our forecast for further increases in BUBOR rates.

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The decision somewhat surprised the market, although the regulator has recently emphasized several times that the end is already on the horizon. After the end of the 16-month interest rate hike cycle, the central bank's benchmark interest rate stands at 13%, the lower end of the interest rate corridor at 12.5%, and the upper end at 15.5%. The one-week loan interest rate is also 15.5%. The MNB emphasized that it no longer makes sense to raise interest rates at the current levels, the tightening of monetary conditions will continue with the narrowing of liquidity, in connection with which additional measures may be in the pipeline in the near future in addition to what is already known.

From October, the reserve ratio will rise, which, based on preliminary commitments, may result in a greater decrease in liquidity than previously estimated. Regular one-week discount bond auctions and two-month deposit tenders can also significantly reduce HUF liquidity in the interbank market. The latter will be able to sufficiently push the BUBOR interest rates even higher, since the conditions (term, premium) can be fine-tuned at any time. In addition, the regulator can also increase the efficiency of monetary transmission with FX liquidity tenders held on a daily basis.

It is definitely important to emphasize that the above set of tools can only significantly curb inflation if it can also significantly ease the pressure against the HUF spot. If, of course, the high HUF yield would not be sufficient to stop its devaluation in the near future, the EUR 36.5 billion FX reserve is also available for direct intervention, which in our opinion is of course only a last resort, in any case the Monetary Council considered it important to mention this. In the longer term, the forint can also be supported by EU funds, if they bypass the FX reserve, i.e. generate demand for HUF in the interbank market (which is clearly a decision of the state treasury in the future).

Based on the above, Raiffeisen does not expect a further increase in the base rate (previously we expected it to peak at 13.75% at the end of Q1 2023), but we maintain our call for a further gradual increase in BUBOR interest rates: the three-month BUBOR will be 14.05% by the end of 2022, and then consolidate to 8.45% by the end of 2023 and 6.45% by the end of 2024. We also leave our medium-term EUR/HUF forecast of 415 unchanged.

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Regarding the economic outlook, the MNB, like the market, is projecting a recession in the short term, which means that after a strong H1, a substantial decline may occur in H2. Our call is -2.3% for Q3 and -3.7% for Q4 in quarterly GDP. According to the Monetary Council's assessment, inflation in September could rise to close to 20%, which is roughly 2.5-3.0 percentage points higher than previous summer calculations. According to his new forecasts, domestic GDP may grow by 3.0-4.0% in 2022, by 0.5-1.5% in 2023, and by 3.5-4.5% in 2024. The annual headline may fall below 10% in the second half of next year, when the pace of price increases may moderate more dramatically. The CPI may return below the central bank's 4% pain threshold in the first half of 2024.

Raiffeisen maintains a similar assessment of GDP growth prospects: 3.5% in 2022, only 1% in 2023, and 3.5% expansion again in 2024. The annual average inflation may be 13.8% this year, 15.2% next year, and 5.7% in 2024. Of course, the most uncertain in the forecasts is next year in all respects. Changes in the energy market and geopolitics pose the biggest risks in 2023.

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