National Bank of Hungary Review: Gentle braking

The National Bank of Hungary delivered on its promise in every respect, slowing the pace of easing without causing any surprises. The new nuanced forward guidance is more hawkish. We are raising our end-June forecast for the policy rate to 7.00%

The National Bank of Hungary in Budapest

7.75% Key interest rate

ING forecast 7.75% / Previous 8.25%

As expected

A careful cut

The gradual easing of Hungarian monetary conditions continued at a slower pace. The National Bank of Hungary (NBH) decided on 23 April to cut its key interest rate by 50bp to 7.75% and to maintain the symmetry of the interest rate corridor with similarly large cuts at both ends. Given that the vast majority of market forecasts were ultimately in line with the actual decision, we view the outcome as a clear case of the Monetary Council delivering on its promise not to surprise markets. In our view, the slowdown is clearly the result of the inflation outlook (mainly its changing structure), while recent volatility and instability in market sentiment mainly stemming from global drivers warrants patient decision-making going forward.

Patience is the new buzzword

Our "hawk-o-meter" beeped louder and louder as we listened to Deputy Governor Virág and read the press release from the April meeting. The central bank really did try to send as many hawkish signals as possible. Among them, the most important and most emphasised message was that the volatile risk environment warrants a cautious and patient approach to monetary policy. The word "patient" was also added to the new forward guidance, leaving room for a more nuanced interpretation of the upcoming decisions.

This, together with a message from Virág in response to a question that while the 6.50-7.00% policy rate expectations at the end of June still look realistic, he stressed several times that the central bank is in "no rush" and that patience is a must. In our view, this is a nugget for the markets, which now shouldn't be so sure that the 50bp pace of rate cuts could be maintained over the next couple of months.

In addition, the Monetary Council emphasised that maintaining financial market stability remains a priority, and not only in the short term. As the structure of inflation deteriorates, as the price increase of market services remains high and sticky, the NBH will have to find a new way to achieve the inflation target in the future. And that is to reduce imported inflation, which in our view means – since the NBH is obviously unable to reduce global inflation – that the central bank must prevent the forint from depreciating. This is not a new message, but it is worth noting that the central bank has been emphasising this message for some time.

We revise our end-June rate forecast to 7.00%

Our general view was that, notwithstanding the recent global risk-off (higher repricing of the Fed's rate path, rising core yields, higher risk premium on Hungarian assets), the inflation outlook itself would have justified slowing the pace of easing to 50bp. Given that we may be only one or two stronger US data points away from a further hawkish repricing of the Fed's rate path, which the NBH highlighted as a key driver, and that geopolitical risks are clearly elevated, we now err on the side of a cautious and patient monetary policy and see a total of only 75bp of rate cuts in the remaining months of the first half of 2024. As a result, we now see the key rate at 7.00% by end-June (+25bp compared with our previous call). We are thus now clearly voting for the most hawkish outcome of the 6.50-7.00% range signalled by the NBH.

As for the outlook further ahead, the central bank has wisely decided to keep its cards close to its chest. The only significant message came in the Q&A session of the press conference. Deputy Governor Virág reiterated that there are two main drivers of monetary policy: the macro outlook (mainly the inflation picture) and market stability. With inflation expected to rise in the second half of 2024 (which we fully agree with) and market stability remaining fragile and volatile, the central bank sees very little room for further easing after June.

Our long-standing view that headline inflation will go through two waves of acceleration (from

May and October) due to base effects and services inflation. We see year-end inflation of around 5.5-6.0%, but rather on the high side. Given a possible further deterioration in the Hungarian inflation structure and a possible hawkish risk from the Fed, we believe that 7.00% could be a mid-cycle terminal rate for the NBH. This level of the policy rate would still maintain a positive real interest rate environment (which the central bank still intends to maintain) together with a substantial risk premium, thus supporting HUF assets. In case of some pleasant surprises (better inflation outlook, reducing risk aversion), as an alternative scenario we could see the National Bank of Hungary making two more 25bp rate cuts in the second half of the year.

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