

National Bank of Hungary preview: Normalisation to continue unabated

Despite recent market volatility, we still see a strong enough environment for the normalisation process to continue, with the need for caution likely to be echoed once again by policymakers. In practice, this means that the National Bank of Hungary will deliver a 100bp of cut in the effective rate at its July meeting this week



The National Bank of Hungary in Budapest

Our call

We expect the National Bank of Hungary (NBH) to continue the normalisation of monetary policy despite recent market volatility, especially in the forint. We believe that global factors and repricing are the drivers of recent selloffs, while the local macro story remains supportive in our view. These episodes proved the need for cautiousness in policymaking and provided a good example as to why the central bank may prefer to err on the side of caution, signalling the importance of patience when it comes to the easing cycle.

At its June meeting, the central bank made a slight rebalancing in the order of factors that are affecting monetary policy. The updated forward guidance now puts the effects of international financial market developments on the domestic risk environment in first place, followed by incoming macroeconomic data and developments in the inflation outlook.

All things considered, we expect the central bank to replicate the decision it made last month and cut the quick deposit tender rate by another 100bp, bringing the effective rate to 15%. Similarly, we anticipate 100bp cuts to the one-day FX swap tender and the overnight repo rate (upper bound of the interest rate corridor).

Caution to continue

Taking all the important drivers now shaping the monetary policy into consideration, we don't believe there's any need for a plan B. This is reflected in our call above, but let's take a look at a few details.

As far as international financial market developments are concerned, we believe that recent HUF weakening was widely driven by global factors. In early July, EUR/HUF briefly touched 388, crossing the 376-378 zone – the resistance level that stopped the forint from depreciating before the last three NBH meetings. While July's move was stronger than the previous three spikes, it still falls short of the rapid rise in March triggered by the collapse of Silicon Valley Bank. We therefore acknowledge the slight deterioration in FX stability, but still believe that it might not be enough to derail the ongoing normalisation of monetary policy. In this regard, market pricing is aligned with our view.

In terms of global monetary policy developments, we believe that we're rapidly approaching the end of hiking cycles for both the Federal Reserve and the European Central Bank (ECB) as the global disinflationary narrative shifts into a higher gear. As a result, the Hungarian interest rate advantage will not be eroded in two directions. In addition, while energy (especially gas) price risks have clearly not diminished, Dutch TTF gas prices are approaching the local lows seen in early June.

From a macroeconomic data perspective, the staggering EUR 1.1bn trade balance surplus in May is welcome news and shows a marked improvement in the country's external balances, which also helps the current account. This is also accompanied by an improvement in the terms of trade.

Lastly, the June inflation figure, which fell from 21.5% in May to 20.1% year-on-year, is yet another positive development. However, given that the central bank separates the issues of price and market stability, we do not believe that this will have a material impact on the pace of the normalisation process. In this respect, recent comments by Deputy Governor Barnabás Virág reinforce our view that better-than-expected incoming data will not change the pace or magnitude of rate cuts. In the case that the disinflationary process occurs more quickly than expected, a positive interest rate environment may come sooner, which is necessary for disinflation to continue.

As the base rate is responsible for tackling fundamental price pressures, we expect it to remain unchanged at 13%. Obviously, the central bank will underscore the acceleration of disinflation as a significant factor, but we don't believe that the Monetary Council will want to make any substantive comments on a possible cut in the base rate any time soon. In contrast, recent volatility showed the need to emphasise the cautious and gradual approach to normalisation. We wouldn't be surprised to hear these hawkish sounds again alongside the cut announcement.

Convergence to finalise by September

If the environment remains supportive and market stability is maintained, the NBH is going

to continue its series of gradual interest rate cuts of 100bps. In our base case, the base rate and the effective rate should converge accordingly at 13% at the September rate decision. There was a minor tweak to the forward guidance in the latest press release, with the term “prolonged period” being dropped as the Monetary Council assessed that maintaining the current level of the base rate will ensure price stability. We believe that this tiny shift might be the first hint that, following the expected convergence of the effective rate with the base rate in September, easing will continue without a pause. In our assessment, this would be roughly in line with recent market pricing.

Our market views

The Hungarian forint is gradually normalising following the sell-off two weeks ago, which affected the whole region. We see global momentum and market overvaluation as the main reasons as local conditions improve. The market sell-off has likely lightened the heavy long positioning and we believe the massive carry will once again attract market interest. In addition, we think the market is pushing NBH to cut rates at a faster pace and the hawkish tone should be a boost going back to EUR/HUF 370.

In the rates space, we see that the very short end of the IRS curve has moved significantly lower in recent weeks due to the market wanting to see a more dovish central bank in the face of better macro numbers. However, our base case is that the NBH will not move away from the set course and these bets will be disappointed. In general, we see more steepening of the curve in the 2s10s spread, but a very short end. The FRA curve should see some repricing up this week, resulting in flattening in this segment.

Hungarian government bonds (HGBs) eased in July and the rest of the region caught up with the swift rally. We therefore see current valuations of HGBs as more justifiable, which could attract new buyers. Despite the fiscal slippage risk, YTD issuance has reached 60% by our calculations, which we see as more than sufficient. Moreover, recent government measures supporting HGBs and the fastest disinflation in the region should be enough to sustain demand.

Author

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial

instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.