MONETARY POLICY COMMENTARY HUNGARY

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No change, only fine-tuning in the monetary policy strategy. Medium-term inflation risks have increased.

As expected, the monthly rate-setting meeting of the MNB's Monetary Council left the base rate and the interest rate corridor unchanged. There were no major new policy announcements in the statement, only fine-tuning of the previous strategy.

The first refinement was to insert into the statement what Deputy Governor Barnabás Virág had already publicly announced on QE. This addition makes it clear that under its QE programme, the MNB could (i) scale down the role of collateralised loan, and increase that of government bond purchases, (ii) if the 50% issuer limit on government bonds becomes binding on the longer horizon, the central bank could start buying bonds with maturities of less than ten years. While the December announcement on the issuer limit was a rather early one, by now the central bank has almost reached the limit on the 10Y+ horizon, our calculations indicate. By extending the programme on bonds maturing in 2030, another HUF 500 bn could be purchased, and with bonds maturing in 2028 or later, the volume could be pumped up by HUF 1,000 bn. So in the following weeks, the MNB will likely start purchasing bonds with medium-term maturity. Another observation is that although rechannelling funds from the collateralized loan facility to bond purchases could be reasonable, this step has its limits. Given that the MNB expects 50% of collateralized loans to be used for government bond purchases, if this facility is lowered, ceteris paribus, market purchases could decrease. Thus, as a secondary effect, central bank purchases reach the 50% limit earlier than otherwise. Overall, we think that while some rechannelling will occur, it could only be limited, unless other elements of the programme are changed as well.

Regarding the second refinement, the Monetary Council decided to raise the amount available under the Bond Funding for Growth Scheme from HUF 750 bn to HUF 1,150 bn and altered some conditions of this scheme.

Overall, we think the former steps are refinements, rather than major changes, in the previous monetary policy framework, which –as discussed in our previous notes– relied on a twofold strategy: (i) keeping long-term financing cost at a low level, but (ii) maintaining short-term rates above the zero bound high enough to avoid that changes in global risk sentiment feed into persistent exchange rate pressures, with the risk of increasing inflation.

According to this strategy, over the past month, the MNB kept increasing weekly liquidity at the previous pace of around HUF 130-140 bn, an annual pace of 16% of GDP, where half of the new liquidity goes to government financing. Based on the policy statement, we think the liquidity increase will be kept at a roughly unaltered pace.

While the main message of the policy statement has not changed, it is worth reviewing what factors the MNB may have considered when making the decision.

- Global financial conditions tightened over the past month, and concerns about global inflationary pressures also increased. There has been a 15 bps increase in 10Y US Treasury yields. Nevertheless, the long-term yields of major EU economies, nudged only slightly higher (except for Italy, where the political crisis had the primary effect). Still, the important point is that with the recent announcement of the new USD 1,900 bn mega stimulus in the USA, the market has started to raise concerns about the medium-term effect of unprecedented fiscal and monetary stimulus, once the lockdowns end. This anxiety has been further strengthened by increasing costs of transport, food, and oil. The global shortage in car chips Also illustrated for market participants that the pandemic could have a more prolonged effect on supply chains. Despite higher US yields, Hungary's long-term yields have not increased and the EUR/HUF remained stable.
- There was no surprise in CPI data, as the headline figure for December turned out at 2.7%, broadly in line with market expectations. However, underlying indicators suggest that the pace of price increases was about 3.5%.

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- Regarding the real economy, monthly indicators up to November, and confidence indices for December all suggest that, contrary to expectations a month ago, Hungary's economy may have avoided recession in Q4 2020. Still, the new virus variants and the slower-than-expected pace of vaccinations likely postponed the economic recovery to 2021H2, later than had been thought in December.

The factors summarized above could well counteract each other and, also given the huge uncertainty, could warrant unchanged monetary stance. Consequently, we do not expect movements in the rate of the weekly deposit rate, either, in the short term.

Still, it is worth noting that while in December risks were roughly balanced around the MNB inflation projection, we think that upside risks have become more prevalent by now. First, recent developments in US Treasury yields point toward the risk of tightening global factors, something that was unimaginable for quite a while. Second, markets are starting to be concerned about supply bottlenecks as well, and there is a risk of further increase in commodity prices, amidst unprecedented fiscal and monetary support. In such scenario, Hungary could hardly exempt itself from the more significant tightening in global financial conditions, and a potential increase in imported inflation. While the former factors may well turn out to be short-lived, the risk is definitely there. Its materialization could make the MNB accept higher interest rates earlier than could have been imagined a month ago.

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