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# MONETARY POLICY COMMENTARY

# HUNGARY

*30 January 2019*



## As core inflation excluding indirect taxes will exceed 3% in the next couple of months, the MNB will start a data-driven interest rate normalization unless the international environment deteriorates further

At Thursday's meeting the MNB did not change monetary conditions. The main message of the press release remained almost the same as in December and what has been confirmed at a conference in Vienna: due to the rising underlying inflation, the MNB is ready to start the normalization of monetary policy.

The starting date and the tightening process itself will be data-driven, as it depends on whether the core inflation excluding indirect taxes indicator calculated by the MNB will exceed 3% in January and February. Based on [our trend inflation forecast](#), core inflation excluding indirect taxes could reach and surpass 3% in the next two months. In the early months of each year, various goods and services are repriced. Owing to the high level of labour shortage and double-digit wage growth, repricing could be strong in the case of services. Furthermore, after a few years of more-or-less stable exchange rate, the HUF depreciated against the EUR in 2018, which adds to risks that goods inflation could also pick up (some retailers make pricing decisions once in a year, usually around January).

Two factors suggest that now the MNB is committed to tightening:

1. For a long period the MNB anchored its rate hike cycle to that of the ECB. But the MNB changed its stance last December when the sharp slowdown in the eurozone took place and the ECB rate hike for 2019 has been priced out.
2. At the time when global interest rate expectations shifted down, headline inflation fell below expectations in December, the market started to speculate that the MNB may postpone the start date of normalization. Therefore yields fell and the HUF depreciated. In order to stop this process, Deputy Governor Márton Nagy reiterated at the Euromoney Conference in Vienna that if core inflation excluding indirect taxes surpasses 3%, the MNB will act.

So in our baseline scenario core inflation excluding indirect taxes inflation could reach and even surpass 3% until February, which could trigger a slow and cautious tightening process by the MNB in March, when the new Inflation Report will be published. This could start by (1) the reduction of the FX swap outstanding, and (2) an increase in the O/N deposit rate to zero. These initial measures could be considered as largely symbolic. The BUBOR curve starts at zero and the 3M BUBOR is around 15 bps, so the first hike in the O/N depo rate will not be really effective. The reduction in the FX swap volume will initially just counterbalance the liquidity increasing effect of phasing out the preferential deposits, from the end of February. Later we expect these measures to become effective so the MNB could drive up BUBOR rates by 20-30 bps quarterly to around 1% by the end of 2019, which move could be followed by a base rate hike in December or in early 2020. Regarding the exchange rate, we think that MNB would communicate to keep the EUR/HUF around the current levels (around or just below 320) under the baseline scenario.

However, it should be kept in mind that the deterioration of external environment is fast. In its press release the MNB highlighted that 'the current international environment continues to suggest a more cautious approach, as the sustained deterioration in the global activity may pose a downside risk to the external inflationary environment.' In our interpretation, this means that if the international environment deteriorates to an extent that could have a material negative effect on domestic inflation, the normalization of monetary policy could be postponed or stopped at any time.

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Dates of the meetings	Dates of the minutes	Inflation report	Base rate decision*	3M BUBOR*
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		0,90	0,17
20 November 2018	5 December 2018, 14:00 CET		0,90	0,13
18 December 2018	9 January 2019, 14:00 CET	x	0,90	0,13
29 January 2019	13 February 2019, 14:00 CET		0,90	0,15
26 February 2019	13 March 2019, 14:00 CET		0,90	0,23
26 March 2019	10 April 2019, 14:00 CET	x	0,90	0,23
30 April 2019	15 May 2019, 14:00 CET		0,90	0,23
28 May 2019	12 June 2019, 14:00 CET		0,90	0,23
25 June 2019	10 July 2019, 14:00 CET	x	0,90	0,23
23 July 2019	7 August 2019, 14:00 CET		0,90	0,33
27 August 2019	11 September 2019, 14:00 CET		0,90	0,43
24 September 2019	9 October 2019, 14:00 CET	x	0,90	0,55
22 October 2019	6 November 2019, 14:00 CET		0,90	0,65
19 November 2019	4 December 2019, 14:00 CET		0,90	0,88
17 December 2019	To be announced later	x	1,15	1,07

\*After January 2019, the columns show our forecast.

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