

Hungary Watch: Extra rate hike to stop HUF weakening

An unexpected extra 50bp rate hike was delivered by the MNB today to stop HUF weakening. Reference rate is at 7.25% and there are more hikes to come. In our view more local policy actions are needed to reduce pressure on the HUF.

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The MNB raised unexpectedly benchmark 1-week deposit interest rate by 50bp today (from 6.75% to 7.25%) to strengthen the HUF. In the current monetary policy setup, the MNB focuses on two rates: on the one hand there is the base rate (that is a subject of change at the rate setting monetary meetings on a monthly basis and the decisions are commented by the Monetary Council) and on the other hand, there is the reference rate (i.e. the 1-week deposit rate, that is a subject of change practically at every Thursday, although since late March the MNB keeps the practice to change it only after the rate setting monetary council meetings). Today's decision therefore can be considered extraordinary, but only to a certain extent – due to the inherent peculiarities of the Hungarian double rate system (that makes the communication on the monetary policy particularly awkward). In the same time, base rate is at 5.9% since 31 May when the last time it was increased (by 50bp from 5.4%).

The trigger of the rate hike was clearly the recent weakening of the HUF. Since the beginning of the year the HUF depreciated by 8% against the EUR and EUR/HUF traded around 400 in the last couple of days. Upon the rate hike decision, HUF strengthened mildly versus the EUR (to 395)

There are multiple reasons behind such a poor performance, such as (1) the negative consequences of the war in Ukraine (including the problem of energy prices and energy insecurity given Hungary's high dependence of Russian oil and gas import), (2) the overall deterioration in the general economic outlook (especially the recession concerns globally and locally and Hungary's rising external imbalance due to the rapid worsening of its terms of trade) and (3) the perceived quality issues of the Hungarian politics/economic policies (i.e. the populist elements of the fiscal policy, the Rule of Law Mechanism initiated by the European Commission and the consequent freezing the payout of most EU funds, and finally the MNB's comments about slowing down the interest rate hike cycle in the environment of speeding up inflation and more tangible monetary tightening by major central banks).

As we can see, today's extra interest rate hike gives no remedy for the ailing HUF — it tackles only one issue, and only partially as the perplexing double rate system remains intact. In our view, the MNB would be better off, if it would quit from this system. Today's rate decision pushed back the EUR/HUF from the previous 400 levels, though a more

Zoltán TÖRÖK

Analyst Editor Analyst (for HU division)

Editor (for HU Division)

+36 1 484-4843

torok.zoltan@raiffeisen.hu

tangible and lasting HUF appreciation can be achieved only by a positive change in the other elements which weigh on the HUF. While obviously external factors are given, local policymakers can improve the quality of both fiscal and monetary policy and make the necessary actions to resolve the issues which block EU money inflow. Provided most of these achieved, the HUF may strengthen towards 380. In our view it is doable, although it may require certain political concessions as well.

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Thomas Sternbach Legal and Compliance Raiffeisen Bank International AG Am Stadtpark 9, 1030 Wien Tel: +43-1-71707-1541 Fax: +43-1-71707-761541 thomas.sternbach@rbinternational.com

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Contacts


GUNTER DEUBER

📍 Austria 
✉ gunter.deuber@rbinternational.com


GOTTFRIED STEINDL

📍 Austria 
✉ gottfried.steindl@rbinternational.com


BRISIDA BUZI

📍 Albania 
✉ Brisida.BUZI@raiffeisen.al

ARISTEA VLLAHU

📍 Albania 
✉ Aristea.Vllahu@raiffeisen.al


IVONA ZAMETICA

📍 Bosnia Herzegovina 
✉ ivona.zametica@raiffeisengroup.ba


ANA LESAR

📍 Croatia 
✉ ana.lesar@rba.hr

HELENA HORSKA

📍 Czech Republic 
✉ Helena.Horska@rb.cz


GERGELY PÁLFFY

📍 Hungary 
✉ gergely.palfy@raiffeisen.hu


NICOLAE COVRIG

📍 Romania 
✉ Nicolae.Covrig@raiffeisen.ro

ANASTASIA BAYKOVA

📍 Russia 
✉ ABAIKOVA@raiffeisen.ru


LJILJANA GRUBIC

📍 Serbia 
✉ ljliljana.grubic@raiffeisenbank.rs


OLEKSANDR PECHERYTSYN

📍 Ukraine 
✉ oleksandr.pecherytsyn@aval.ua

CASPER ENGELEN

📍 Austria 
✉ casper.engelen@rbinternational.com


FRANZ ZOBL

📍 Austria 
✉ franz.zobl@rbinternational.com


VALBONA GJEKA

📍 Albania 
✉ valbona.gjeka@raiffeisen.al


OLGA ZHEGULO

📍 Belarus 
✉ olga.zhegulo@priorbank.by


MIRZA ZORNIC

📍 Bosnia Herzegovina 
✉ mirza.zornic@raiffeisengroup.ba


ELIZABETA SABOLEK-RESANOVIC

📍 Croatia 
✉ elizabetha.sabolek-resanovic@rba.hr


DAVID VAGENKNECHT

📍 Czech Republic 
✉ david.vagenknecht@rb.cz


ZOLTÁN TÖRÖK

📍 Hungary 
✉ torok.zoltan@raiffeisen.hu

ANDREEA-ELENA DRAGHIA

📍 Romania 
✉ Andreea-Elena.DRAGHIA@raiffeisen.ro


GREGORY CHEPKOV

📍 Russia 
✉ grigory.chepkov@raiffeisen.ru


TIBOR LORINCZ

📍 Slovakia 
✉ tibor_lorincz@tatrabanka.sk


MATTHIAS REITH

📍 Austria 
✉ matthias.reith@rbinternational.com


PETER ÖHLINGER

📍 Austria 
✉ peter.oehlinger@rbinternational.com

FJORENT RRUSHI

📍 Albania 
✉ Fjorent.Rrushi@raiffeisen.al


ASJA GRDJO

📍 Bosnia Herzegovina 
✉ asja.grdjo@raiffeisengroup.ba


EMIL KALCHEV

📍 Bulgaria 
✉ emil.kalchev@raiffeisen.bg


ZRINKA ZIVKOVIC-MATIJEVIC

📍 Croatia 
✉ zrinka.zivkovic-matijevic@rba.hr

LEVENTE BLAHÓ

📍 Hungary 
✉ levente.blaho@raiffeisen.hu


DOROTA STRAUCH

📍 Poland 
✉ dorota.strauch@raiffeisen.pl


IONUT DUMITRU

📍 Romania 
✉ Ionut.Dumitru@raiffeisen.ro

STANISLAV MURASHOV

📍 Russia 
✉ stanislav.murashov@raiffeisen.ru

SERHII KOLODII

📍 Ukraine 
✉ serhii.kolodii@aval.ua

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