

## National Bank of Hungary Review: Press pause

Due to the instability in the financial markets, the NBH decided to keep the key policy rate at 6.50% in October. The new forward guidance is hawkish but avoids extremes. Time will tell if the markets are satisfied with this decision, but for now, it is difficult to have a high conviction call



The National Bank of Hungary kept the key rate at 6.50%

# 6.50%

Key interest rate

On hold

### Interest rates remain unchanged after the October meeting

About a month ago, there was a remote possibility that the National Bank of Hungary (NBH) would be able to continue its cautious, careful and stability-oriented easing in October. However, the

significant weakening of the Hungarian forint, first due to idiosyncratic (dovish repricing) and then due to global risk aversion shocks, threw this idea out of the window.

Guided by the stability-oriented approach, the National Bank of Hungary kept its base rate at 6.50% in October. The central bank also kept the interest rate corridor unchanged, with a range of +/- 100bp around the base rate. Despite some positives in the economy from a monetary policy perspective, the decision was a no-brainer due to market instability issues, as we discussed in our [NBH Preview](#).

## Negatives outweighed positives this time around

Back in September, the National Bank of Hungary gave the markets an easy-to-read playbook for the upcoming decision. At the time, it highlighted three key factors that would play a role in the outcome of the rate-setting meeting.

The first was the inflation outlook, with a focus on factors that could change the medium-term forecast and the re-pricing of services. Hungary's risk perception was also key, with a focus on the external balance and fiscal policy developments. Last but not least, financial market stability was in the crosshairs, with the need to maintain positive real interest rates on a sustained basis and the change in global investor sentiment being important.

The Monetary Council highlighted some of the positive developments in the above areas. Inflation reached the 3% inflation target after 44 months. Fiscal policy is actively trying to meet deficit targets. The country's external balances look much better than expected. But in the end, the show was stolen by the growing instability in the financial markets and the related deterioration in the inflation outlook.

Both the press release and the briefing (this time led by Vice Governor Kandrács) underscored the importance of the shift in market sentiment. Geopolitical tensions intensified, commodity prices generally moved higher, and there was a significant hawkish repricing of the Fed's expected rate path. With the European Central Bank continuing to ease, the Fed-ECB divergence is back on the table as a risk factor for emerging markets.

Changes in commodity prices and the weakening of the forint have led to a deterioration in the risk map for the inflation outlook. In line with the upside risks to inflation, households' inflation expectations have moved in the wrong direction. While it is far from being unanchored, the central bank is clearly interested in avoiding such a scenario.

As far as the forint is concerned, Deputy Governor Kandrács tried to downplay the situation by calling the EUR/HUF hitting 400 as a rather symbolic move. He emphasised that the exchange rate has remained in a narrow range and although the importance of the FX pass-through has intensified recently, there is no need to overreact or hit the panic button. Instead, the National Bank of Hungary is hitting the pause button.

## A new forward guidance

The Monetary Council, in its data-driven stance, continues to focus on the well-known three factors that have proven to be the basis for monthly decisions. The inflation outlook, Hungary's risk perception (via fiscal and external balances) and financial market stability will decide the fate of interest rates.

The cautious, patient and stability-oriented approach will also remain. “In the Council’s assessment, re-intensifying geopolitical tensions, volatile financial market developments and the risks to the outlook for inflation warrant a pause in cutting interest rates.” While this hawkish message is in line with recent pre-meeting commentary, it doesn’t bring any new threat to the table.

Indeed, talk of a rate hike was clearly avoided in the press release and also during the press conference, although the main focus of the Q&A session was to find out whether a rate hike is an option in the current setup. Time will tell if the markets are satisfied with this communication, but for now it is difficult to have any high conviction call with all the risk events looming in the coming weeks.

## Our market views

EUR/HUF tried to break through the 400 level after the NBH’s decision, but after the press conference, it is slightly above this level again. The 400-402 range seems to be the new playing field and the central bank doesn’t have many tools to make it come back down, but at the same time the hawkishness of the NBH prevents further HUF weakness. Unfortunately for the central bank, after the meeting the focus shifts back to the global story, which will be the main driver for the HUF in the next three weeks.

In our view, the HUF is the most exposed currency in the CEE region, especially to the downside. For example, in a Trump scenario, NBH will face further FX depreciation beyond local control in the initial reaction to the election result. On the other hand, a Harris victory would benefit CEE peers – CZK and PLN – more than HUF. Should the global situation calm down at some point in the future, HUF has the highest interest rate differential since the beginning of the year as a supportive driver after aggressive repricing.

Overall, it is difficult to expect a quick recovery of the HUF in the near future, given the risk-off sentiment in the markets ahead of the [US elections](#). At the same time, it is easier to see further weakness than strength at the moment, but in the medium term the HUF has support in interest rates if the global story allows it. In any case, we see a shift of the trading range to 400-410 EUR/HUF as a base case scenario next year.

The market has priced out most of the rate cuts in the HUF curve over the past three weeks. The priced-in terminal rate has moved from 4.50% to 5.75%, while the entire spot IRS curve has moved to roughly the BUBOR level. In other words, the market is not expecting much now from the NBH, with the first rate cut targeted for March next year and roughly two to three rate cuts in total.

Although the market pricing seems aggressive in our view and the pause in the cutting cycle will be shorter, from a market perspective we can find justification for such an aggressive move here. The probability of further HUF downside is not small and in case of an escalation, the market would start pricing in a rate hike in the nearest FRA contracts, which would postpone potential rate cuts in the future.

Thus, the levels themselves may be tempting for receivers, but we believe that in the current environment it is difficult to go against the risk-off sentiment ahead of the US elections and the market will have to see a more significant calming of the situation, which cannot be expected in the coming weeks.

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