MONETARY POLICY COMMENTARY HUNGARY

23 September 2020

Institutional Sales Desk

Attila Preisz
Head of Department
+36 1 288 7526
Attila.Preisz@otpbank.hu

János Mladoniczki
+36 1 288 7551
MladoniczkiJ@otpbank.hu

Zoltán Ballai
+36 1 288 7545
Zoltan.Ballai@otpbank.hu

Kitti Palásthy
+36 1 288 7574
Kitti.Palasthy@otpbank.hu

Corporate Sales Desk

János Imrei
Head of Department
+36 1 288 7544
Janos.Imrei@otpbank.hu

Nóra Ilona Gordos
+36 1 288 7549
Nora.Ilona.Gordos@otpbank.hu

Roxána Kosztelnik
+36 1 288 7541
roxana.kosztelnik@otpbank.hu

Edit Kovács Gyimóti
+36 1 288 7542
KovacsGyE@otpbank.hu

Anna Almási
OTP Trader
+36 1 298 3169
AlmasiA@otpbank.hu

Fodor István
+36 1 288 7555
Istvan.Fodor.1@otpbank.hu

Andorka Rudolf Flórián
+36 1 288 7558
Rudolf.Florian.Andorka.1@otpbank.hu

MNB sees symmetric risks around inflation and says to be ready to act in case of changing the inflation outlook

As expected, the MNB's Monetary Council left its base rate and the interest rate corridor unchanged. However, the MNB updated its growth forecast as well as its inflation forecast. Concerning the growth forecast, the central bank expects a 5.1-6.8% decline in GDP for 2020, which could be followed by a 4.4-6.8% GDP growth next year. Inflation is expected to be 3.5-3.6% this year, 3.4-3.6% next year and only reaching the 3% inflation target in 2022. In the Press Release the MNB made it clear again that – despite the downgraded economic forecast – it does not see further room for lower money market rates. Additionally the MNB stated that: "If warranted by a persistent change in the outlook for inflation, the Council will be ready to use the appropriate instruments."

The MNB sees inflation risks as symmetric due to the pandemic's negative economic effect on the one hand and the high inflation on the other. However, the depreciating HUF may complicate things if left unchecked. Looking under the hood, we think the base rate could be kept at its current level until at least mid-2021, but the risks are high both to the downside and the upside:

- First of all, the current environment should result in disinflationary pressures. GDP could decline by 5-7% this year, but more importantly, the damage on the labour market is more substantial than the moderate effect suggested by the most frequently used indicators. Since 2020 February unemployment rate increased from 3.5% to 4.8% only, while wage growth remained close to double digit levels through the summer (and even rose to 15.6% in July, but that was due to the one-off bonus to health care workers). However, the labour market is far from being in a good shape. 4% of employees lost their jobs and the majority of them remained inactive so far, while another 4% became part time workers and face the risk to be laid off soon due to the second wave of the pandemic and the end of the Kurtzarbeit program in August. Headline wage growth are calculated from salaries of full-time jobs at companies with at least 5 employees, therefore it overstates the true wage growth, not to mention the composition effect coming from that employees those who were laid off from the Covid-shaken industries are usually had salaries well below the national average. According to the MNB, the true wage growth could be only half of the headline number and our calculations suggest that the growth of household's real disposable income fell into the negative territory. Considering the above, we think that the Covid-19 could have a stronger effect on household spending than previously thought. This could impose a downward pressure on inflation next year, as household spending could slow down due to lower wage growth.
- On the other hand, the risk that inflation expectations may become less anchored should not be underestimated. Inflation and especially core inflation have been high compared to the upper band of the inflation target – getting close to or sometimes even exceeding it - for many quarters, and this tendency has not been broken by Covid effects so far. In July inflation jumped to 3.8% exceeding expectations (3.1%) by a wide mark due to widespread and strong repricing activity. Although August inflation data came in as expected – supporting the view of the MNB that July's repricing was a one-off – headline inflation rose to 3.9%, while constant tax core inflation accelerated to 4.2%. All-in all inflation is clearly at the upper edge of the 3 +/- 1% target band and at the same time is the highest in the EU. Even if inflation will decrease from October on base effects, the prospect of another round of strong repricing should not be downplayed, as many industries face supply side bottlenecks and the HUF has started to depreciate recently again.

In our view as long as risks are so high, the central bank will try to maintain the current monetary conditions. The MNB does it's best to support government debt financing and corporate lending, so it will go on with injecting liquidity (roughly HUF 100 bn / week) to bond and loan markets through unconventional measures. Second, after

Chief Economist

Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

Analyst

Dániel Módos, CFA
+36 1 301 2810
modosd@otpbank.hu

many years of weak exchange rate policy, now the MNB would like to avoid further depreciation in order to decrease inflation pressures. This is why the MNB emphasises that there is no room for lower short-term rates and that additional liquidity will be fully sterilized. This leads also to the recent introduction of the reversed FX-swap tender. This instrument provides short term (1 week) FX liquidity for the banks and withdraws HUF and will be used at the end of each quarter to prevent the anomalies (drying up FX liquidity, falling FX-swap implied yields, depreciation of the HUF) occurred in March and June.

To sum it up, we maintain our previous view, that any further loosening is off the table, but despite the current inflation levels, we see limited chance of a rate hike before the end of 2021 due to the negative economic effects of the pandemic. In our view disinflationary effects of the current crisis could dominate at least until mid-2021. We expect the MNB to keep the short end of the yield curve at 0.6% for a while, to control the long end through QE measures (with higher volume, if needed) and to mitigate HUF volatility by FX and reversed FX swaps. The MNB may start tightening after the expected economic rebound, supported by the higher EU fund absorption would close the output gap, definitely no sooner than in H2 2021.

Disclaimer

1. **The statements in this document shall not be considered as an objective or independent explanation of the matters. Please note that this document (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and (b) is not subject to any prohibition on dealing ahead of the dissemination or publication of investment research.**
2. This communication does not contain a comprehensive analysis of the described issues. No part, chapter, or the entirety of this information shall be considered as investment recommendation, an offer or solicitation for the purchase or sale of any financial instrument, inducement to invest, financial or investment analysis, investment research or marketing communication, not even if any part of this document contains a description of a certain financial instrument in terms of its possible price or yield development, and the related investment options; the data herein are for informational purposes only. This document shall not be considered as investment recommendation falling under Directive 596/2014/EU of the European Parliament and of the Council. This document does not take into account investors' individual interests, circumstances, or objectives; therefore, in the absence of personal recommendation, it shall not be considered as investment advice. OTP Bank intends to make this document available to its clients or to the public, or to make it accessible to other persons in such a way that allows this document to be disseminated to the public.
3. Information herein reflects the market situation at the time of writing. However, it provides only momentary information and may change as market conditions and circumstances develop. You may request more information from OTP Bank. Although the information in this document has been prepared in good faith from sources that OTP Bank believes to be reliable, we do not represent or warrant its accuracy or completeness. This document was prepared using data, facts and information from the following essential sources: Bloomberg, Reuters, KSH (Hungarian Central Statistical Office), Eurostat, Magyar Nemzeti Bank (Hungary's central bank) ÁKK (Hungary's Government Debt Management Agency), and European Central Bank (ECB). The opinions and estimates in this document are based on the opinion of OTP Research's analyst(s) at the time when the document was prepared, and they may be subject to change at any time in the future without further notice. You may receive different recommendation from the staff of OTP Bank, in particular if you are provided investment advice based on an investment advice agreement.
4. This publication contains generic presentation of information and knowledge, thus it does not take into account the individual clients' unique and special interests, financial condition, or their ability and willingness to take risks. Therefore please contact our staff or contact your banking consultant for advice before you make an investment decision. The assessment and the consideration of the individual circumstances is provided by the suitability and appropriateness tests that assess clients' financial knowledge, experience, risk-taking abilities, as well as the examination of the target market.
5. Before making an informed decision to invest and to use the services, please carefully read through all documents, including the documentation, prospectus, regulations, terms and conditions, announcements and key information documents for that product/service, and carefully consider the subject, the risk, the fees and costs of your investment, the possibility of any loss, and seek information about the tax regulations regarding the product and the investment. The prices of financial instruments and securities are changing, outrights sales are realized at then current market prices, which may involve losses.
   The information and opinions in this document do not substitute or take the place of the issuance documentation for the given financial assets (e.g. prospectus, fund management rules), or their brochures or announcements.
6. You assume total responsibility and risk for any specific decision or investment; OTP Bank shall not be held responsible for the effectiveness of investment decisions or for reaching your purpose, nor for the individual investment decision made based on this document or any part thereof, or for their consequences.
   Investments in financial instruments carry a certain degree of risk, which may affect the effectiveness of the investment decision, and investors may not receive the whole amount they expected the investment to yield in their investment targets; they may not preserve even the invested amount, therefore the invested capital might even decrease, be wholly lost, or even lead to additional payment obligation.
7. Trading with leveraged products (such as foreign exchange contracts) or with shares and indices that have underlying products carries a considerable amount of risk, and these products are not suitable for all investors. Trading with leveraged products carries the risk of losing all capital, and it may incur losses that exceed the amount invested.
8. **The figures and information described herein refer to yields or changes in the past. Past performance is not a reliable indicator of future yields, changes, or performance.**
   The changes on money and capital markets, the fluctuation of prices, the development of investments and their yields are influenced by the combined effect of multiple factors; one important factor of them is the change in investors' expectations. **The development of prices, the future yield of financial assets, indices or indicators, the examination of their changes, trends, and future performance is based on estimations and forecasts, which forecasts do not allow reliable conclusions to be drawn about the future moves of prices, real future yields, changes, or performance.** For each product and service, please assess their tax accounting implications, and other tax consequences, taking into account that they cannot be precisely assessed without knowing the effective tax regulations or the client's individual circumstances; and these legislative provisions as well as the circumstances may change over time.
9. This document shall not be a basis for any further analysis in relation to the financial instruments contained therein. Any reference in this document to the future distribution of a financial instrument shall be construed as indicative, preliminary and informative, and any analysis of such financial instrument is exclusively based on publicly available information listed in the respective prospectus or announcement. The content of this document shall not imply that OTP Bank acts as an agent, a fiduciary, or an advisor to, or on behalf on, any prospective purchaser of the financial instruments discussed herein.
10. For certain persons, access to the products and/or services discussed in this document may not be granted, or it may be limited. The act of preparing this document by OTP Bank, its uploading to the website, its publication may under no circumstances be considered as OTP Bank's intention to make available the product and/or service information in the prospectus to persons whom any country or state prohibits from having or obtaining the given product and/or service, including the promotion and the advertisement thereof.
11. OTP Bank maintains a conflict of interest policy and it keeps such records, and it also has requirements that regulate the transmission of bank secrets and securities secrets, which requirements shall be considered as the effective internal organizational and management solutions as well as information barriers to prevent or manage conflicts of interest.
   OTP Bank has developed appropriate internal procedures for (i) the personal transactions and trading of financial analysts and other relevant persons, (ii) the physical separation of the financial analysts involved in the production of investment research and other relevant persons; moreover, information barriers have been implemented, (iii) for accepting and managing incentives and remuneration.
   Please be informed that OTP Bank is entitled to deal or trade as market maker, acting in good faith and in accordance with the usual way of market-making, with the financial instruments distributed by the issuer(s) specified in this document, as well as to provide other investment activities or ancillary (investment) services, and/or other financial or ancillary financial services to the issuer and other persons.
12. Previous documents on investing in this asset or product are available on the website of OTP Research: www.otpresearch.com
13. OTP Bank (company registration number: 01-10-041-585; registered seat: Nádor utca 16., Budapest H-1051, Hungary. Supervisory authority: Magyar Nemzeti Bank (National Bank of Hungary – H-1054 Budapest, Szabadság tér 9); financial customer services: H-1013 Budapest, Krisztina krt. 39. PSZÁF licence numbers: III/41.003-22/2002 and E-III/456/2008; further information: https://www.otpbank.hu/portal/hu/Megtakaritas/Ertekpapir/MIFID).

14. If you received this document from OTP Bank Plc, then it was sent to you with your previous consent. You may withdraw this permission by sending an e-mail to research@otpbank.hu or by writing a letter to 'Research Center', Hungary H-1051, Budapest, Nádor utca 21. Please refer to your name and e-mail address in both cases.
   Data management registration number: NAIH-89457/2015
15. The personal data in this investment research are processed by OTP Bank. The legal basis for processing the data is the legitimate interest of OTP Bank. The detailed information about the processing of personal data and the related rights of data subjects is available here.

This document was prepared on 23 September 2020.