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MONETARY POLICY COMMENTARY

HUNGARY

27 May 2020



The MNB is comfortable with the current situation; no mention of any rate cut, yet

At yesterday's meeting, the MNB left monetary policy conditions unchanged, as expected, and its press release did not contain any new information regarding monetary policy. The central bank seems to be comfortable with the current position of the HUF and the yield curve.

Over the past month, the international environment was favourable as stock indices increased, volatility declined across major markets, while bond yields stabilized at low levels in most countries. However, incoming data reinforced the belief that the economic consequences of the virus could be serious, as the US economy is expected to decline by 5.7% and the euro area by 6.6% in 2020. Therefore, the market expects the current low-interest-rate environment to remain in place for a considerable amount of time. In this environment, the MNB's [new monetary policy framework](#) seems to be adequate in achieving its dual goal through flattening the yield curve: (1) the HUF appreciated against the EUR to around 350, (2) the long end of the yield curve came down (the 10-year bond yield is near its pre-pandemic levels), thereby providing a comfortable financing environment for the government.

It is worth mentioning that the long end of the yield curve declined to pre-pandemic levels despite the fact that the MNB was much less ambitious with its bond purchases than originally announced. When launching its QE a month ago, it said that HUF 80 bn purchases could be expected per week, which would have meant that the announced HUF 1,000 bn would be used until July. However, since the announcement, the MNB has purchased altogether only around HUF 100 bn government bond during the month (including HUF 10 bn in the last auction, which led to a 10-bps uptick at the long end). Additionally, the central bank provided only around HUF 75 bn per week in 5Y loans to commercial banks, even though the bid amount was nearly three times higher than the allotted amount. In the meantime, the MNB sterilized the provided liquidity through one-week deposit auctions. It seems that interest rate hike expectations were priced out over the past month, and we think that the central bank is utilizing the currently favourable international environment and wants to keep its powder dry, that is why it used its long-term liquidity enhancing measures in a conservative fashion.

Near-term inflation risks for Hungary have declined considerably due to the coronavirus. First, inflation fell to 2.4% from 3.9% due to lower oil prices. Although the underlying inflation measures are still well above 3%, the declining domestic demand, a widening output gap, and lower wages will help inflation risks to disappear in the near term, and there may be room for further monetary easing.

This is supported by the fact that by now Hungary has the highest base rate in the CEE region (Poland: 0.5%, Czech Republic: 0.25%), with the lowest inflation in April (Poland: 3.4%, Czech Republic: 3.2%). In March, the HUF depreciated toward 370 against the EUR due to the panic across international markets and high domestic inflation risks. In that situation, the MNB had to increase the short end of the yield curve in order to dampen the depreciation of the HUF. In the meantime, however, the Polish and the Czech central banks were able to reduce the base rate, therefore the interest rate differential between Hungary and the other two countries turned upside down.

All things considered, we think the expected ultra-low international interest rate environment and the negative economic effects of the coronavirus could prompt the MNB to lower short-term yields in the second half of the year. Compared to its regional peers, we can see a 30-40 bps decline in the short-term rates by the end of the year. However, due to the nature of the current economic crisis, uncertainties are considerable.

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Dates of the meetings	Dates of the minutes	Inflation report	Base rate decision*	3M BUBOR*
29 January 2019	13 February 2019, 14:00 CET		0,90	0,15
26 February 2019	13 March 2019, 14:00 CET		0,90	0,15
26 March 2019	10 April 2019, 14:00 CET	x	0,90	0,13
30 April 2019	15 May 2019, 14:00 CET		0,90	0,16
28 May 2019	12 June 2019, 14:00 CET		0,90	0,20
25 June 2019	10 July 2019, 14:00 CET	x	0,90	0,24
23 July 2019	7 August 2019, 14:00 CET		0,90	0,26
27 August 2019	11 September 2019, 14:00 CET		0,90	0,26
24 September 2019	9 October 2019, 14:00 CET	x	0,90	0,21
22 October 2019	6 November 2019, 14:00 CET		0,90	0,21
19 November 2019	4 December 2019, 14:00 CET		0,90	0,19
17 December 2019	8 January 2020, 14:00 CET	x	0,90	0,16
28 January 2020	12 February 2020, 14:00 CET		0,90	0,18
25 February 2020	11 March 2020, 14:00 CET		0,90	0,48
24 March 2020	8 April 2020, 14:00 CET	x	0,90	0,60
28 April 2020	13 May 2020, 14:00 CET		0,90	1,13
26 May 2020	10 June 2020, 14:00 CET		0,90	0,95
23 June 2020	8 July 2020, 14:00 CET	x	0,90	0,91
21 July 2020	5 August 2020, 14:00 CET		0,90	0,84
25 August 2020	9 September 2020, 14:00 CET		0,90	0,77
22 September 2020	7 October 2020, 14:00 CET	x	0,90	0,71
20 October 2020	4 November 2020, 14:00 CET		0,90	0,63
17 November 2020	2 December 2020, 14:00 CET		0,90	0,56
15 December 2020	to be specified later	x	0,90	0,50

*After 2020 February, the columns show our forecast.

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