National Bank of Hungary Preview: Preparing for the season finale

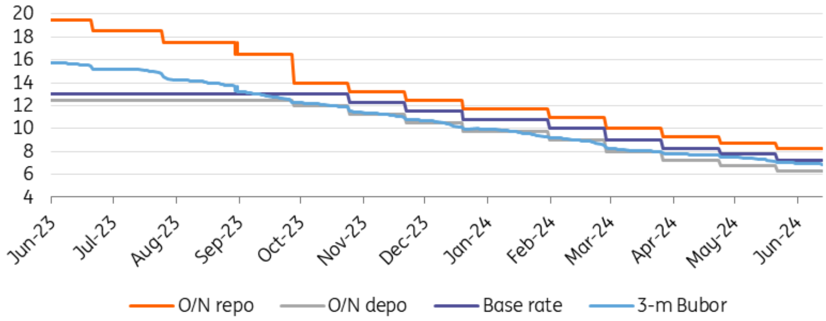
Based on the central bank's guidance, there are only two options left on the table in Hungary. In our view, the choice will be the cautious option – a 25bp cut – given the recent market instability. The forward guidance will point to very limited or no room for further easing

The National Bank of Hungary, Budapest

Central bank maintained the 50bp rate cut size in May

The National Bank of Hungary (NBH) cut its key interest rate by 50bp to 7.25% in May, maintaining the previous pace of its rate cuts from April. The Monetary Council recycled the messages from the previous rate-setting meeting, as we discussed in our previous NBH Review.

The main interest rates (%)



Source: NBH, ING

There are only two options on the table

At the May meeting, Deputy Governor Barnabás Virág reiterated the previous message that the mid-year interest rate target remains between 6.75% and 7.00%. In practice, this gives the Monetary Council in June two options: 50bp or 25bp of easing.

We believe that both the macro fundamentals and the recent market instability – as well as the divergence in the rate paths of the Federal Reserve and European Central Bank – would argue for a slowdown in the pace of rate cuts. As a result, our official call for the June meeting is a 25bp rate cut.

The end of disinflation means that the room for further rate cuts remains limited

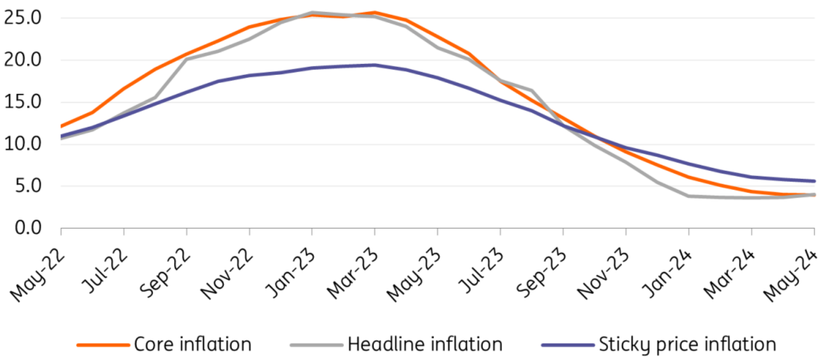
Headline inflation rose by 0.3ppt to 4.0% year-on-year in May. Although the jump was smaller than previously expected, it is important to note that the downside surprise was not driven by core elements that monetary policy can influence, but rather by volatile and autonomous elements that the central bank cannot influence. Not to mention the fact that corporate wage growth is still running hot at 12.7%, which limits the room for services inflation to cool down.

Moreover, as we have long argued, another reflation round will arrive in October, which will be driven by price pressures within the core basket, along with base effects. At the moment, this shouldn't stop the central bank from continuing the rate cutting cycle in June, but we believe that the room for further rate cuts after June is significantly limited – or even non-existent.

On the economic front, the latest first quarter GDP data for this year confirms that the Hungarian economy has once again emerged from stagnation. The recovery was led by the services sector, most notably by consumption-related areas such as wholesale and retail trade, accommodation and food service activities, and leisure/recreation-related services. While the extent of the recovery in consumption is still limited, it poses an upside risk to services inflation. In our view, this would justify a wait-and-see approach by the central bank after the June meeting, which means it's likely to keep rates on hold for an extended period to assess the underlying inflation dynamics.

From a fiscal perspective, the results of the recent elections have led investors to speculate on the timing of any fiscal stimulus before the 2026 elections. In this regard, we believe it may be too early for the central bank to address this possibility – but given that the issue will remain in the spotlight, this could support a more hawkish rate cut already in June.

Headline and underlying inflation measures (% YoY)



Source: NBH, ING

Divergence between the Fed and ECB rate paths materialised in June

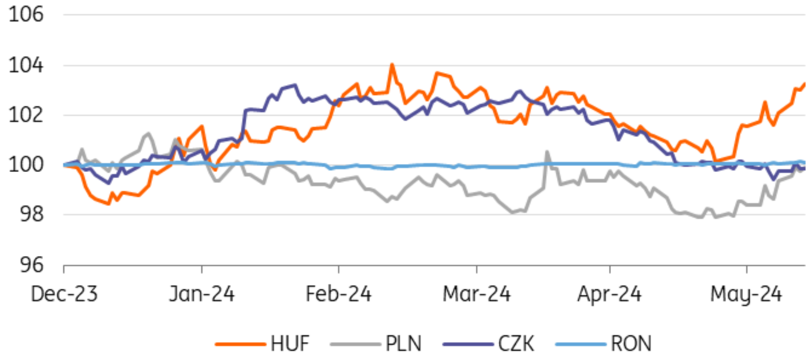
At the May meeting, the NBH put the focus on the divergence between Fed and ECB policy, which could lead to increased volatility in emerging markets. In this regard, the divergence has officially begun, as the ECB cut its key rate by 25bp in early June, while the Fed is not expected to make its first rate cut until September.

In this regard, we believe that the NBH will remain cautious and patient in its decision-making as it closely monitors the Fed's communication. If US inflation and economic activity were to cool significantly, this could open the door to further rate cuts, which in turn could ease the pressure on EM central banks. For the time being, however, we believe that the Fed's current stance coupled with Hungary's reflationary prospects would justify a patient approach by the NBH. We therefore expect the central bank to keep policy rates on hold for an extended period in the second half of the year.

Recent weeks haven’t been favourable to the forint

Since the May rate-setting meeting, EUR/HUF has depreciated by more than 2% due to unfavourable international winds coupled with some idiosyncratic factors. In this regard, the US data flow, the hit to some popular EM carry trades and the results of the Hungarian election may have contributed to the recent forint weakness. Overall, we believe that the Hungarian currency remains in a vulnerable position as the risk premium needs to be carefully managed.

Performance of CEE FX versus EUR (end-2023 = 100%)



Source: NBH, ING

Our call

All in all, we see the National Bank of Hungary slowing down the pace of rate cut to 25bp on 18 June. This could bring the key rate down to 7.00% after the rate-setting meeting, while we expect the Monetary Council to also cut both ends of the rate corridor by 25-25bp.

New staff projections won't cause too much excitement

The National Bank of Hungary will publish its latest set of macroeconomic projections for the main measures (GDP and inflation) alongside the interest rate decision, while the detailed June Inflation Report is due on 20 June.

We don't see any reason for the central bank to deviate from its March baseline on the GDP outlook. The first quarter was roughly in line with expectations, so we think the NBH will maintain the forecast range of 2.0-3.0%. As for 2025, while speculation has started about a possible stimulus package ahead of the 2026 general election, the central bank should ignore this until it materialises. We therefore see no change in the GDP outlook for 2025-2026.

On the inflation front, actual headline data has surprised to the downside compared to the March forecast, so we expect the central bank to revise its 2024 CPI forecast from a range of 3.5-5.0% to a narrower range of 3.5-4.5%. We see no reason to change the inflation forecast for 2025-2026, which remains at 2.5-3.5%.

Our mid-term view remains unchanged

As for the forward guidance, we think it's likely that the NBH will signal that the room for easing beyond June remains very, very limited or – even state outright that there is no room left as of now. In our view, this could definitely help the HUF to strengthen from these levels and regain some territory.

As our year-end inflation forecast for December is still in the range of 5.5-6.0% YoY, this leads us to believe that the terminal rate cannot go any lower after June. In this regard, we expect a sustained pause by the NBH, which in turn would still maintain a positive real interest rate environment and keep some risk premium over regional rates supporting HUF assets.

Nevertheless, we see downside risks to our view. In the case of a favourable turn of events, such as a continued cooling of US inflation, lower reflationary prospects in Hungary and/or a dovish shift in the regional monetary policy outlook, we could see the NBH continuing the rate cutting cycle after its June meeting. In this context, we would expect two more rate cuts of 25bp over the rest of the year (the timing of which are highly uncertain), which would bring the key rate down to 6.50% in our view.

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