National Bank of Hungary preview: unchanged pace of tightening

Incoming data don't sharply contradict the central bank's March forecast. We see a maintained pace of tightening, hiking the base rate and the 1-week deposit rate by 100bp and 30bp, respectively. Even with hawkish forward guidance, we don't envision a marked Hungarian forint strengthening, but we see room for higher market rates

The National Bank of Hungary in Budapest

+100bp

ING's call

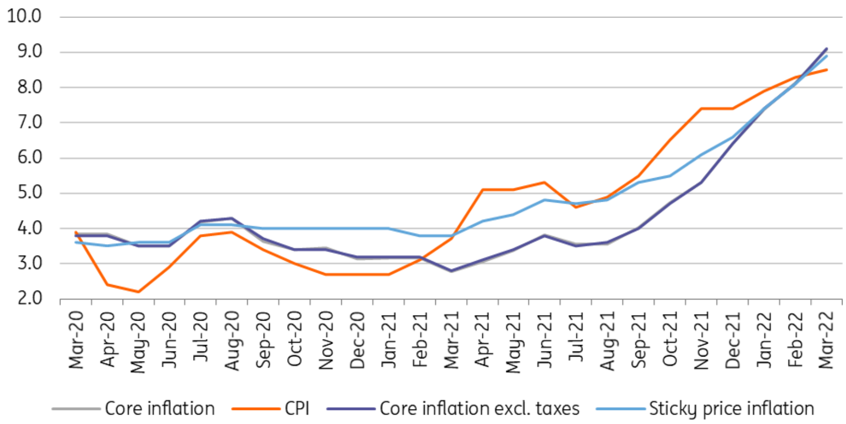
Change in the base rate

The rationale behind our call

Incoming data of the past month haven't been in sharp contradiction with the National Bank of Hungary (NBH) forecasts. We say this despite the surprisingly strong economic activity data and the lower-than-expected headline inflation in March. Our confidence lies with the wide forecast bands of the central bank, providing a bigger margin of error in actual data.

Pre-war data from retail, industry, and construction sectors, and even the latest big data, are suggesting surprisingly strong first quarter GDP growth. This could mean a wider positive output gap, translating into longer and stronger demand-driven inflation for the remainder of the year, in our view.

Headline and underlying inflation measures (% YoY)

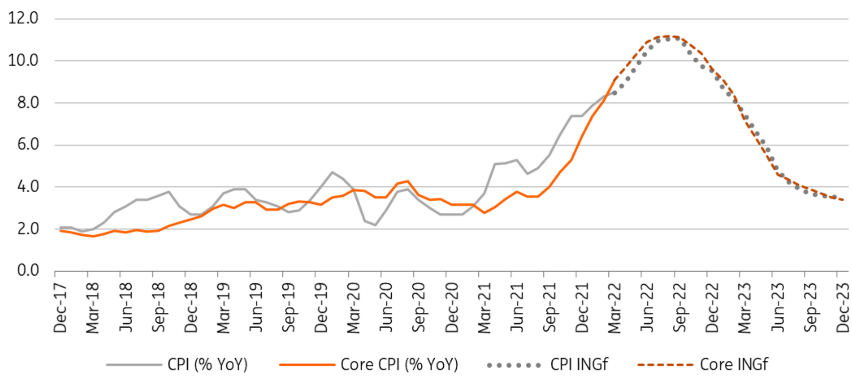


Source: HCSO, NBH, ING

This demand-driven inflation has already been visible in the core inflation reading, moving to 9.1% year-on-year in March. So, despite the slight downside surprise in headline inflation at 8.5% year-on-year, the underlying price pressure remains powerful. In any case, these are not meaningful changes compared to the NBH-forecasted path.

In this respect, we see no urgency to change the tactics of monetary policy during the April rate-setting meeting. The central bank remains data-driven and not “what other forecasters are thinking”-driven. So, even if the International Monetary Fund's latest projection sees headline inflation at 10.4% on average in 2022, and even if we tend to agree with that with our updated 10% forecast, the central bank’s world won’t shake.

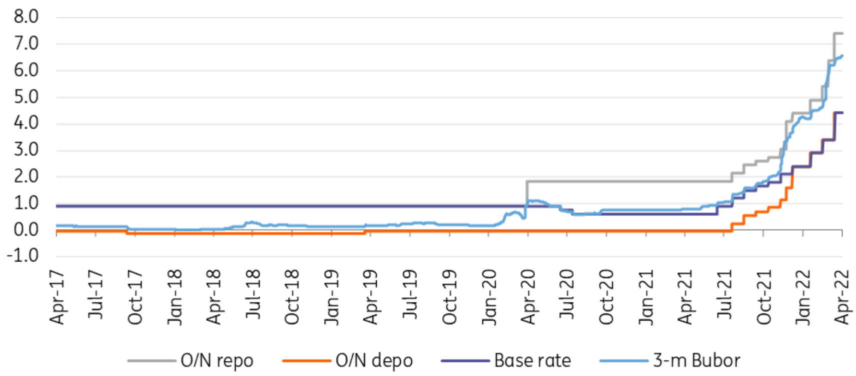
Inflation forecast of ING (% YoY)



Source: HCSO, ING

Against this backdrop, we see the NBH sticking to its March playbook. This means a 100bp rise to 5.40% in the base rate on 26 April and a 30bp hike to 6.45% in the 1-week depo rate on 28 April. The forward guidance should remain hawkish as we expect the central bank to emphasise the upside risks in inflation.

The main interest rates in Hungary (%)

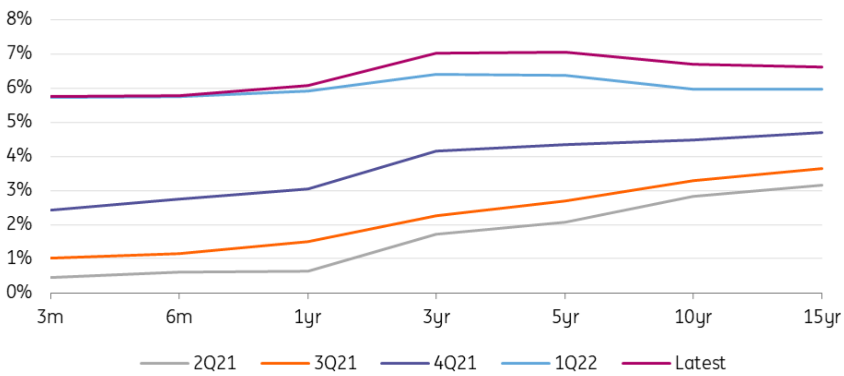


Source: NBH, ING

What to expect in FX and rates markets

With EUR/HUF now being close to pre-election levels of 368, we hardly see this April rate-setting being a game-changer. Although it can provide some support for the Hungarian forint (HUF), we don't envision a marked strengthening here purely based on monetary policy decisions. Sanctions and inflation risks, as well as the rule-of-law debate, will keep investors on alert. We see EUR/HUF around 370 in the short run with a possible quick move to 355-360 should we see a sudden de-escalation in geopolitics.

Hungarian yield curve



Source: GDMA, ING

The situation in debt and rates markets remains fragile. Investors need to deal with uncertainties regarding core market monetary policies, scope and magnitude of local fiscal tightening, sources of extra financing needs, inflation risks, rule-of-law debate, and the war and sanction policies. However, Hungary is the only market in the region that has not yet erased the losses from last week's rate correction. Thus, we see room for the market to return to recent highs or move even slightly higher, especially in the current environment of rising core rates. On the FRA curve, we see the juiciest spot within six months. On the longer horizon, the market is still pricing in higher levels than our forecast, but we don't expect the market to have a reason to lower its expectations in light of the coming NBH meeting.

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