National Bank of Hungary Preview: Systematic easing continues

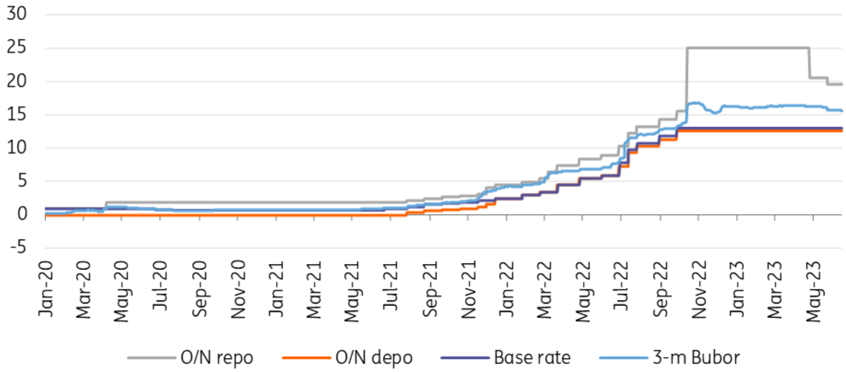
The National Bank of Hungary's easing cycle is subject to conditions, and we still see a good enough constellation for the rate cuts to continue. We see a "copy-paste" decision, meaning the effective rate moves lower to 16%

The National Bank of Hungary in Budapest

Our call

We expect the National Bank of Hungary to continue its systematic easing which started with a symbolic step in April and the first effective rate cut in May. We believe that the circumstances are right for the Monetary Council to vote for another cut in the effective interest rate (quick deposit tender rate) by another 100bp, replicating the decision seen in May. This will put the effective rate at 16%. Alongside that – just to fully emulate the previous move – the top-end of the interest rate corridor will be lowered by 100bp as well to 18.5%.

The main interest rates (%)

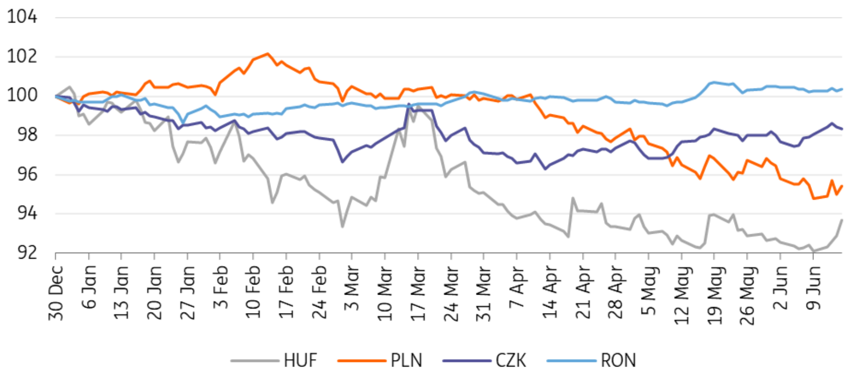


Source: NBH, ING

The rationale behind our call

The central bank has given markets a fairly concrete guide regarding the conditions to continue rate cuts. Having reviewed these, we think the upcoming decision seems clear. The current account and trade balance indicators continue to be a focus of attention, and we have seen a further improvement in the last month. This has been accompanied by an improvement in the terms of trade as well.

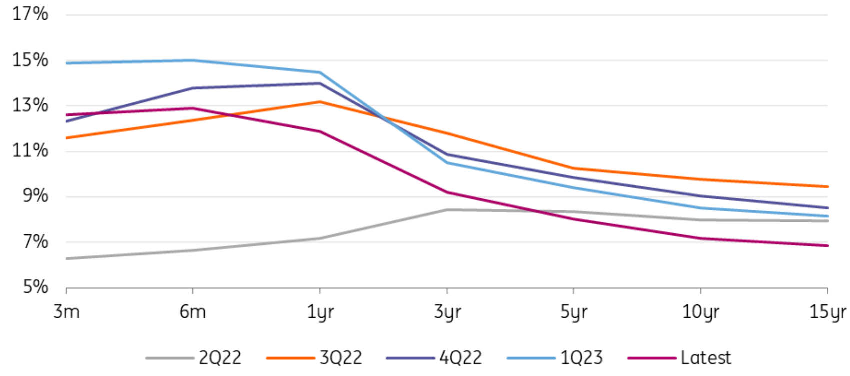
CEE currencies vs EUR (end 2022 = 100%)



Source: NBH, ING

Market stability has remained in place in all major submarkets (FX, bonds & swaps). Although the forint has been weakening in recent days, the exchange rate against the euro has not hit a critical level that could prompt the central bank to back down. Nor do we see any grey clouds hovering over global financial markets that could darken the future. This is certainly a significant help, as it continues to mean a constructive investment environment overall. In addition, the major central banks (Federal Reserve, European Central Bank) have not surprised markets in any meaningful way, which would be drastically countered by the easing of the Hungarian central bank.

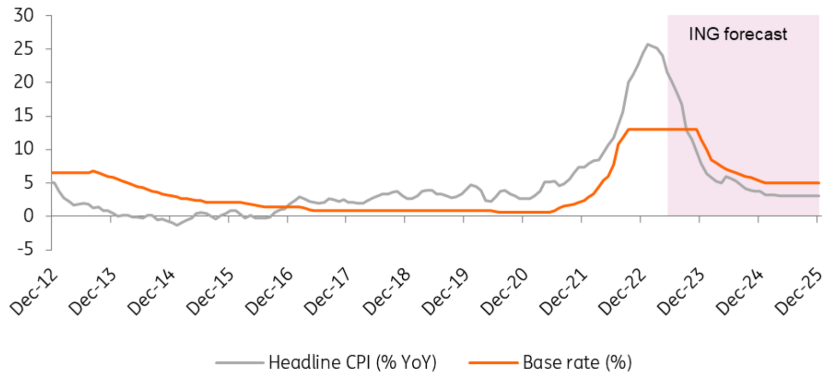
Hungarian yield curve



Source: GDMA, ING

We don't expect any substantive change in the tone of the press release and the expected press conference. The NBH will continue to define the series of interest rate cuts as a function of market stability and remain committed to the principles of gradualism and prudence. Obviously, the central bank will underscore the acceleration of disinflation as a significant factor, but we think that the Monetary Council will still not want to make any substantive comment on a possible cut in the base rate soon. In other words, the sound distinction between market stability and price stability will remain. The forward guidance is, therefore, unlikely to change in light of this.

ING's inflation and base rate forecasts for Hungary



Source: HCSO, NBH, ING

Looking further down the road

If the supportive environment remains and market stability is maintained, the NBH is going to continue its series of gradual interest rate cuts of 100bps. Accordingly, the base rate and the effective rate should merge at 13% at the September rate decision, in our base case. As to whether the rate cuts will resume immediately from here or whether there will be a pause, we will only be able to say with a high degree of certainty once we have seen market conditions and the inflation situation in the autumn. At the moment, we would give a higher probability to a pause of one or two months after September. When we see that inflation has fallen to single-digit levels (which could happen as early as November, so the NBH can make a decision in December with this in mind), then the base rate cut will start.

What about the forecast changes?

Perhaps the most important change will be that, as the extreme risk scenarios have now disappeared, the central bank will hopefully also narrow the updated forecast ranges when it presents the main figures in the June Inflation Report. A narrowing of the forecast range downward would send a rather strong message regarding GDP growth in 2023. This would put the central bank in the ranks of those who do not think it likely that GDP growth of 1.5% will be achieved this year. However, as the economic outlook now depends largely on the performance of agriculture, it may still be justified to maintain a wider band.

In the case of inflation this year, more and more information is becoming available, so a narrower forecast range seems appropriate from this point of view as well. In our view, a symmetric band narrowing would be rational. Inflation of 15% seems hardly achievable now, but in light of the May data, inflation above 18.5% would come as a big upside surprise. But here too, a move up from 15% would be a clear signal that the central bank no longer considers the government's similar forecast to be within reach, even taking into account the risks.

ING's expectations regarding the NBH's forecasts

	GDP growth (% YoY)		Inflation (% YoY)	
	2023	2024	2023	2024
Official NBH forecast (March 2023)	0.0 – 1.5	3.5 – 4.5	15.0 – 19.5	3.0 – 5.0
Expected NBH forecast (June 2023)	0.0 – 1.5	3.5 – 4.5	16.0 - 18.5	4.0 - 6.0

Source: NBH, ING

There is a lot of uncertainty around GDP growth next year, so perhaps there is no point in seriously revising expectations. As for inflation, the NBH is likely to raise its forecast, if only because of the change in the excise duty from 1 January 2024. In addition, an inflation rate clearly above 3% could also send an important message to markets, supporting the central bank's new stance that sustained tight monetary policy with a continuous real positive interest rate environment is needed to achieve the inflation target in a sustainable manner.

Our market views

The Hungarian forint has come under pressure for the first time in a while, reaching its weakest level against the euro since the end of May. We see EUR/HUF in a 368-378 range for the rest of the year and see the current higher values as only temporary. The market will probably want to wait for the NBH meeting to see how it sees the situation. However, we believe the market will use weaker forint levels as an opportunity to build new positions and benefit from the highest FX carry within the region. Thus, we expect the forint to return more towards the lower end of our range around EUR/HUF 370 next week.

In the rates space, we see the market more or less fairly pricing in the rate cuts this year and the super short end is thus anchored. However, looking at the longer 1-3y horizon, we see room for the market to further price in some normalisation of NBH policy. Our long-term view thus remains unchanged and the 2s10s spread should steepen with the entire curve moving lower, and catching up with the market. In the short term, for next week, we see major scope for a move within the short end of the curve and a flattening in the 1s3s segment that may get the market's attention.

Hungarian Government Bonds (HGBs) have had a massive rally in recent weeks and are posting the highest overall returns in the CEE region this year. We continue to like HGBs, which benefit the most from the whole story in Hungary, further supported by government measures and funding fully under the control of the debt agency. In the coming days, we could see some profit-taking and upward yield pressure from core rates, however, we still see HGBs as expensive relative to CEE peers. On the other hand, it is hard to see a significant trigger for a sell-off and we expect the market to continue to like HGBs.

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