National Bank of Hungary preview: New sheriff, same town

The next rate-setting meeting in Hungary will be the first under Governor Mihály Varga. There might be a new sheriff in town, but we expect the same result as the last five months: no change in rates. It's the same "town" with the same inflation problems, after all

Next week's NBH meeting will be the first led by Governor Mihály Varga

Our call

We still see no room for the Hungarian central bank to ease monetary policy in the short term. In our view, the Monetary Council – led by Governor Mihály Varga for the first time – will likely leave the interest rate complex unchanged at the 25 March meeting. This means that the key rate remains at 6.50% with a +/- 100bp interest rate corridor, which is a high conviction call from our side.

It is important to note that this will be the first meeting of the new Monetary Council, with Governor Gyorgy Matolcsy being replaced by former Finance Minister Varga, and Council member Gyula Pleschinger being succeeded by former Council member Andrea Mager. So far, based on the first batch of comments, we see the same hawkish orientation, but it will be interesting to see the detailed thinking and the nuanced changes to the forward guidance. Sometimes small changes are the most significant.

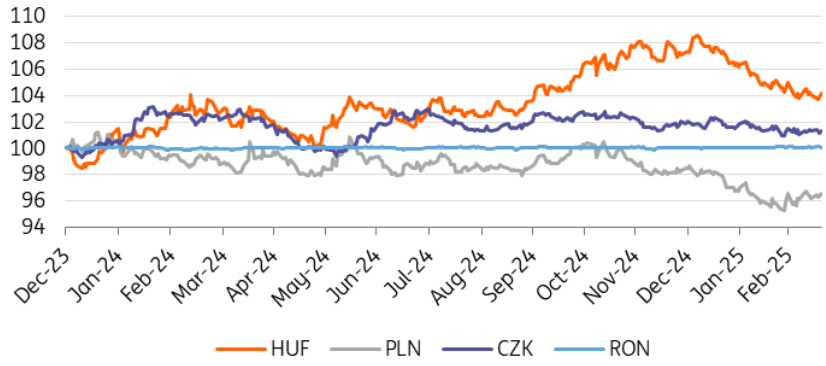
Looking through the upcoming meeting, the deterioration in the inflation outlook means that our baseline is now zero cuts throughout the year. However, we do not rule out the possibility that the situation in the second half of the year could allow for some easing. Given the significant tightening of liquidity in the banking sector (approximately HUF3,000bn out of HUF10,000bn of excess liquidity) expected throughout the year, there may be increased scope for unconventional easing through balance sheet measures.

As for the market talk of a rate hike, we believe that the National Bank of Hungary will want to wait and see the effects of the government's new price controls, so it is expected that it will only be able to talk about a rate hike at the May meeting if the inflation problem persists, as meaningful April inflation data will not be released until early May. But even then, the central bank may decide to wait a little longer to see the impact of the price curbs on inflation expectations.

Our market views

The Hungarian forint remains a playing field for geopolitical events at the moment, in particular German fiscal expansion and negotiations between Ukraine and Russia, but also potential US tariffs. Recent weeks have seen the HUF heading towards stronger levels, which may also be the case for the very short-term horizon given several events on the calendar. A continuation of the NBH's hawkish rhetoric following the change of governor in March is also supportive.

CEE FX performance vs EUR (end-2023 = 100%)



Source: NBH

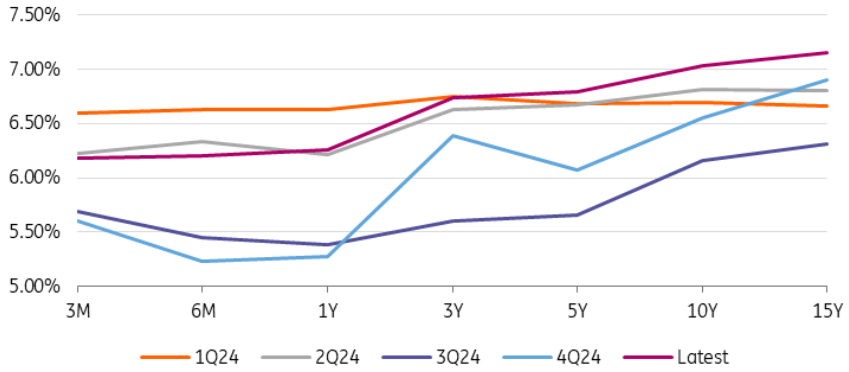
However, the medium-term overall picture for Hungary remains largely unchanged. A weak economic performance, inflation, and fiscal risk should keep the forint on the weaker side. Overall, we may see some support due to global events in the short term but we expect local factors to drive FX weaker again later on, with EUR/HUF around – and possibly even above – 410 in the second half of the year.

Since the beginning of the year, the Hungarian rates market has experienced phases of sell-offs following unexpected inflation spikes over the past two months, interspersed with rallies driven by attractive valuations and global market trends. Repricing after the February inflation number lifted the curve to near-yearly highs and well above 3M BUBOR.

At this point, the market is expecting one NBH rate cut this year and a second rate cut next year. It seems increasingly likely that we will not see any monetary easing this year, but we cannot

assume that the market has priced out all probabilities. We therefore believe that the short end of the IRS curve will remain anchored by NBH policy. However, the belly and long end of the curve should head lower given that we see NBH rate hikes as unlikely in the current environment and that current valuations are not justified in the context of our inflation forecast and global story.

Hungarian yield curve



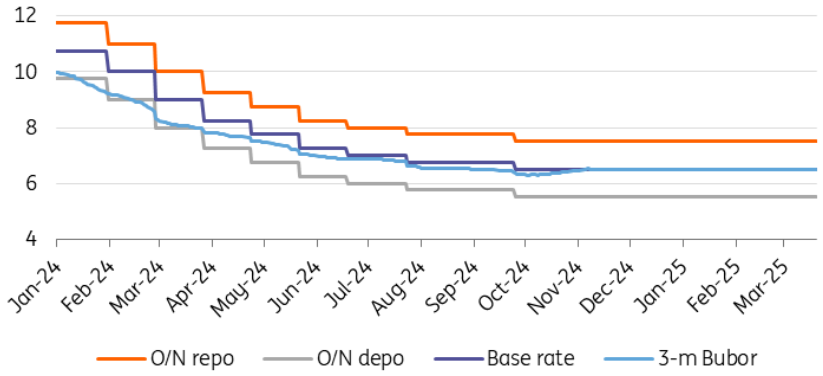
Source: GDMA

Similarly, Hungarian government bonds (HGBs) look attractive to us in the belly and long-end curves. The debt agency has covered roughly 26.5% of all projected HGBs including our slightly higher budget deficit this year, according to our calculations. We also see strong issuance in retail, benefitting from both tax incentives and strong redemptions coming back into the system. Asset spreads against IRS have significantly widened since around last October due to strong supply. Overall, cheap valuations and the global story should keep demand strong in the bond market in our view, painting a positive picture for the market.

The background

The National Bank of Hungary maintained its key interest rate at 6.50% in February, keeping the interest rate corridor at +/- 100 basis points around the base rate. This decision was influenced by rising inflation, which exceeded expectations in January. While market sentiment has improved, particularly for the Hungarian forint, the central bank emphasises a cautious monetary policy to ensure long-term price stability.

The main interest rates (%)

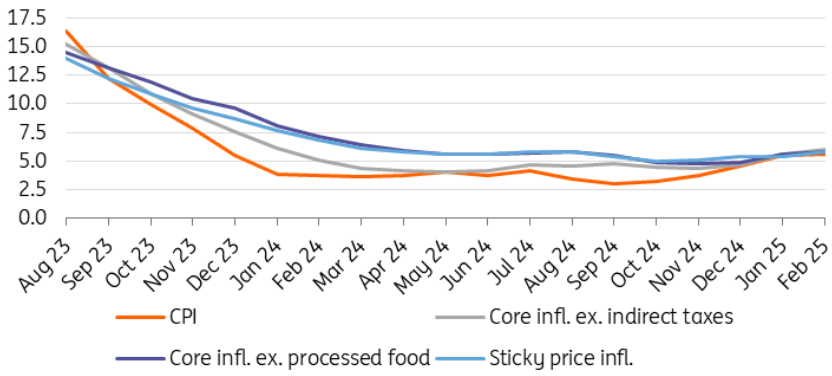


Source: NBH

Headline inflation rose to 5.6% year-on-year in February, contrary to expectations of a slowdown, driven mainly by increases in food and services prices. The recent rise in food prices resembles trends seen during the cost of living crisis, while an unexpected acceleration in services inflation may be linked to minimum wage hikes. This situation is eroding consumer confidence. In response, Márton Nagy, Minister for the National Economy, and Prime Minister Viktor Orbán announced measures to combat inflation from March to May, though their effectiveness on the official headline inflation data remains uncertain. Additionally, core inflation has risen to 6.2%, further limiting monetary policy options.

In terms of risk perception from a monetary policy perspective, in February, the budget deficit was high but consistent with trends since 2020. The government aims for a 3.7% GDP deficit target for 2025, which is achievable, but we project a 4.0-4.2% deficit due to expectations of weaker economic activity. The newly announced tax relief measures won't have a major impact in 2025 but will result in a higher deficit target for 2026. This may also encourage a more cautious approach from monetary policymakers.

Headline and underlying inflation measures (% YoY)



Source: NBH

In terms of market stability, the recent strengthening of the forint is certainly welcome, but it

won't be enough to justify a change in the monetary policy stance due to the overarching inflation issues. Over the past month, the forint has appreciated by around 0.8% against the euro and 1.6% against the Polish zloty.

Meanwhile, the risk premium in Hungarian bonds has increased significantly, with the spread between Hungarian and Polish bonds widening by 50bp, possibly due to the inflation outlook and the longer-term impact of the newly announced fiscal measures. In such an environment, we think a continuation of the hawkish stance – with a change of leadership – is justified.

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