

National Bank of Hungary Review: Narrowing margin of manoeuvre

The National Bank of Hungary repeated its previous decision, cutting the main interest rates by 50bp. The outlook for monetary policy after June remains clouded, although the cautious and patient approach suggests a narrow margin of manoeuvre



The National Bank of Hungary in Budapest

7.25%

As expected

Key interest rate

ING forecast 7.25% / Previous 7.75%

Rinse and repeat

The cautious and patient easing of monetary conditions in Hungary continued in May. The National Bank of Hungary (NBH) cut its key interest rate by 50bp to 7.25% on 21 May. The size of

the move was similar to the one in April. Besides the base rate, the central bank maintained the symmetry of the interest rate corridor with 50bp cuts at both ends. Given that market expectations of the upcoming decision were virtually unanimous this time around, the actual outcome did not contain any surprises. The Monetary Council decided to recycle the messages from the previous rate-setting meeting. The "rinse and repeat" process implies a hawkish stance across the board.

Monetary policy divergence and services inflation in focus

While the press release and the background discussion following the decision did not contain any unexpected, eye-opening messages, we did find two new emphases in the communication. Both were based on previous messages, but are now a little more nuanced, underlining the cautious and patient approach of the Monetary Council going forward. In practice, these panels were a must in order to have the option of choosing between 25bp and 50bp of easing at the June meeting. This time, however, the Monetary Council was again unanimous in favour of the 50bp move, the only option on the table.

But back to the new narratives. The first relates to the Federal Reserve's monetary policy. Previously, the central bank focused on the timing of the expected easing cycle, but now the message is more about the expected divergence between Fed and ECB policy, which may lead to a persistently higher US interest rate environment and possibly increased volatility in emerging markets. With this kind of change, the Monetary Council has made itself independent of the decisions of the Fed and the ECB, while acknowledging that possible money market instability created by this divergence could cause headaches in the future.

The second focus was on local (and global) services inflation and the risks to the inflation outlook. While these issues had also been highlighted in previous months, the Monetary Council put more emphasis on the sticky nature of services inflation and the bad habit of backward-looking repricing patterns that limit the disinflation process. What is more, this type of pricing decision goes against the central bank's will to anchor inflation expectations at a lower level. The latest survey showed that the decline in inflation expectations has stuck, and it has remained at a high level (around 8% according to the NBH's calculations, twice the upper limit of the inflation target tolerance band).

All in all, the focus on services inflation risks and on the divergence of key monetary policymakers now serve as risks that warrant the NBH to remain on the side of caution and patience.

We also need to be patient to learn more about the post-June monetary plan

Deputy Governor Virág reiterated the previous message that the mid-year interest rate target remains between 6.75% and 7.00%. In practice, this gives the Monetary Council in June two options: 50bp or 25bp easing. In our view, we need to be patient and gather all the necessary data and information over the next four weeks in order to be able to make a high-conviction call for the June meeting. Looking at the latest risk maps of the central bank, listening to the narratives and our expectation that the upcoming sovereign rating decisions will bring negative changes, we prefer to err on the side of caution with a 25bp rate cut in June. However, we now give roughly equal odds to a 50bp easing in June.

For now, we favour a 25bp rate cut at the June meeting

We will update our monetary policy outlook for the second half of 2024 on the basis of the June forward guidance. Against this background, the National Bank of Hungary's June Inflation Report is the next milestone, as it will serve as the main source of information for the Monetary Council to decide on the short-term policy stance. Considering that the Deputy Governor's main implicit guidance was that "the further scope for rate cuts is very, very limited as far as we know at the moment", we think we can see an even more hawkish National Bank of Hungary. We still see a realistic chance that the base case for the second half of the year will be monetary policy on hold, i.e. no change in rates after June – especially if our non-consensus call for a year-end inflation print of 5.5-6.0% holds.

Our market views

Today's meeting didn't bring much new for markets and we don't see much reason to change our market views from our NBH preview at the moment. EUR/HUF remains basically unchanged and the rates market has not shown much movement either. However, FX along with spot inflation seems to be the key indicator for the next meeting in June. On the one hand, HUF is the strongest performer since February. On the other hand, it is the biggest underperformer among peers. And at the same time, we still see a big FX disconnect from rates, which after the recent rally indicate levels rather in the range of 390-395 EUR/HUF. The mid-May mini-correction also showed that the forint is still fragile and that the recent rally is a tactical rather than a structural move. For the days ahead, HUF may continue to benefit from favourable global conditions and the hawkish tone of the NBH. However, medium term we retain a rather negative bias coming from an unclear economic recovery, a less rosy outlook in the external balance, fiscal risks and a possible sovereign rating downgrade, which has the potential to switch the HUF back into a risk-off mood.

The rates market barely moved after today's NBH meeting. For the June meeting, the market is pricing in a near-even chance between 25bp and 50bp rate cut with a slight preference for a larger cut if we consider the gap between the key rate and BUBOR. This is not that far from our expectations but for the second half of the year markets are still pricing in a roughly 60bp in rate cuts which we think first needs confirmation in the data. We do not have that yet and our baseline in the second half of the year is no rate cuts. On the other hand, a weaker HUF may thus be a signal for markets to outprice these rate cuts from the near-term path. On the other hand, looking further out, we see value in the belly and long end of the curve which price in almost no additional rate cuts with a basically flat shape from the 2y maturity. The combination of a hawkish NBH and a rally in core rates following favourable US data should bring back the curve inversion. That's why we continue to like the flatteners here which can benefit from a very attractive carry.

In the bond space, on the supply side, the situation remains very favourable despite the fiscal risk. The debt agency has front-loaded Hungarian government bond (HGBs) supply, eyeing a higher deficit and, according to our calculations, covered about 53% with very high demand in primary auctions compared to CEE peers. Thus, HGBs especially at the long end of the curve can still offer decent outright and relative value due to still wider spreads to CEE peers and the IRS curve. On the other hand, we are less optimistic on our own side. Fiscal risks and potential negative news from rating agencies, rising inflation and a pause in the cutting cycle in the second half of the year could end the recent rally and trigger a significant correction in the coming months.

Authors

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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