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HUNGARY

National Bank of Hungary Preview: Ready, steady, go

The National Bank of Hungary will, in our view, deliver 100 basis points of cuts in rates of overnight tools which have been effectively shaping monetary policy since mid-October. The base rate should remain on hold for a while and we will hear more about prudence and gradualism, adding some hawkish taste to the easing



The National Bank of Hungary in Budapest

Cuts are coming, but why now?

With the [interest rate decision in April](#) (reducing the upper end of the interest corridor by 450 basis points), the National Bank of Hungary opened the door to the effective interest rate cut cycle. According to the central bank's promise, the persistence of improvements in risk perceptions will be considered in order to make a decision about the start of the effective interest rate cut cycle affecting overnight instruments.

In the past month, we have not experienced a deterioration in any of the important groups of conditions, in fact we can report further improvement. Thus, overall, the developments can be considered by the Monetary Council to be trend-like.

In the case of external balance indicators, we could see further positive change: Hungary's

terms-of-trade has continued to improve, while the trade and current account balances also improved. The former has reached surplus territory, while the latter has seen a €1.7bn improvement from a €2.2bn deficit (first quarter 2022) to a €0.5bn deficit (first quarter 2023). These positive changes are due to the decreasing import demand of the country. The combination of a significant drop in the price of energy carriers, shrinking energy consumption and extremely weak domestic demand (consumption and investment) is breaking the import activity, while export-oriented industrial sectors are still performing well.

The trend-like improvement also continued in terms of market stability. In the period since the April interest rate decision, the forint has strengthened and although it is still vulnerable, this does not prevent an interest rate cut. The reason for this is that the market has practically priced in the interest rate cut cycle. If the central bank, in accordance with its previous promise, also includes market expectations as part of its decision function, we can say that the light has turned green here as well.

In the case of government bond and swap markets, things also moved in a favourable direction during the past month, thus continuing the trend-like improvement. Finally, we have not experienced any drastic changes in the international risk environment either. Although concerns about the banking system are still present in the United States, this did not cause significant turbulence in local markets. The expected path of the monetary policies of major central banks did not undergo any significant changes. Despite concerns about the US debt ceiling, investors' risk-taking did not show any significant deterioration, thus there is no sign of a significant capital outflow in emerging markets. Overall, we believe that the Monetary Council considers the processes to be favourable in light of all this and that the effective interest rate cut can begin.

What we think will change?

- 100bp cut to the overnight quick deposit rate from 18% to 17%, effective from the first tender after the rate-setting, thus from 24 May.
- 100bp cut to the upper end of the interest rate corridor from 20.5% to 19.5%, so reducing the margin between the base rate and the overnight repo rate.
- 100bp cut to the euro liquidity providing one-day foreign exchange swap tender rate from 17% to 16%, as this tool was also introduced as part of the emergency package in mid-October. However, the practical importance of this tool has decreased to a minimum recently.

What we think won't change?

The regular overnight deposit rate (lower end of the interest rate corridor) will be kept unchanged at 12.5%, as this interest rate wasn't touched during the emergency measures. In this regard, we see the interest rate corridor being narrowed further.

The base rate will remain unchanged at 13% and we don't expect any change in the tone regarding the fight against inflation, which will continue with the help of the base rate.

We do not expect any substantial changes in the forward guidance. The central bank will continue to emphasise that for further rate cuts the persistent improvement of the risk sentiment must continue. We also expect the central bank to underscore that keeping the base rate at 13% permanently ensures the achievement of price stability.

In our view, the prudent and gradual approach of the easing cycle will be emphasised as well. In practice, this could mean that if the Monetary Council deems that interest rate expectations, market reaction and market stability are taking an unfavourable turn, it will retain the possibility of pausing the interest rate cut cycle. That is why we think it is quite possible that the central bank will not refer to the period ahead as an interest rate cut cycle but will define it as a series of individual (data-driven) decisions.

How will the easing cycle be shaped?

According to our expectations, the central bank – if everything goes according to plan – will merge the base rate and the effective rate at 13% at its September rate-setting meeting. This would mean a series of “copy-paste” decisions based on the May moves. In accordance with this merging, the interest rate corridor with a width of 300 basis points that existed before mid-October will also be restored. This would translate into an interest rate corridor with the repo rate at 15.5% and the depo rate at 12.5%.

Looking further down the road, before the first cut to the base rate (which we see in December 2023), we give a significant chance to have another indicative or symbolic decision, which will precede the actual base rate cut: making the interest rate corridor symmetrical again around the base rate a month before the cut to the base rate.

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