

## National Bank of Hungary Preview: A fight against scepticism

New taxes have spooked the markets, making the shift to a gradual rate hiking cycle more difficult. Though we see the central bank fighting against the current investor scepticism, it would require a masterstroke of communication to turn the tide in Hungarian assets immediately



The National Bank of Hungary in Budapest

# +60bp

ING's call

Change in the base rate

### The rationale behind our call

Usually, we start our preview by assessing the latest set of incoming data, and comparing this to the National Bank of Hungary's forecasts. However, monetary and fiscal policy communications have been the dominating forces in the past couple of weeks.

The central bank has flagged an upcoming shift in approach: it is ready to give up on aggressive rate hikes in exchange for a more gradual tightening cycle. Our view is that such a change might be a response to the rising uncertainty whereas the general expectation is that Hungary is getting closer to the peak in inflation amid mounting negative risks in economic activity.

This cautious approach might translate into a lengthier tightening cycle compared to the expectations laid out in March (the latest official NBH Inflation Report) but this doesn't necessarily mean an outright shift from being less hawkish in terms of the total volume of tightening over the remainder of the year.

Previously, the central bank said that the rate hike cycle will end when the convergence of the base rate and the 1-week deposit rate comes to an end. A slower pace of base rate hikes while maintaining (+30bp) effective hikes in the 1-week depo rate could mean a longer tightening cycle and a higher terminal rate, compared to the original view when this pledge was made. If our view is right, telegraphing this message could be the most important challenge facing the National Bank of Hungary.

Obviously, the recent sell-off - a result of new taxes levied on specific sectors to cover the budget gap - will not make the situation any easier. With EUR/HUF being in the 390-395 range, the pro-inflationary pressure mounts further. As a base case, we see the central bank enacting a 60bp base rate hike on Tuesday followed by a 30bp hike in the 1-week deposit rate. Should we see EUR/HUF weaken further, the NBH might need to make a bolder move, hiking both the base rate and the 1-week deposit rate by 60bp each, reacting to the idiosyncratic market shock.

## What to expect in FX and rates markets

We expect choppiness in the EUR/HUF market in the coming days until the dust settles on the fiscal announcement. After that, we might see investors purely focusing on the result: a rebalancing in the fiscal stance. With simplified, cleaned-up forward guidance, the NBH might be able to bring calm to the HUF market after the rate-setting meeting. Though flipping the market's scepticism could prove very difficult and would take a masterstroke of communication to trigger such a turn immediately. We see EUR/HUF around 390 in the short run with a possible quick move to 380 should we see the NBH making a bold move in the 1-week deposit rate and/or hitting a home run with its forward guidance.

On the rate side, we see room to go higher again given our view that the market is underestimating the central bank's monetary tightening, especially in the short term. In that sense, short-dated FRA payers still make sense to us, however, low liquidity and the high cost of holding may be a problem. Therefore, it may be more beneficial to look beyond the terminal rate horizon currently priced in, meaning the 1y-3y segment with neutral or positive carryroll. Although we believe the NBH will deliver a rate cut sooner than the market currently thinks, next week's meeting is too early to change the market direction in our view.

On the bond side, the focus will eventually shift to the improved fiscal balance, thus a lower risk of excessive financing needs. This, along with our view that the looming rule-of-law debate will be settled, with positive news of an agreement starting to trickle in possibly in mid-3Q, could be good news for Hungarian government bonds. We have seen a significant tightening in asset spreads over the past week, however, we believe HGBs have further potential for richening given the market's reassessed view on bond supply and the delayed reaction to the IRS curve move.

## Authors

### **Peter Virovacz**

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

### **Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

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