

National Bank of Hungary Preview: A decision almost set in stone

The forint has been remarkably strong since the central bank's last decision, so both market stability and macro fundamentals would, in our view, justify maintaining the previous pace of rate cuts. We therefore see a 50bp cut in May



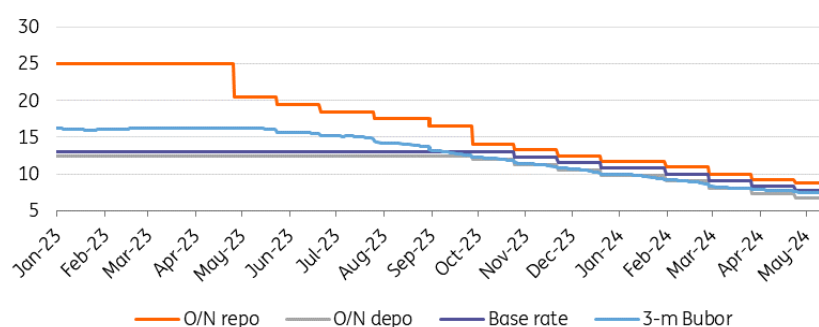
The National Bank of Hungary, Budapest

Central bank slows pace of rate cuts as promised

The National Bank of Hungary (NBH) cut its key interest rate by 50bp to 7.75% in April, slowing down the pace of easing seen in March. Thus, the central bank kept its promise that the size of the rate cuts in the second quarter would be smaller than in the first quarter of this year.

Moreover, the central bank sent some hawkish signals to the markets, as we discussed in our previous [NBH Review](#).

The main interest rates (%)



Source: NBH, ING

The decision has long been clear

At the Portfolio Lending 2024 Conference on 14 May, Barnabas Virag, Deputy Governor of the NBH highlighted in his speech that the central bank sees the most realistic outcome for the policy rate by June in the range of 6.75–7.00%. This means that we will either see two 50bp rate cuts or one 50 and one 25bp cut in May and June.

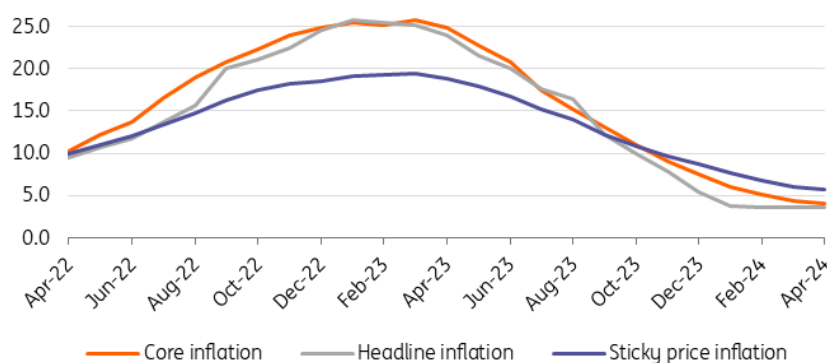
With both domestic and international factors looking supportive, it would be logical to go for that 50bp cut now, rather than to cut by 25bp in May, and then increase the pace of the rate cut to 50bp in June. Therefore our official call for the May rate-setting meeting is for a 50bp rate cut.

End of disinflation fully in line with central bank expectations

Inflation developments and the inflation outlook have been in line with both our and the central bank's expectations over the past month. Disinflation has come to an end, as headline inflation rose by 0.1ppt to 3.7% year-on-year (YoY) in April. However, core inflation fell further, reaching 4.1% YoY in the same month. Both readings were roughly in line with the central bank's forecast published in the March inflation report.

The bottom line is that although two waves of base-effect driven reflation (May and October) will push inflation steadily higher, it is also in line with the NBH's latest forecasts and guidance. In our view, this is the reason why the central bank adopted the word 'patience' in its latest forward guidance.

Headline and underlying inflation measures (% YoY)

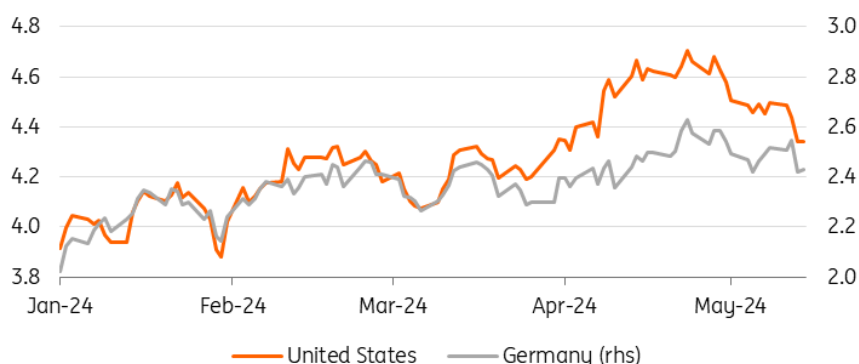


Source: NBH, ING

Fed's interest rate path still remains the biggest question

In terms of geopolitics, the situation has not changed significantly since the last rate-setting meeting. However, the market is now pricing in the Fed's rate cuts this year with a little more confidence than at the end of April. The current pricing indicates two full rate cuts in September and December.

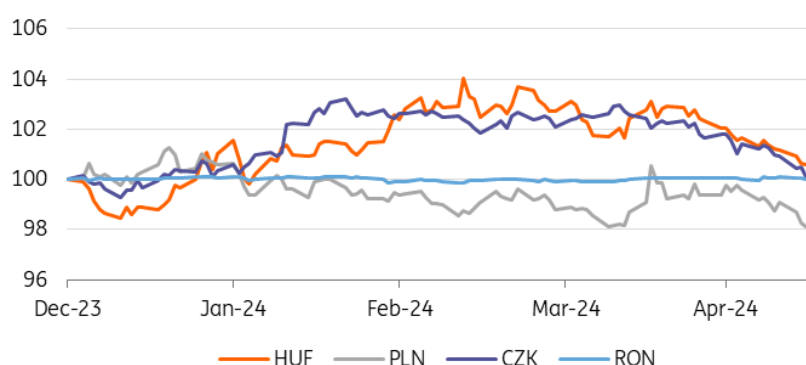
Developed market 10-year yield developments (%)



Source: Eurostat, ING

This repricing has contributed to a moderate dollar weakening, along with a notable decline in developed market yields from this year's highs. These corrections, together with the absence of material country-specific risks in Hungary over the past month, have significantly improved money market stability. As a result, the forint has appreciated to as low as 385 versus the euro by mid-May and is now at around the strongest levels seen since February.

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



Source: NBH, ING

Our call

Based on the NBH's guidance, along with our assessment, we see the National Bank of Hungary maintaining the previous pace of rate cut at 50bp on 21 May. This could bring the key rate down to 7.25% after the rate-setting meeting. We also expect the Monetary Council to cut both ends of the rate corridor by 50-50bp.

Our mid-term view remains unchanged

As we expect the policy rate to be lowered to 7.00% by the end of the first half of 2024, this implies that our call is for a 25bp cut at the June meeting. However, we see a dovish risk to our call, depending on the development of core rates and the outlook for regional and major central banks. That said, the country's risk premium could be heavily influenced by a possible Fitch downgrade decision due in June, as well as possible revenue-related austerity measures announced after the June elections. This, in turn, could lead the central bank to err on the side of caution and further reduce the pace of rate cuts to 25bp at the June meeting.

Furthermore, as our year-end inflation forecast for December is still in the range of 5.5-6.0% YoY, this leads us to believe that the terminal rate cannot go any lower after June. In this regard, we expect a sustained pause by the NBH, which in turn would still maintain a positive real interest rate environment and keep some risk premium over regional rates supporting HUF assets.

On the economic front, although the extent of the recovery in consumption is still quite limited, it poses an upside risk to services inflation. In our view, this would justify a wait-and-see approach by the central bank, which means it's likely to keep rates on hold for an extended period to assess the underlying inflation dynamics.

Nevertheless, we see dovish risks to our view over the mid-term. In the case of a favourable turn of events, such as a cooling US inflation, lower reflationary prospects in Hungary and/or a dovish shift in the regional monetary policy outlook, we could see the NBH continuing the rate-cutting cycle after the June meeting using even smaller steps. In this regard, we would expect a total of 50bp easing in the second half of the year. However, we wouldn't go so far as to predict the sequence of these moves at this stage.

Sub-6% year-end rate looks unrealistic

The only guidance from the central bank for the second half of this year is that the room for manoeuvre will be limited. However, the NBH also stressed that a policy rate below 6% by the end of 2024 is unrealistic. In this regard, this hawkish pushback against aggressive pricing is fully in line with our long-held inflation view, as we expect the NBH to cautiously manage the positive real interest rate environment throughout 2024.

Our market views

EUR/HUF has traded surprisingly well over the past month with the lowest levels since early February. A weaker US dollar and risk-on sentiment are behind the rally across the CEE region and still, HUF is the biggest underperformer among peers. At the same time, we still see a big FX disconnect from rates, which after the recent rally indicate levels rather in the range of 390-395 EUR/HUF. The mid-May mini-correction also showed that the forint is still fragile and that the recent rally is a tactical rather than a structural move. For the days ahead, HUF may continue to benefit from favourable global conditions and the hawkish tone of the NBH. However, medium term we retain a rather negative bias coming from an unclear economic recovery, a less rosy outlook in the external balance, fiscal risks and a possible sovereign rating downgrade, which has the potential to switch the HUF back into a risk-off mood.

The rates market has shown a strong rally across the curve in recent weeks with a steepening bias. However, we think markets supported by low inflation have once again priced in too many rate cuts and especially for this year with end-year pricing around 6.15% and 3M BUBOR nearly 50bp below the key rate. On the other hand, looking further out, we see value in the belly and long end of the curve which price in almost no additional rate cuts with a basically flat shape from 2y maturity. The combination of a hawkish NBH and a rally in core rates following favourable US data should bring back the curve inversion. That's why we continue to like the flatteners here which can benefit from a very attractive carry.

In the bond space, on the supply side, the situation remains very favourable despite the fiscal risk. The debt agency has front-loaded Hungarian government bond (HGBs) supply, eyeing a higher deficit and, according to our calculations, covered about 53% with very high demand in primary auctions compared to CEE peers. Thus, HGBs especially at the long end of the curve can still offer decent outright and relative value due to still wider spreads to CEE peers and the IRS curve. On the other hand, we are less optimistic on our own side. Fiscal risks and potential negative news from rating agencies, rising inflation and a pause in the cutting cycle in the second half of the year could end the recent rally and trigger a significant correction in the coming months.

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