Hungary set to raise base rates again next week

The National Bank of Hungary meets on August 24th to set interest rates. A third consecutive 30 basis point hike in the base rate is widely expected. It looks too early to expect a let-up in NBH hawkishness, yet a front-loaded tightening cycle is already priced in

The National Bank of Hungary

Growth and inflation to keep tightening in full swing

Having hiked the base rate by 30bp in both June and July, a third 30bp rate hike is widely expected on Tuesday. The move is consistent with the NBH's press statement that it is 'taking firm steps on a monthly basis to ensure price stability'.

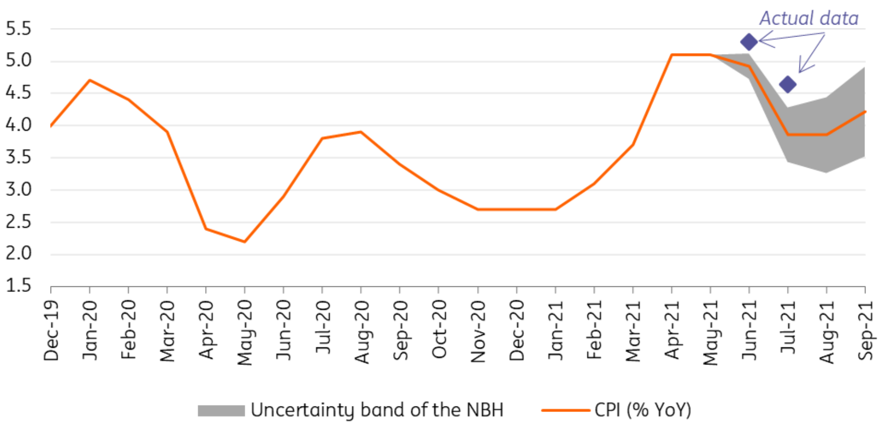
Since its last hike in late July, the NBH has seen two important inputs to its decision-making progress. The first, as Peter Virovacz outlines here, was the July inflation release. Despite a temporary dip in the YoY headline inflation figure to 4.6%, MoM figures were still 0.5% and core figures remained firm. As such, there seems little from the figures to assuage NBH fears that headline inflation will stay above the NBH's 2-4% target all year. Indeed, Peter sees headline CPI potentially pushing to a new high in November.

Additionally, Hungary's 2Q21 GDP release came out at an impressive 2.7% QoQ. This could see the

NBH revising higher its GDP forecast of 6% this year. And loose fiscal policy suggests the NBH will remain hawkish.

This all points to a 30bp hike in the base rate to 1.50% and probably language signalling further increases. We favour the base rate being brought close to the 2.00% area by year-end. No doubt the market will want to see if the statement retains the description of 'monthly' adjustments in policy and whether it introduces any conditionality on the scale of tightening linked to the release of the September Inflation Report.

The NBH's near term inflation forecast



Source: NBH, ING

Markets pricing in tightening

Local interest rate markets price a lot of this tightening already. The FRA market prices the base rate close to 2.00% into early next year and the 5yr. vs 10 yr. IRS curve is quite flat at 20bp, suggesting a lot of the tightening is priced in.

Given the current state of the global economy, it would seem a struggle for markets to price the terminal rate for the NBH base rate too much higher than the current 2.00%. The hurdle seems quite high, therefore, for the NBH meeting to trigger a sell-off in the interest rate market.

For FX, the HUF has been performing very well. In fact, the HUF is the top CEE performer over the last month at +1.6% versus the dollar. Expectations of a hawkish NBH are clearly helping as are the relatively high implied yields of 1.3% that can be earned through the three-month forwards. Given that a lot of the good news looks priced into the HUF, and fragile EMFX in general, we would say the balance of risks in EUR/HUF lie towards the 353, possibly 355 area.

One wild card at the meeting is what the NBH does with its QE policy. Currently, the central bank is buying around HUF55bn in mostly government securities each week and now has a stock of around HUF2.9trn. It considers this QE programme 'crucial'. It has said it will give an update on this programme when the QE stock hits HUF3trn. Any hints that it could start a gradual taper could hit the pricing of the terminal base rate (a similar story looks to be playing out for the Bank of England's policy) and could upset a market going into the meeting long the forint.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Disclaimer