

## National Bank of Hungary preview: inflation takes the lead

We believe interest rates will remain unchanged at the next Monetary Council meeting, the final one under Governor György Matolcsy. This time, macroeconomic factors will play a key role in the decision-making process due to the deteriorating inflation outlook



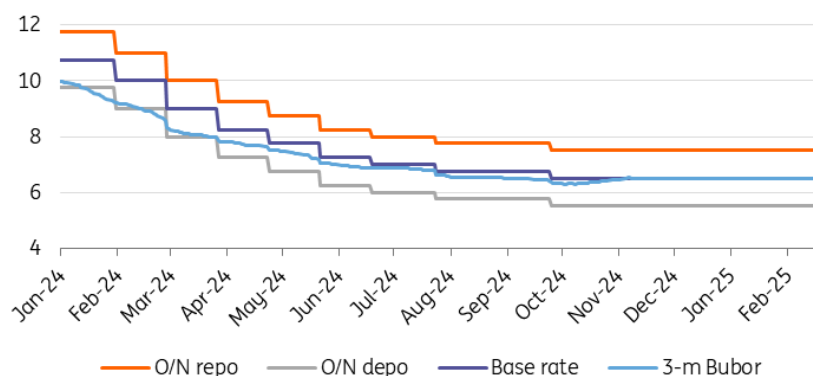
Finance Minister Mihaly Varga will be Hungary's next central bank governor

### The central bank left rates unchanged in January

As expected, the National Bank of Hungary maintained its key interest rate at 6.50% in January. The interest rate corridor also remained unchanged, with a range of +/- 100bp around the base rate. In line with its stability-oriented approach, this decision was primarily driven by rising inflation.

December's higher-than-expected price pressures were coupled with increased risk aversion and ongoing geopolitical tensions, impacting commodity prices and the forint. Despite some changes in the landscape, we expect the same outcome this time.

## The main interest rate (%)



Source: NBH, ING

## Macro picture deteriorates due to high inflation

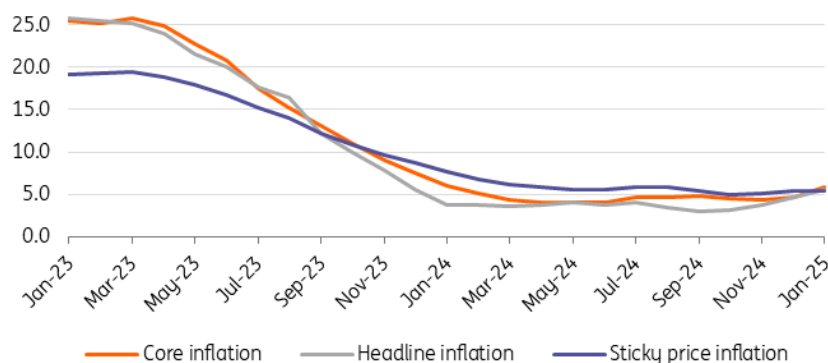
Headline inflation accelerated more than expected in January, rising to 5.5% year-on-year (YoY), exceeding even the highest expectations. The acceleration was mainly driven by further increases in food, fuel and services prices. Given such an unexpectedly elevated print, recent comments by Economy Minister Márton Nagy on the possible reintroduction of price caps for food are hardly surprising.

The details show that underlying inflationary pressures have also increased, as reflected in the 1.4% rise in core inflation on a monthly basis. The inflation outlook is therefore deteriorating: our inflation forecast for 2025 has been revised from 4.5% to 5.1% due to the January data. And we haven't adjusted the previous month-on-month profile yet, so we see upside risks to this forecast.

In terms of risk perception from a monetary policy perspective, the budget deficit in January was negligible. However, January typically generates a surplus, not a deficit. In this case, it was interest expenditure that caused the larger amount on the expenditure side and reversed the general picture. The most important driver, however, is that the government is still committed to the deficit target of 3.7% of GDP for 2025.

As for the external balances, we have not seen an alarming deterioration, but the expected strengthening of import activity will reduce the surpluses. However, low investment, lower-than-expected consumption and poor industrial performance could also reduce the country's import needs, hence we see limited room for deterioration.

## Headline and underlying inflation measures (% YoY)



Source: HCSO, NHB, ING

## Market sentiment improves but can't counterbalance the inflation outlook risks

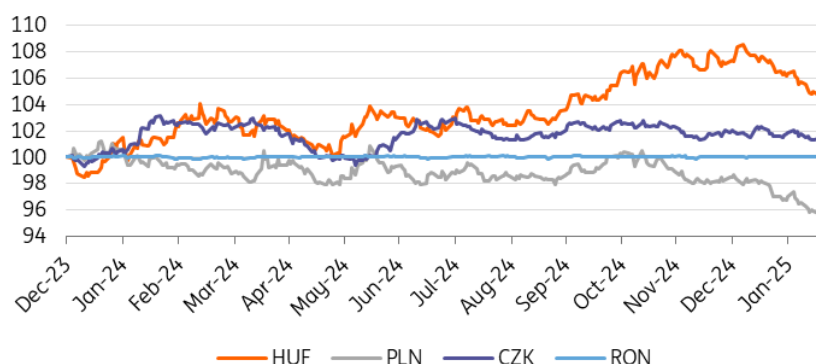
Previously, the weak performance of the forint and the ongoing instability and high volatility in the financial markets stood in the way of a possible rate cut. This time around, the story is different; it is the aforementioned inflation outlook that is killing any possible buzz around a dovish move.

The forint has recently shown a strengthening trend against the euro, moving from 408 (at the time of the last rate-setting meeting) to around 401. While the HUF has slightly outperformed in the region, it is still an unfinished correction if we look at where the forint stood against its peers around six months ago. In the short term, we do not expect any major impact on the inflation outlook via the FX channel, as we believe that the corporate reaction function is asymmetric.

If the HUF can hold onto its gains, a downward impact on inflation is more likely to occur in the second half of the year. However, these positives could easily be wiped out as risk appetite has improved on hopes that geopolitical tensions will ease with a possible ceasefire or peace deal in Ukraine. Any setback here could derail market optimism.

Then there is the looming tariff war, which has the potential to worsen financial market stability. Therefore, in our view, the market remains very fragile, and we can't label the situation as a rock-solid turnaround.

## Performance of CEE FX versus EUR (end-2023 = 100%)



Source: NHB, ING

We can highlight another positive development, which was highlighted as a key factor for monetary policy decisions going forward. Commodity prices have improved since the last meeting. Gas prices have dropped significantly since 10 February, but this doesn't directly affect the consumer price index because household energy prices are regulated and don't follow market fluctuations. The main benefit to the overall economic outlook comes from reduced pressure on the external balance.

In such an environment, it is hardly surprising that the central bank's communication remains hawkish, emphasising the need for stable rates for the foreseeable future. This was echoed and underlined by central bank speakers, including Council Member Pleschinger, whose mandate ends in March. It seems that the market is becoming more confident in the central bank's communication as investors now see no room for easing in the near term.

However, the market is still pricing in one rate cut and has not eliminated the possibility of another one around the end of the year.

## Our call

All things considered, we see no room for the central bank to ease monetary policy in the short term. In our view, the National Bank of Hungary will leave the interest rate complex unchanged at its next rate-setting meeting on 25 February. This will leave the key rate at 6.50% with a +/- 100bp interest rate corridor, which is a high conviction call.

It is important to note that this is the last meeting of the current Monetary Council. Therefore, the most interesting part could be the forward guidance. The main question is whether the central bank will stick to such a binding message or soften the tone already. In our view, the evolution of the inflation outlook leaves no room for tinkering, so we expect the same hawkish message, keeping easing off the table for the foreseeable future.

We have revised our forecast for 2025 as a whole because of the worsening inflation outlook. We now see zero cuts throughout the year in our baseline, although we do not rule out the possibility that the situation in the second half of the year could allow for some easing. However, we see little chance of this for the time being. Should the economic activity deteriorate, though, we could

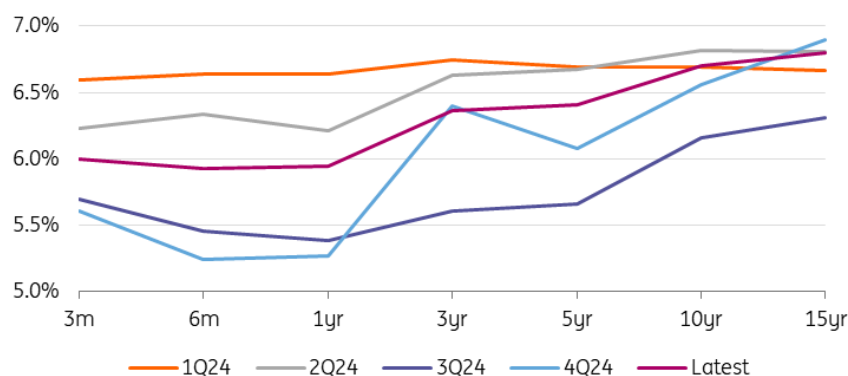
rather see room for some unconventional easing via balance sheet measures.

## Our market views

The Hungarian forint, as well as other CEE peers, has enjoyed a strong rally since the end of January, primarily driven by the prospect of Ukraine peace. There is a clear positive channel for markets here for CEE countries led by Hungary, given the high dependence on energy imports and geographic proximity. In our view, the immediate impact on the economy or inflation is debatable but the long-term impact is positive. Although momentum has been clear in recent weeks, at the moment the market seems to have priced in most of the positivity in FX, while long positioning especially in HUF and PLN will hinder further rallies, in our view.

At the same time, we believe that the rally is mainly driven by positive sentiment rather than an imminent change in the fundamentals of the economy. The rates market also saw some rally and ended the day with a narrower rate differential. Thus, overall, we believe that apart from the immediate war-end scenario, which for now is unlikely, the HUF should see some correction as sentiment evaporates. Still, the hawkish NBH is a good anchor for the short-end of the IRS curve, which should keep the HUF in check in the weeks ahead, and EUR/HUF should not go much higher if the market starts to see the Ukraine story as a longer run than it initially appeared.

## Hungarian yield curve



Source: GDMA, ING

Last week, the market reacted strongly to higher-than-expected inflation, but in the current global environment, this has created an opportunity for new received positions. For this year, the market has priced out one rate cut and stabilised with expectations of only one cut. Although our new forecast anticipates rates will remain unchanged, it's unlikely the market will eliminate all expectations at this point. However, we believe the prospect of lower commodity and food prices is positive, particularly for the belly and long end of the curve, which remain elevated above or near BUBOR.

In the bond space, HGBs have seen some cheapening against the IRS curve since the beginning of the year, making valuations now more fair in relative terms. At the same time, the funding picture looks positive in the early weeks of the year with some refinancing of retail bonds and high redemption in the HGBs market. Overall, we are positive about the duration in Hungary.

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