

National Bank of Hungary preview: The door is wide open

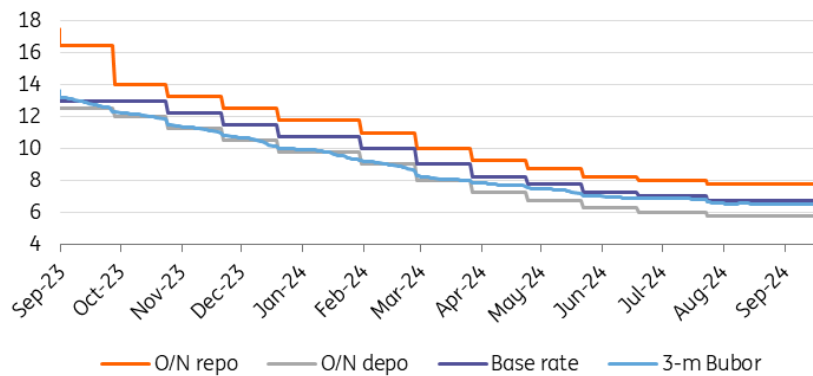
Even before the Federal Reserve's latest decision, we were leaning towards a 25bp cut at the September NBH meeting. Post-Fed, we see a non-negligible chance of a slight dovish shift in forward guidance, with the 6.00-6.25% range cited as a realistic target for the 2024 terminal rate



The central bank paused the easing cycle in August

The National Bank of Hungary (NBH) left its key interest rate at 6.75% in August. The decision was justified by both the incoming data and an unfavourable turn in market developments, as we discussed in our previous [NBH review](#).

The main interest rates (%)



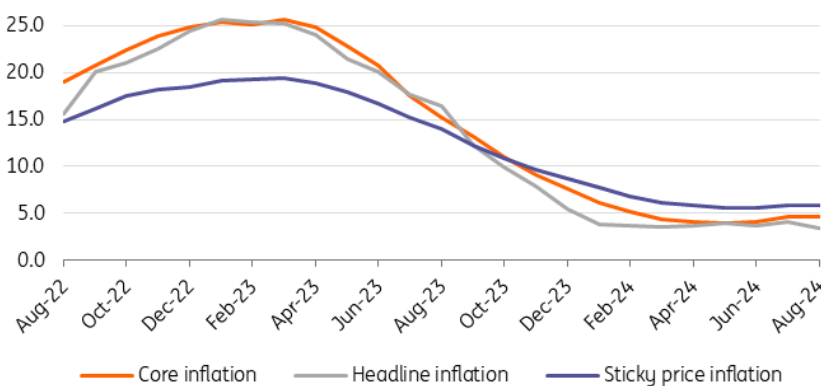
Source: NBH, ING

Both inflation and economic activity surprised on the downside

Headline inflation slowed by 0.7ppt to 3.4% year-on-year in August, providing a significant downside surprise compared to expectations. In contrast to the previous release, this time the incoming data hit the bull's eye of the central bank's June forecast range, showing virtually no systematic deterioration relative to the expected inflation path. More surprisingly, core inflation also slowed, although rounding helped a lot. Nevertheless, the recent decline in headline inflation has brightened Hungary's short-term inflation outlook, although services inflation remains a concern.

What also improves the overall inflation outlook is weak economic activity, which provides less of a pro-inflationary risk. July's high-frequency activity data from the retail, industrial and construction sectors are all worrying for the economy's performance in the third quarter. In addition, the monthly budget deficit in August brought us closer to a flashing red light for GDP growth. Behind the weak performance, we suspect a weak revenue side, either due to a high level of household savings and/or a significant increase in retail activity in extraterritorial webshops (e.g., Temu, AliExpress).

Headline and underlying inflation measures (% YoY)



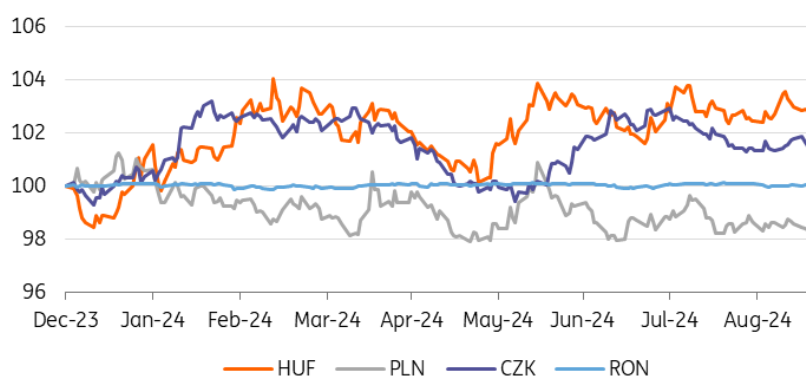
Source: HCSO, NBH, ING

Changes in market sentiment not a factor this time

Since the last NBH rate-setting meeting (27 August), core rates have trended lower, with the US 2-year yield falling by almost 35bp by 19 September. The long end of the US yield curve also moved lower by around 10bp. The direction of the German yield curve was broadly similar, with less pronounced amplitudes. The spread between 10-year HUF and PLN government bond yields widened by only 5bp compared to the August rate-setting meeting – hardly a game changer.

The EUR/HUF exchange rate also failed to surprise over the past month. The range between 393 and 397 provides some stability. We expect that HUF will be anchored around 395 unless there is a significant idiosyncratic market shock. Expectations for rate cuts have remained virtually unchanged, as based on the FRA curve, and investors still see the terminal rate at around 6.00% by the end of the year – although the central bank's forward guidance, which is still valid, refers to the 6.25-6.50% range as a realistic target.

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



Source: NBH, ING

Hungary's central bank gets a helping hand from Fed's jumbo cut

As if market stability (for a stability-oriented central bank) and an improving inflation outlook weren't enough, the Federal Reserve's 50bp rate cut and Chair Jerome Powell's statement that the US economy remains in good shape is definitely a mood booster for the Monetary Council. The Fed's unusual (though not unprecedented) flying start to the easing cycle is clearly reshaping monetary policy realities, especially for emerging market central bankers.

The recent jumbo cut provides an opportunity to ease pressure on vulnerable currencies such as the Hungarian forint and, accordingly, gives a bit more room for those willing to cut rates. And this is where the National Bank of Hungary enters the stage.

Our call

All in all, we believe that the National Bank of Hungary will cut the key rate by 25bp to 6.50% on 24 September, which is a high conviction call. We also expect the Monetary Council to cut both ends of the interest rate corridor by the same 25bp, leaving the width of the band at a symmetrical 200bp.

New staff projections could pave way for slight dovish tilt

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 September Inflation Report is due on 26 September.

Given the downside surprise in second-quarter GDP growth and the weaker-than-expected start to the third quarter, we expect a significant downward revision to the GDP forecast. After a 1.0ppt cut, we see the central bank's forecast range for economic activity this year at 1.0-2.0%. The lack of domestic demand is worrying enough to prompt a 0.5ppt downgrade in 2025 GDP growth to a range of 3.0-4.0%.

On the inflation front, actual headline data since the June forecast release has been more or less in line with the projected path. However, as we approach the end of the year, we expect the NBH to narrow the forecast range from 3.0-4.5% to 3.5-4.5%, as the lower end of the previous forecast has become statistically unlikely to be reached. While we see average inflation next year above but close to 4%, we don't think the central bank is ready to pull the trigger on a forecast change just yet. In turn, the NBH's inflation forecast for 2025-2026 will remain at 2.5-3.5%, in our view.

We see a chance for a slight dovish shift in the forward guidance

Our baseline scenario for the terminal rate in 2024 remains at 6.25%, implying another rate cut in the fourth quarter of this year. However, we would like to cautiously draw attention to downside risks and the possibility of a dovish shift.

With the GDP outlook for 2024 and 2025 expected to be revised sharply downwards, the potentially more muted pro-inflationary risk may warrant a shift in the risk map. In June, the central bank presented three main alternative scenarios, two of which were pro-inflationary. It may be that the majority of the main alternative scenarios presented this time around will favour downside risks to inflation.

Moreover, the Fed's willingness to deviate from the standard size of a rate cuts raises the possibility of another jumbo cut. Our baseline scenario for the Fed's rate cuts sees a total of 75bp of easing over the rest of the year, and market pricing tends to agree. In this case, we could see EUR/USD reach 1.12 before the US elections, which would be a boost for EM currencies. In such a supportive environment, the National Bank of Hungary might be inclined to cut not once, but twice in the remaining three rate-setting meetings after September.

To pave the way for such a turn of events, this could be the perfect opportunity for the Monetary Council to present a new, slightly more dovish forward guidance. The cautious, patient and stability-oriented approach will remain in place, even in a super-data-driven mode, only raising the possibility of a 6.00-6.25% range for the year-end terminal rate (fully in line with market pricing).

However, monetary policy in the next one to two quarters may depend on changes in global risk sentiment following the outcome of the US election. We therefore refrain from taking a firm view

on the 2025 rate path at this stage and leave our baseline forecast unchanged, expecting a total of 100bp of easing next year, in line with the expected easing by the Fed and the European Central Bank.

Our market views

In the FX market, the HUF may see very favourable conditions into the NBH meeting next week. On the global front, EUR/USD is moving up to 1.120 after the Fed's decision, in our view adding support to the entire CEE region. At the same time, HUF market rates have bounced up from their lows this year, improving the rate differential and somehow pointing to levels in the range of 392-393 EUR/HUF – which may be the level for Tuesday's NBH meeting, providing confidence in a dovish tone from the central bank.

In the medium term, we see pressure on HUF. While global conditions should be supportive for EM currencies at least until the US election, continued rate cuts from the central bank and weaker economic growth will pressure a weaker HUF. At the same time, we see that the market may be sensitive to fiscal policy discussions and the state budget (expected to be presented in November) preparation headlines. Still, the range of 392-400 EUR/HUF should be a framework until the end of the year, with levels more in the upper part of the range.

The rates market is rebounding from this year's lows, but the IRS curve remains the steepest in the CEE region. We don't believe this will change in the near term. In the short end, the terminal rate has stabilised at roughly 4.75% if we assume the BUBOR premium is to return to positive territory, which is not far from our economists' forecast.

On the other hand, if the NBH delivers rate cuts coupled with a dovish tone, we can assume the market will be open to moving the terminal rate even lower, as we saw earlier this year (e.g., below 4.50% in early August). The curve may in turn steepen further – however the belly and long end, in our view, also offer decent value with 5y5y at 6.40%, too high above the discussed terminal rate. The entire curve should therefore continue to move lower for the rest of the year unless the global story direction turns, while domestic risks are more on the dovish side at the moment.

Having said that, our positive view on the rates market is also projected into Hungarian government bonds (HGBs). On the supply side, HGBs auctions continue to show the highest demand among CEE peers and the funding picture looks bright.

According to our calculations, the debt agency has covered roughly 93% of the planned HGBs issuance, assuming a government deficit of 4.5% of GDP. Even with our economists' view of the risk of a slippage to 5.0%, we don't believe the picture will change much. Debt agencies will likely focus on next year's pre-funding, which will see higher redemptions compared to this year, but we could still see some supply reduction in the coming months. HGBs offer a 30-45bps premium over the IRS curve and the belly and long end look attractive to us at current levels.

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