

National Bank of Hungary Review: Maintaining control

The National Bank of Hungary delivered a hawkish surprise at its January meeting and maintained its previous 75bp pace of easing. Going forward, data dependency will remain at the forefront as the focus stays fixed both domestic and international developments



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

10%

Key interest rate

ING forecast 9.75% / Previous 10.75%

Higher than expected

Tensions in domestic financial markets prompted a hawkish surprise

The National Bank of Hungary (NBH) cut the key interest rate by 75bp to 10% at the January rate setting meeting – a hawkish surprise compared to the market consensus of a 100bp cut. At the same time, the entire interest rate corridor was lowered by 75bp, maintaining the symmetry of

the +/- 100bp range.

The main reason for erring on the side of caution and maintaining the previous pace of 75bp of easing is the domestic risk environment. The central bank emphasised in its [background discussion](#) that a focus on macroeconomic fundamentals alone would have allowed for a larger cut, but the clear deterioration in the domestic risk environment warrants a cautious approach.

In this regard, let's first look at domestic developments. Disinflation in the Hungarian economy has been broad-based and sustained, with the headline CPI declining to 5.5% year-on-year in December. Short-term dynamics also look encouraging, as the three-month annualised change in core inflation has been around 3% since September. What's more, the current account balance is improving faster than expected, with the NBH highlighting that the year-end figures for 2023 and 2024 could be more favourable than the surplus projected in the December Inflation Report.

Domestic risk environment will remain closely monitored

Macroeconomic fundamentals were moving in the right direction, which would have allowed for a larger rate cut. On the other hand, emerging tensions in the domestic risk environment warranted a cautious approach. In this regard, the NBH reflected on two recent issues that emerged in the last few days, both of which contributed to a sizeable weakening of the HUF.

First, relations with the European Union have become more uncertain following a recent article in the Financial Times, which raised the possibility of economic sabotage against Hungary. We do not wish to comment on the validity of the content, but as Deputy Governor Virág mentioned at the press conference, the news nevertheless contributed to a deterioration in the risk environment. This was evident in EURHUF levels, as the currency pair weakened to 390 after the article was published.

However, the forint has been in a vulnerable position since last Monday, when discussions started about a possible change in the reference rate for new corporate bank loans. This has contributed to an increase in uncertainty and, as a result, tensions in domestic financial markets have risen, as the NBH also noted. Overall, the combination of these two unfavourable factors outweighed the favourable macroeconomic developments and the central bank remained cautious.

International factors likewise warrant a careful approach

The reaction function of the National Bank of Hungary does not only take domestic factors into account, but also international factors. In this respect, both favourable and unfavourable international developments have been noted. The external inflation environment is better than expected, which is good news in terms of lower imported inflation. Moreover, while long-term yields in developed markets have risen in recent weeks, they are still well below their peaks.

However, as the start of the easing cycle for the Federal Reserve and the European Central Bank has been pushed back somewhat, a cautious approach is warranted for all emerging market central banks, including the NBH. Not to mention the fact that geopolitical tensions are still with us, and are even on the rise if we look at the latest developments in the Middle East. In the context of these unfavourable geopolitical developments, the risk of shocks in energy and commodity markets is still high and is likely to remain that way unless we see a clear de-escalation.

The forward guidance remains the same

Going forward, we expect the NBH to maintain a data-dependent approach when deciding on the optimal pace of rate cuts. In this regard, the central bank left the previous forward guidance unchanged, emphasising data dependency and a cautious approach to monetary policy.

This means that if both domestic and international developments allow, the central bank could increase the pace of rate cuts to 100bp, as a possible dovish shift is not entirely ruled out. At this point, everything depends on the upcoming data and how the risk environment evolves.

Our market views

The main take away from the NBH meeting is that EUR/HUF matters more, and the pain threshold is lower than we thought. We will likely play a similar game in the coming months which will attract even more market attention in FX. To no surprise, HUF rallied following the decision of leading gains in the CEE region. These days, HUF can benefit further from this, but the medium-term view is a bit more complicated in our view. Rates are heading lower again despite the hawkish surprise. So, for a longer HUF rally, we need to at least stop pricing in more rate cuts. For now, it looks like it will be difficult for EUR/HUF to get back to 380. However, there are more stories in the mix, and it isn't just the NBH that makes us positive on HUF once again in the overall view.

The short end of the rates market probably needs a few days to adjust to a more hawkish NBH approach instead of pre-meeting priced 100bp cuts for each meeting in the near future. However, beyond the one-year horizon, the NBH decision does not appear to be a game changer for the market. Indeed, the inflation profile remains same, and the terminal rate is also unlikely to change. Moreover, the NBH may change its view at the next meeting. The market has sold off significantly in the last two weeks, making the current levels attractive again. Overall, as we mentioned in our [full NBH preview](#), we are positive on rates and bonds again. In particular, the belly of the HGBs curve seems like the sweet spot given current levels and the issuance outlook.

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