

## National Bank of Hungary Review: Living in the moment

As the first decision in the new phase, the National Bank of Hungary cut the key interest rate by a further 25bp at its July meeting. The move comes as no big surprise and is essentially a frontloading move. The forward guidance remains unchanged and we see one more rate cut for the rest of the year



The National Bank of Hungary in Budapest

# 6.75%

Key interest rate

ING forecast 7.00% / Previous 7.00%

### New era, same decision

Emphasising that the National Bank of Hungary had entered a new phase of monetary easing was a key element in the communication of the previous interest rate decision. However, the new era

brought the same decision, although the mantra "every meeting is a live meeting" also proved true. In practice, this means a decision between no change and a 25bp cut.

The outcome of the July rate-setting meeting was a 25bp easing, bringing the policy rate to 6.75% on 23 July. The central bank maintained the symmetry of the interest rate corridor with 25bp cuts at both ends. Given that two-thirds of analysts (based on a Bloomberg survey) expected exactly this outcome, we can hardly call this a surprise.

## Incoming data, market developments support frontloading

In its communication, the National Bank of Hungary highlighted both local and global developments that supported the July easing decision. On the local side, the main story is the recently announced fiscal action plan, which is expected to improve this year's budget balance by 0.6% of GDP through a mix of expenditure and revenue measures. The central bank's calculations show a positive impact of 0.7% of GDP on the budget in 2025, mainly from revenue measures. While the Monetary Council focuses on the reduction in country-specific risk as a result of these announcements, we continue to believe that the fiscal package also carries pro-inflationary risks.

When it comes to global factors, the central bank places a lot of emphasis on movements in the global yield environment. Although market volatility has remained elevated, the risk premium on European assets has declined and core yields in the euro area have moved lower, supporting local risk sentiment. More striking, however, were the various references to the market's pricing of the Fed's future rate path. Deputy Governor Virág mentioned this change in every block of his press conference, highlighting that the probability of a rate cut at the September meeting is now at 90%.

## Caution remains a feature in the monetary policy ahead

As a balancing act, the central bank stressed the importance of re-anchoring households' inflation expectations, which needs to be done with a continued tight monetary policy. The cautious and patient approach of monetary policy was also emphasised several times, although the latter part seems to be less pronounced now that the Monetary Council has taken the first opportunity to cut interest rates further.

Among the hawkish messages, the central bank highlighted the stickiness of market services inflation and warned against any kind of complacency based on one incoming inflation data, as the June figure alone did not change the expected inflation path. The key factors for the upcoming data-driven decisions remain the inflation outlook, financial market stability, the country's risk perception and its relative position in the region.

The main features of monetary policy will also remain the same: a data-driven decision-making process that makes each meeting a live meeting. This means a decision between no change and a 25bp easing at the upcoming meetings. However, this doesn't necessarily mean that the central bank is ready to cut at every meeting, as the year-end interest rate target remains unchanged (for now) at 6.25-6.50%. This leaves room for one or two more rate cuts over the rest of the year.

### Our monetary policy call for the rest of the year

We continue to believe in the need for a substantially positive real interest rate and, in contrast to the central bank's forecast, we continue to expect stronger monthly repricing over the remainder of the year, mainly on the back of pro-inflationary fiscal measures and

stronger-than-expected wage growth. Against this backdrop, we maintain our call for a year-end policy rate of 6.50% with some downside risk to our call mainly stemming from our non-consensus inflation outlook.

## Our market views

As we mentioned in the [NBH Preview](#) we have been bearish on the HUF for some time now mainly due to the significant move down in market rates in recent weeks. So, today's NBH decision to cut rates is just confirmation to the market that the earlier dovish move was correct in our view. Despite the fact that the front of the curve probably does not have much more room to price in more rate cuts now, the HUF will follow the previous rate differential tightening and weaken. Already the initial reaction shows EUR/HUF heading higher and we expect more in the days ahead. In general, we have seen a 385-400 EUR/HUF trading range for some time now and this continues to make sense to us as a framework for the rest of the year with 394 as the next stop for us in the near term from current levels.

In the rates space, it seems that today's NBH decision was fully priced and the initial reaction showed slightly higher rates, especially at the very front of the curve. However, due to low summer liquidity, we may see some delayed reaction in the days ahead. The NBH is making it clear that it is open to further rate cuts in the rest of the year. The market at this point is pricing in roughly a 50% chance for each of the five remaining meetings this year with the end-year rate approaching 6.00%. For next year, it is pricing in a little more than 3x25bp rate cuts with 5.15% for year-end 2025. Although we see fewer rate cuts this year and more last year, our expectations for the terminal rate are near market pricing. So, the short end of the curve doesn't have too much to offer at the moment in our view, although we can't rule out that further surprises in inflation to downside will lead the market to undershoot the terminal rate as we saw in January this year when the priced in terminal rate touched 4.50%. More attractive from this perspective, in our view, remains the long end of the IRS curve with the 5y5y still elevated at around 6.50%. Thus, within CEE peers we see the most value here given the NBH's openness to rate cuts and inflation profile looking forward.

In the Hungarian government bond (HGBs) space, following the announcement of fiscal measures to keep the government deficit under control at 4.5% of GDP, HGBs are entering a very attractive situation. The central bank is open to rate cuts, fiscal policy is showing efforts to keep the budget under control, and at the same time the debt agency has already frontloaded about 70% of HGBs issuance. We see a small problem here in the slower issuance of retail bonds (45% of the plan), which make up about a third of the entire funding plan. However, the other sources of funding are rather above plan, and in addition the debt agency can improve the parameters of the retail bonds if needed. Demand for HGBs in primary auctions remains the highest among CEE peers in July, and although it's declining elsewhere, it remains stable here. Of course, after the rally over the last two weeks, HGBs are less attractive with the 10y yield around 6.50%, but ASWs have widened and we still see best value compared to CEE peers.

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