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HUNGARY

National Bank of Hungary review: In search of inflation anchors

The National Bank of Hungary opted to maintain the base rate in August, marking the eleventh consecutive on-hold decision. The general stance remained hawkish, with no new messages emerging. We are maintaining our call for unchanged rates this year



The National Bank of Hungary kept the base rate at 6.50% and Governor Varga remained hawkish in the press conference

6.50%

Key interest rate

Unchanged

ING's view: Inflation expectations and risk sentiment rule the landscape

It is our long-standing opinion that underlying inflation in Hungary is too high. While the recently extended mandatory margin freezes, in combination with the voluntary price shield measures, are proving beneficial in the short term, underlying price dynamics and the trade-

off for future inflation should remain a concern for the Monetary Council. During the August press conference, Governor Varga reiterated on several occasions that households' inflation expectations remain at high levels and are not aligned with price stability.

At present, the market sentiment remains fragile. The central bank can't afford to be complacent, despite some progress having been made in trade and tariff deals. The long-awaited ceasefire in the Russia-Ukraine war has not materialised either. As expected, these factors will continue to influence global investor sentiment, and financial markets will remain sensitive to incoming news.

The strong messages regarding the need to anchor inflation expectations, and unchanged forward guidance should be convincing enough to show what the National Bank of Hungary intends to do for the rest of the year. We believe that the central bank is prepared to keep interest rates at their current level for the foreseeable future.

Against this backdrop, we assume that the policy rate will remain at 6.50% for the rest of the year. However, we cannot rule out the possibility of a deviation from this towards the end of the year, particularly if major central banks adopt a more dovish approach in contrast to recent market expectations.

ING's market views

Given the lack of new stories and the well-telegraphed NBH stance in the recent days, it seems like a non-event for the markets. EUR/HUF has been grinding upwards for the last few days as a result of long HUF positions being taken back after disappointment from the US-Russia talks. Still, the forint seems to be the most long currency in the CEE region after a bullish summer. Therefore, the currency may remain vulnerable to global fluctuations.

On the other hand, the NBH provides stable support thanks to its hawkish stance, which should continue for some time. The market is pricing in roughly a 50% chance of one 25bp cut this year, which seems fair. On the other hand, there is still room for pricing in more rate cuts next year, mainly due to weak economic data. This should sooner or later undermine the strength of the HUF, keeping it at 405 for the end of the third quarter and 410 for the end of the year in our forecast.

The rates market saw some dovish repricing after the spike at the beginning of August, but HUF rates failed to break out of the 2Q-3Q ranges. The belly and long end in particular still seem too high, with 5y5y remaining stable above 7% and strong widening vs. USD rates. However, at least in the short term, it is difficult to see any trigger for a more significant movement here, and we are likely to remain stuck in the current ranges for longer. Our preference here is still to receive spikes given the downside surprises coming from the economy and some likelihood of earlier rate cuts than in our forecast.

In the bond market, according to our calculations, the debt agency covered approximately 65% of Hungarian government bond (HGBs) issuance, and the situation appears to be fully under control, with FX issuance almost covered and good progress in other sources of financing. On the other hand, long-term HGBs are still trading cheap after the ASW widening before the summer. This could attract market demand if the priced-in fiscal premium proves to be too high and the debt agency manages to reduce the supply of bonds for the rest of the year.

The rate decision in August

The outcome of the August rate-setting meeting was not unexpected. On 26 August, the National Bank of Hungary kept its key interest rate at 6.50%. This was the eleventh consecutive decision in which both the policy rate and the interest rate corridor (+/- 100bp) remained unchanged.

Regarding the economic outlook, the central bank welcomed the EU-US trade deal, as it helps reduce uncertainty to some extent. However, it is too early to assess the economic impact. When asked about the impact of the recent dovish shift in market pricing for Fed rates on the local monetary policy decision, Governor Varga tried to downplay it, citing the fact that European economies are facing different difficulties to the US.

The forward guidance in the press release remained unchanged from the previous month. According to the central bank, a stability-oriented, cautious and patient monetary policy is needed. Tight monetary conditions — i.e. sustained positive real interest rates — are necessary to achieve price and market stability over the monetary policy horizon.

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