National Bank of Hungary Preview: Dipping a toe into the shark tank

The National Bank of Hungary is preparing a monetary policy pivot. The first step will be to cut the upper end of the interest rate corridor at the April meeting. The inflation and economic activity data will decide the timing and the size of the first effective cut: May or June and 50bp or 100bp, in our view

The National Bank of Hungary in Budapest

At a glance

It is time to talk openly about a dovish pivot in Hungary. The National Bank of Hungary opened the floodgates with a well-timed interview. We see the central bank cutting the upper end of the interest rate corridor to 18% or 20% at the April meeting and preparing markets for the upcoming effective rate cuts, with market risks showing trend-like improvements. We see the first 50bp effective rate cut in June.

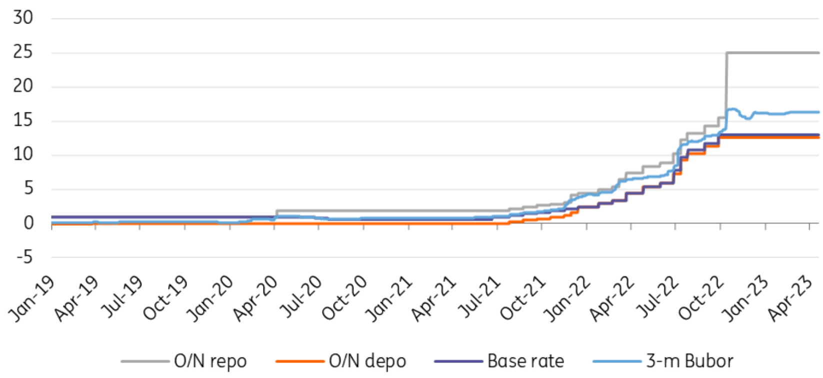
Pandora's box is open

The minutes of the March rate-setting meeting of the National Bank of Hungary (NBH) contained traces of satisfaction towards developments in risk sentiment. However, the global bank panic rewrote the playbook, and the central bank was left without any choice but to remain cautious.

However, the winds are changing again. It seems that there is growing confidence in the markets that banking contagion risk has ebbed.

This positive development made the NBH brave enough to dip a toe into the shark tank, paving the way for a monetary policy pivot. Deputy Governor Barnabás Virág noted that the Monetary Council might consider cutting the upper end of the interest rate corridor (sitting at 25%) when it gathers again on 25 April to decide on interest rates. He also mentioned that cutting the 18% quick deposit rate (the effective marginal interest rate) would only be on the agenda at subsequent meetings.

The main interest rates (%)



Source: NBH, ING

The first step is taken at arm's length

We see the 19 April announcement by the deputy governor as a due diligence exercise before the April rate-setting meeting. The central bank wanted to test the waters. In our view, with the EUR/HUF reaction being okay-ish, the only question remains the size of the cut in the overnight collateralised loan rate (repo rate). It is important to note that nothing else will change in the interest rate complex in April, in our view.

If the NBH would like to show the utmost confidence, it could cut the repo rate by 700bp to 18%, matching the level of the effective rate. This would nullify the room for manoeuvre in the quick deposit rate on the upside, suggesting that from now on, the only way is down. Should the central bank wish to keep some of its powder dry in case of emergency, it could cut the repo rate to 20%. In this decision, the linchpin would be the forint. If it behaves well and remains below 380 versus the euro (or even moves south), then it would be job well done and the NBH could cut to 18%.

The start of the effective rate cut cycle approaches

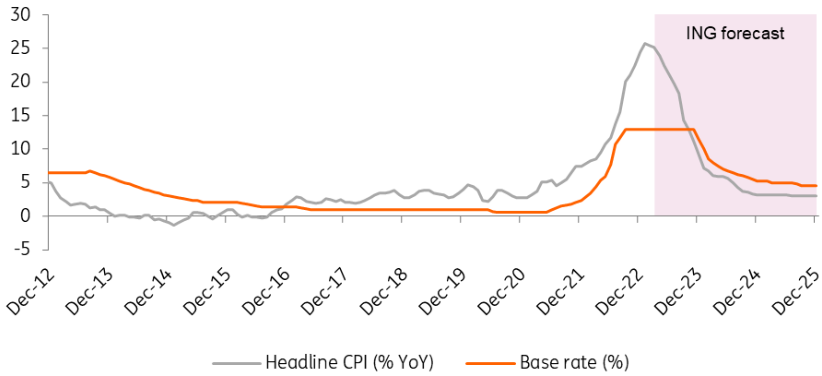
When it comes to the first effective rate cut, we see this as a coin toss, both regarding the timing and the size. Let's start with the timing. Before the May rate-setting meeting, we are going to see the April inflation print. The central bank is betting on a marked reduction, opening the door for a rate cut. However, we see some headwinds here, especially in services inflation, which might prove to be stickier than expected. If indeed we see yet another upside surprise in services and core inflation, this might delay the start of the easing cycle until June.

Other data, like economic activity, could play a bigger role in the size of the first effective cut. We expect the technical recession to continue in the first quarter of 2023. If we see a downside surprise and/or a bad growth structure (e.g., strong positive impact from agriculture due to a low base, but other sectors nosedive), it might nudge the central bank towards a 100bp cut.

The EU funds deal could be decisive both in terms of the timing and the size of the first effective rate cut. Positive headlines in the coming weeks could tilt the decision towards an earlier and stronger start to the cycle, while nagging uncertainty could make the central bank more cautious, moving the 50bp first cut into June.

If we had to roll the dice, we would roll with a first cut of 50bp coming in June, and yet another 50bp following in July followed by 100bp step sizes until the effective rate merges with the base rate at 13%. Our view considers an upside surprise in the April inflation reading with weak first-quarter GDP data combined with more uncertainty regarding the EU funds.

ING's inflation and base rate forecasts for Hungary



Source: NBH, ING

No one should have been surprised

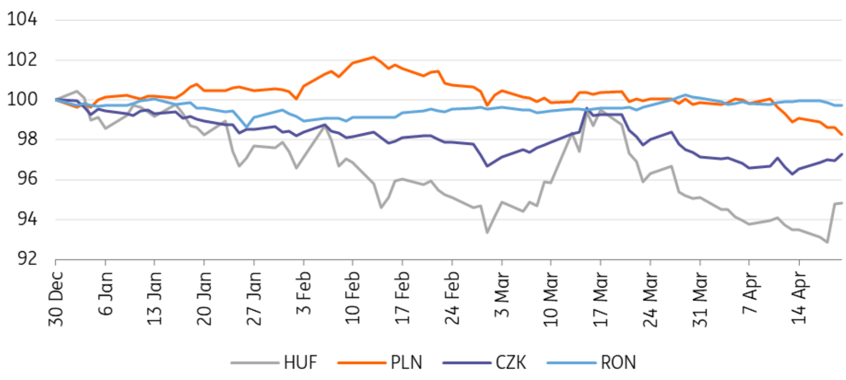
Finally, it might be worth writing a few words on the timing of the central bank's dovish pivot, which started with comments on 19 April. The NBH drew a marked distinction between the base rate and the temporary targeted tools introduced in mid-October 2022. The base rate is there to tackle long-term inflation pressure, and thus take care of price stability. The temporary targeted tools – including the overnight quick depo rate as the effective rate – are there to have the ultimate control over market stability (which is pretty much about the forint, in our view). The first phase of the easing cycle is about the developments in market stability concerns and less about inflation.

EUR/HUF dipped back to 370 in the days before the policymaker's comments, reaching levels last seen in April 2022. Recall, that was when the political and EU fund-related risk started to pick up after Fidesz won the general election by a supermajority and the EU started its Rule of Law procedure against Hungary. All the technical levels around and above 380 provide a strong enough safety net and the necessary room from 370 to test the waters for a monetary policy pivot. Kudos to the central bank for noticing and taking advantage of this opportunity. So far so good.

Let’s look at the inventory of other risk elements. There is no escalation in the war, which is relatively good news. The energy crisis might be behind us with global prices of energy carriers coming down a long way from their peaks. The market has pretty much priced in the peak of the Fed’s hiking cycle and the same looks to be true when it comes to the European Central Bank. In this regard, in relative terms, there is not much room for significant divergence on the majors' side versus forint rates. The global banking issue looks to be only a margin note now in the book of market volatility. Hungary's external balances are showing a trend-like improvement with dropping energy prices, lowering energy demand, and retreating domestic economic activity. EU funds remain a black box, but it is only a matter of time before Brussels and Budapest settle the dispute, we think.

In the grand scheme of things, knowing all of this, no one should have been surprised by the National Bank of Hungary's pivot.

CEE currencies vs EUR (end 2022 = 100%)

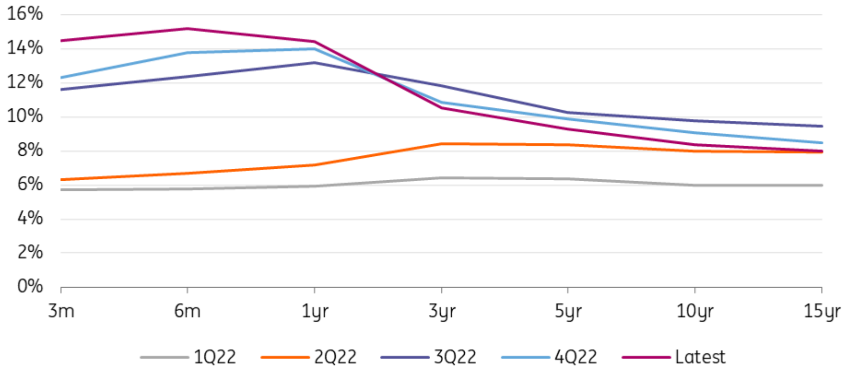


Source: NBH, ING

Volatility ahead in FX and rates

The Hungarian forint has come under pressure again and will be a major variable for NBH decision-making next week. So, the question is where the forint will be before and after the meeting. The jump in market rates in recent days and the very long positioning of the market indicates that the forint may see further selling in the coming days. Higher EUR/HUF levels in the 380-385 band could make the rhetoric from the NBH more cautious and risk-sensitive. On the other hand, we hardly see the forint rallying as it did before. Thus, another sell-off and some stabilisation after the NBH meeting are likely for the week ahead. Still, the forint will offer by far the highest carry in the region after next week's meeting and the NBH move was inevitable, so we do not expect the current picture to change completely, it's just that every rally must end.

Hungarian yield curve



Source: GDMA, ING

The interest rate swap (IRS) and Hungarian Government Bond (HGB) curves moved significantly lower after yesterday's statements, but we still think there is a long way to go. Although markets have been pricing in rate cuts for a long time and from that perspective the NBH's change in the stance is not a big surprise, the curves are still by far the most inverted in the region. Thus, the start of monetary policy normalisation is an opportunity for the curves to start normalising too, in our view. The 2s10s slope of the IRS curve has not changed much from previous weeks so far and we think next week's meeting will attract further market attention for steepeners.

Hungary bond issuance needs under control

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