Hungary’s central bank ain’t got no room for change

The National Bank of Hungary strummed exactly the strings we expected at its March meeting. The tone was hawkish, and the message that the central bank still needs more evidence before considering any changes was clear. In our view, we'll need to wait at least a couple of months before seeing any hint of a pivot

A potential dovish shift hasn't been entirely ruled out for the NBH moving forward, but much will depend on both upcoming data and the ways in which the risk environment evolves

No changes in the rates space

The National Bank of Hungary has decided to maintain its monetary setup by leaving interest rates unchanged at its March meeting. This means no change in the regular overnight deposit rate at 12.50%, the base rate at 13.00% and the overnight repo rate at 25.00%. According to the Monetary Council’s assessment, maintaining the current level of the base rate for a prolonged period will ensure that inflation expectations are anchored and that the target is achieved in a sustainable way.

So, no change to the rates managing the price stability goal. The same can also be said for the market stability goal, which remains crucial in the central bank's fight against inflation alongside the strengthening of monetary transmission. There was no signal at all regarding any hint of a potential pivot on the marginal effective rate, which still sits at 18%.

Discipline is a must amid high uncertainty

Against this backdrop, the most important takeaway from this month's rate setting meeting is that the NBH will remain cautious, patient and disciplined. Key reasons for this behaviour are continued high levels of uncertainty in the local and global economic environment, recent market volatility, and the lack of evidence confirming any permanent improvement in both external and internal imbalances.

The high degree of uncertainty is showing up in two key elements. Firstly, the Monetary Council highlighted four alternative scenarios for the baseline projection in the March Inflation Report. Two of them feature higher inflation, while two factor in lower inflation. There are more risks, but for now, they remain balanced.

Secondly, uncertainty is also reflected in the latest update to GDP and CPI figures. The central bank sees the average inflation rate at 15-19.5% in 2023, an unusually wide (and still unchanged) range. For 2024, the forecast range remains wide and was revised up. It now excludes the sub-3% territory, and sees inflation at 3-5%. This signals a rising risk of stubbornly sticky inflation and justifies the central bank's hawkish stance.

When it comes to the overall economic outlook, the NBH now sees this year's growth in the range of 0% to 1.5%, a 0.5ppt downward revision to the lower band of the forecast range versus the December Inflation Report. This is a result of a weaker nowcast of GDP growth in the first quarter as sky-high inflation devours purchasing power.

The local banking sector remains safe and sound

The central bank also provided a reminder that new reserve requirement system is set to go live from 1st April as planned, and finds no issue in doing so despite the recent global banking turmoil. Echoed several times was the message that the capital and liquidity situation of the Hungarian banking sector remains safe and sound, with macroprudential policies now ensuring a much more secure environment than in 2008. Even so, the central bank confirmed that the global situation continues to be closely monitored.

Mr. Virág also reiterated that the decision of the Monetary Council was unanimous in every aspect. This was likely in reference to the fact that a newly appointed member of the Monetary Council, Zoltán Kovács, was present and voted as well. The other newly appointed decision maker, Éva Búza, is set to join the Council from 7th April.

Our monetary and market views

Overall, the outcome of the March rate setting meeting strengthened our view that we won't see any change in the monetary policy setup until June. The forward guidance echoes this, with the central bank focusing on the "persistent changes in risk perceptions when setting the conditions of overnight instruments introduced in mid-October" – in our interpretation, this persistence means several months. Against this backdrop, the central bank's hawkishness will likely remain a key alignment point for market players.

Together with the Czech koruna, the Hungarian forint remains our favourite currency in the current market conditions. The NBH has made it clear that priced-in rate cuts are not on the table at the moment, which should keep FX carry by far the highest in the region. In addition, the decline in risk aversion, higher EUR/USD rates and lower energy prices provide perfect conditions for a forint recovery in the coming weeks.

Following the recent sell-off, long positioning is no longer an issue and the forint should see a clear path to regain momentum. Moreover, HUF was the most popular trade at the beginning of the year, and we expect people to come back as the dust settles after the recent global turmoil. Although the Czech koruna may seem less risky, the current calm in global markets is starting to favour the HUF. On the other hand, aside from the global story, we see the reopening of conflict with the European Commission as the main risk.

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