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MONETARY POLICY COMMENTARY

HUNGARY

19 September 2018



Dovish message in hawkish disguise: notwithstanding monetary policy tool changes, the MNB's previous forward guidance remained intact. As the MNB foresees no inflation risks, normalization is unlikely to start before mid-2019

The main message of yesterday's interest rate decision is that the MNB does not see any inflation risks on its forecast horizon. Therefore the current monetary policy conditions could remain broadly intact at least until mid-2019. This is basically the reiteration of the current forward guidance, which stated that the normalization of monetary policy conditions could start in mid-2019 and the first interest rate hike could come in Q1 2020. Nevertheless, the MNB also pointed out yesterday that it would not hesitate to adjust its current stance should inflation risks materialize or the international environment change significantly. This statement gives somewhat more flexibility to the current forward guidance. After the decision the HUF slightly appreciated against the EUR, but the long end of the yield curve has risen. This latter development could be related to the planned tapering of MIRS tool and the mortgage program.

The following announcement was made in Tuesday's meeting:

- Interest rate conditions are unchanged, as expected
- The three-month central bank deposits will decline to zero. As a result, the base rate will cease to exist in its current form. The interest rate on preferential deposit and on the required reserve remains the same as before. The required reserve rate will be 1% and the MNB does not intend to change this.
- The effective base rate in the future will be based on the required reserve. This will be supplemented by the outstanding amount of FX swaps and the interest rate corridor as additional monetary policy tools. According to the MNB, the change in the composition of the maturities of the outstanding FX swaps could provide information for markets in the future, but its amount will never be zero. The tool will remain in place for an undetermined period of time. Hence, this latter instrument may be viewed in the future as a conventional measure.
- The MIRS, and the mortgage securities purchasing program will come to an end at the end of this year – this was somewhat expected, but could result in a one-off increase in long-term yields.
- Finally, the MNB introduced the Funding for Growth Scheme Fix (FGS Fix), which will provide HUF 1,000 bn funding for SMEs. The aim of the program is to raise the proportion of long-term, fixed-rate loans to an adequate level. Currently its share is around 16% and the central bank would like to see this level rising toward 30%.

Overall, we think that despite the recalibration of the monetary policy framework and the slightly hawkish communication of the MNB, this is a dovish message. We believe so because, in spite of an expected pick-up in trend inflation and a more volatile international environment, the MNB did not change its original forward guidance: it intends to start the normalization phase only around mid-2019.

This unchanged guidance is somewhat more dovish than envisaged [in our previous MPC Report](#), where we assumed that the normalization could start in 2018Q4 or at the beginning of 2019 and interest rate hikes could come in 2019H2. The reason for our expectation was that due to a strong real economy, the very tight labour market conditions and the recent depreciation of the HUF, inflation risks are clearly on the upside. Additionally, as the share of fixed-rate loans increases among households and non-financial companies, the interest rate channel of the transmission mechanism weakens. This basically means that it may take more time for the rate hikes to exert their full effect on the economy. In our opinion, this may warrant a sooner start of the normalization.

Looking ahead, the forward guidance of the MNB could change if the inflation outlook worsens or the international environment significantly deteriorates. In that case earlier normalization is possible.

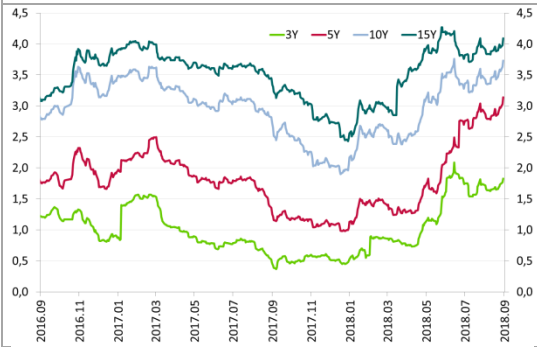
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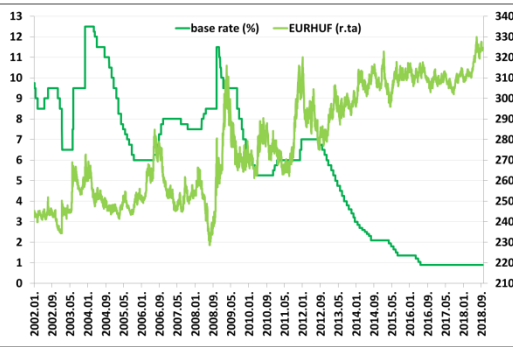
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Chart 1: Government bond yields (%)



Sources: ÁKK, OTP Research

Chart 2: Base rate (%) and the EUR/HUF exchange rate



Sources: MNB, OTP Research

Dates of the meetings	Dates of the minutes	Inflation report	Base rate decision	3M BUBOR
26 January 2016	10 February 2016, 14:00 CET		1.35	
23 February 2016	9 March 2016, 14:00 CET		1.35	
22 March 2016	13 April 2016, 14:00 CET	x	1,20	
26 April 2016	11 May 2016, 14:00 CET		1,05	
24 May 2016	8 June 2016, 14:00 CET		0,90	
21 June 2016	13 July 2016, 14:00 CET	x	0,90	1,00
26 July 2016	10 August 2016, 14:00 CET		0,90	0,94
23 August 2016	7 September 2016, 14:00 CET		0,90	0,86
20 September 2016	12 October 2016, 14:00 CET	x	0,90	0,88
25 October 2016	9 November 2016, 14:00 CET		0,90	0,85
22 November 2016	7 December 2016, 14:00 CET		0,90	0,66
20 December 2016	11 January 2017, 14:00 CET	x	0,90	0,60
24 January 2017	8 February 2017, 14:00 CET		0,90	0,30
28 February 2017	15 March 2017, 14:00 CET		0,90	0,23
28 March 2017	12 April 2017, 14:00 CET	x	0,90	0,21
25 April 2017	10 May 2017, 14:00 CET		0,90	0,16
23 May 2017	7 June 2017, 14:00 CET		0,90	0,15
20 June 2017	5 July 2017, 14:00 CET	x	0,90	0,15
18 July 2017	2 August 2017, 14:00 CET		0,90	0,15
22 August 2017	6 September 2017, 14:00 CET		0,90	0,15
19 September 2017	4 October 2017, 14:00 CET	x	0,90	0,12
24 October 2017	8 November 2017, 14:00 CET		0,90	0,03
21 November 2017	6 December 2017, 14:00 CET		0,90	0,03
19 December 2017	10 January 2018, 14:00 CET	x	0,90	0,03
30 January 2018	14 February 2018, 14:00 CET		0,90	0,02
27 February 2018	14 March 2018, 14:00 CET		0,90	0,02
27 March 2018	11 April 2018, 14:00 CET	x	0,90	0,03
24 April 2018	9 May 2018, 14:00 CET		0,90	0,03
22 May 2018	6 June 2018, 14:00 CET		0,90	0,11
19 June 2018	4 July 2018, 14:00 CET	x	0,90	0,18
24 July 2018	8 August 2018, 14:00 CET		0,90	0,24
21 August 2018	5 September 2018, 14:00 CET		0,90	0,19
18 September 2018	3 October 2018, 14:00 CET	x	0,90	0,21
16 October 2018	7 November 2018, 14:00 CET			
20 November 2018	5 December 2018, 14:00 CET			
18 December 2018	tba	x		

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