

National Bank of Hungary preview: Not there yet

We are seeing tentative signs of improvement in Hungary's economy, but it's still early days and so we expect central bank policymakers to continue adopting a wait-and-see approach



The National Bank of Hungary in Budapest

13%

ING's call

No change in the base rate

The rationale behind our call

The National Bank of Hungary (NBH) has made it clear on several occasions that the temporary and targeted measures (introduced in mid-October) will remain until there is a material and permanent improvement in the general risk sentiment. This general risk sentiment is defined by the combination of external risks (war, global monetary policy, energy, general investor sentiment) and internal risks (EU funds, current account imbalance).

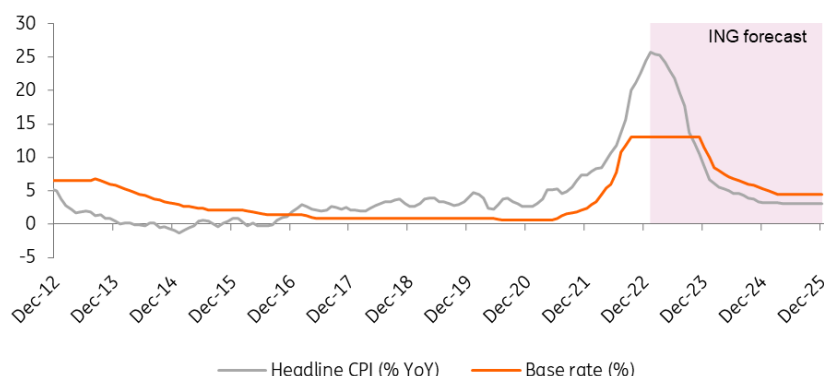
There has been a lot of improvement in the general situation. When it comes to market sentiment,

the market's view is clearly positive about Hungary; EUR/HUF is now flirting with 380, in contrast with the 400 seen before the last rate-setting meeting.

The emerging market relief rally on dropping energy prices has fuelled an improvement in global sentiment as well. However, Hungary is still experiencing high energy prices at the back end, so there has been little relief, so far. And the improved global sentiment around energy prices has only just started to translate into hard evidence: the December trade balance showed a deficit of only €154m (vs €1.2bn in November). The fourth quarter (preliminary) current account deficit came in at €3.95bn, showing a €0.52bn improvement over a quarter. This is the impact of lower energy prices.

There is also anecdotal evidence that food prices have started to drop, alongside fuel prices, which makes us think that we've already seen the peak in inflation in January of 25.7% year-on-year. Because of this, we expect the National Bank of Hungary to keep its composure at its 28 February meeting and wait for more hard evidence before it starts to communicate about any upcoming pivot.

ING's inflation and base rate forecasts for Hungary



Source: NBH, ING

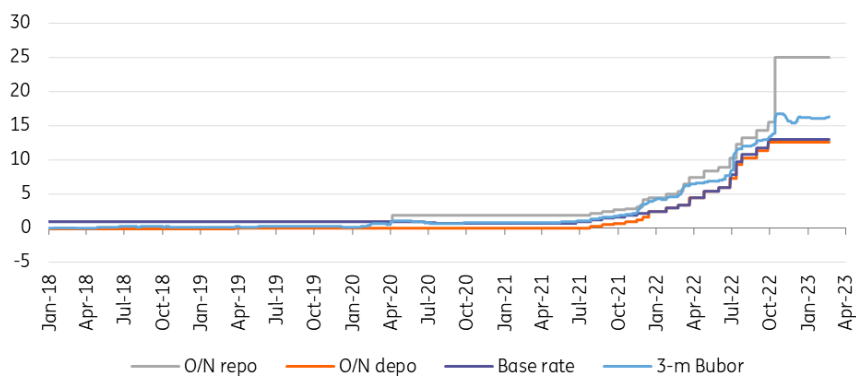
Even if the data suggest that the time is right for a change, there is a need to be patient due to the ongoing debate over the reforms needed to unfreeze access to EU funds. Though we see the government settling the dispute regarding the judiciary reform (a horizontal issue, which needs to be cleared before meeting other super milestones), there is just too much uncertainty still about the deal.

In such an environment, we see the central bank keeping its guard up, sending hawkish messages and patiently waiting for more proof of improvement regarding external, internal and political topics. In our view, the base rate remains unchanged at 13.00% with no change to the interest rate corridor as well. The targeted, temporary measures will continue as well, as any abrupt change to the structure or to rates could reverse the gains made by the forint, which would hinder the central bank's task to reach the inflation target over the monetary policy horizon.

A trend-like change in external and internal risk sentiment could lead to a better situation by the time the March rate-setting meeting takes place. However, we think that the NBH will wait at least until April to deploy any changes to the targeted, temporary measures. Even if easing starts during the second quarter, the process will be gradual and slow with a pause after the rates

merge at 13%. We see the central bank starting regular rate cuts during the fourth quarter, strictly taking care of the real interest rate to remain positive.

The main interest rates (%)

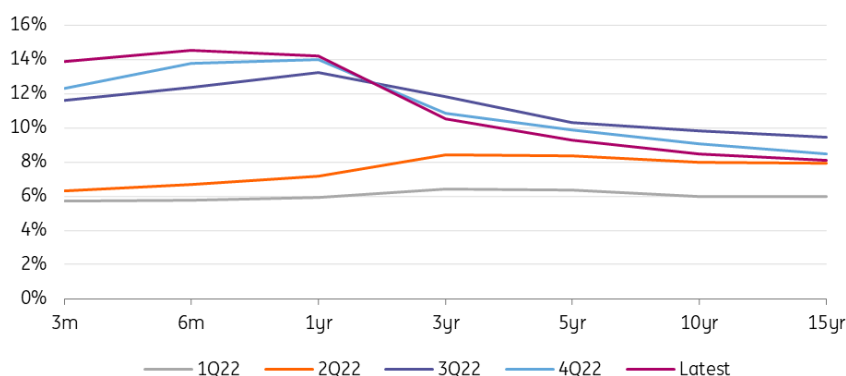


Source: NBH, ING

Our FX and rates call

On the rates and bonds side, the global sell-off has hit the Hungarian market hard over the last few days, and the high CPI number and hawkish NBH pushed the whole interest rate swaps (IRS) and Hungarian bonds (HGBs) curve up, disrupting the normalisation process. The NBH appears to be serious about its hawkish tone, and in our view it will be a challenge for the market to start pricing in a central bank rate normalisation again. On the other hand, in the interim, core rates should ease their pressure on the long end of the curve. The question mark is whether we will see a steeper or flatter curve first. At the moment, we are leaning more toward the latter. In either case, however, the direction of the curve movement should be downward.

Hungarian yield curve

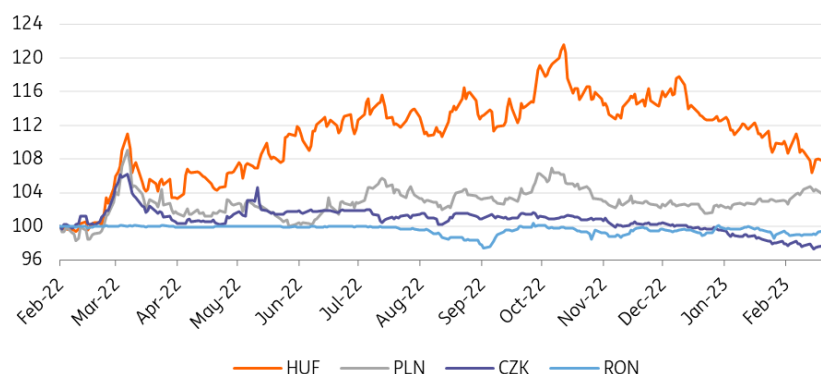


Source: GDMA, ING

On the bond side, although the beginning of the year showed a surprising deficit in the state budget, we remain optimistic that the MinFin target will be met this year. On the funding side, we estimate that the Government Debt Management Agency AKK has issued about 14.2% of planned HGBs, a bit behind Central and Eastern European (CEE) peers. On the other hand, issuance is strong on the retail and FX bond side, so overall we see AKK in a comfortable position. After the global

sell-off, the 10y HGB yield got as high as 8.85%, correcting down a bit later, but these levels should attract new buyers again. We still see a better story in the Czech Republic and Romania in the CEE space but remain constructive on HGBs and the positive normalisation story in Hungary.

CEE currencies vs EUR (1 Feb = 100%)



Source: NBH, ING

The forint continues to maintain a number one position within the CEE region and in our view the reasons why the forint should outperform persist. Higher EUR/USD should improve the outlook for the region as a whole, gas prices are again testing new lows, plus the recent sell-off in the rates space has once again pushed the rate differential in Hungary back to levels from the beginning of the year and pushed FX implied yields back to record levels.

Overall, we continue to see a positive story supporting further gains in the forint. However, heavy long positioning remains an obstacle on the way down. In the short term, we expect the NBH meeting may only deliver a small boost to the forint given the clearly hawkish message in January. On the other hand, Moody's ratings review in early March may bring a reminder of the issues still on the table. Moreover, the EU story could again bring some headlines that may not be positive for FX at first glance. Overall, we expect the forint to peg toward the 380 EUR/HUF level in the coming weeks.

Authors

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 <http://www.ing.com>.