National Bank of Hungary Review: Season finale with a cliffhanger

The National Bank of Hungary reduced the pace of easing to 25bp at its June meeting. The forward guidance signalled the possibility of a pause in the rate-cut cycle in the coming months, a clear hawkish shift. We continue to expect no change in policy rates in the second half of the year

The National Bank of Hungary reduced its rate cut pace to 25bp in June and is likely to pause for a while

7.00%

As expected

Key interest rate

ING forecast 7.00% / Previous 7.25%

Increased cautiousness

The cautious and patient easing of monetary conditions in Hungary continued in June. The National Bank of Hungary (NBH) cut its key interest rate by 25bp to 7.00% on 18 June. As a fun fact we share, this is the first time since July 2013 that the central bank has used a standard size rate cut. Back to the boring facts, besides the base rate, the central bank maintained the symmetry of the interest rate corridor with 25bp cuts at both ends. Given that 80% of the market (based on a Bloomberg survey) was expecting exactly this outcome in the rates complex, we can hardly call this outcome a surprise.

Pause introduced as a future option

Not only the rate decision itself, but also the subsequent communication (press statement and briefing) was in line with our expectations. This means that the National Bank of Hungary delivered a hawkish cut. The focus of the communication is the new forward guidance. While the previous one highlighted the possibility of “further reduction in the base rate in a cautious and data-driven manner”, the new one clearly states that the Monetary Council “will take decisions on the level of the base rate in a cautious and data-driven manner”. In practice, the NBH now focuses on the level rather than the delta.

With this restructuring of the forward guidance, the central bank has introduced a pause as a future option. Deputy Governor Virág emphasised the change in guidance several times, but in the end he explicitly mentioned the pause as an option during the Q&A session. It now appears that there is very, very limited room for further easing in the coming months, with the possibility of a pause.

It's important to clarify that – as we understand it – while every meeting from now on is a live meeting and the NBH may pause the rate-cutting cycle or make small cuts, this does not mean that the central bank's intention is to cut at every meeting. Rather, the label “live” is there to emphasise the pause itself. In this sense, a live meeting means that a pause is definitely an option and a cut is not a given.

Plenty of reasons to keep rates on hold in the second half

Among the central bank's key messages, we found at least six red flags, or rather supporting factors, for our long-standing hawkish call for no change in rates in the second half of the year.

The most obvious, of course, is the change in tone and wording of the forward guidance. But beyond that, the central bank has emphasised the "higher for longer" external interest rate environment several times. Turning to the inflation outlook, the most glaring issue on our side is the rising core inflation, which will reach 5% by the end of the year according to the central bank's new forecast. Our forecast is for core inflation to reach 5.3% by December 2024.

But it is not only the inflation outlook that justifies a hawkish stance, as household inflation expectations have started to drift higher recently and show signs of becoming unanchored. There has also been a shift in the risk assessment. While in March the central bank saw more downside risks to inflation, now two of the three main alternative scenarios are pro-inflationary (further Fed-ECB divergence, stronger real wage growth). Regarding the latter risk, the central bank stressed that the labour market remains strong and that wage growth has recently surprised on the upside, which could pose a problem for already high and sticky services inflation.

The updated GDP & CPI forecasts

The full macroeconomic assessment and outlook will be published with the June Inflation Report on 20 June. The NBH has revised down the short-term inflation outlook in line with the latest incoming data, forecasting headline CPI of 3.0-4.5% in 2024, shaving half a percentage point off compared to the previous range. The vast majority of this change is related to non-core factors like fuel, market energy, unprocessed food. The forecasts for 2025 and 2026 remain unchanged, with inflation in the range of 2.5-3.5%. While the outlook for 2024 is in line with our baseline projection (though the lower end seems a bit unrealistic as of now), we see next year's forecast as somewhat optimistic, with inflation accelerating to 4.4% on average after 4.1% in 2024.

The forecast range for GDP growth was left unchanged for the entire forecasting horizon. Thus, the central bank sees the performance of the Hungarian economy in the range of 2.0-3.0% on average this year, which contains our base case forecast (2.2%). When it comes to 2025 and 2026, the NBH projection sees GDP growth somewhere between 3.5-4.0% and 3.0-4.0% respectively.

Our monetary policy call for the second half of the year

We still believe that the policy rate cannot go any lower after June. The central bank wants to control both the short and the long end of the curve, and the best tool to have a lasting impact on the long end is to be as hawkish as possible. In this respect, we expect a prolonged pause by the NBH, which in turn would maintain a positive real interest rate in a rising inflation environment and keep some risk premium over regional rates, supporting HUF assets.

Nevertheless, we see downside risks to our view, as the central bank has not completely closed the door to further easing later this year. In the like of a favourable turn of events, such as a further cooling of US inflation, lower reflationary prospects in Hungary, a dovish shift in the regional monetary policy outlook and/or a material improvement in the global risk sentiment, we could see the NBH continuing the rate-cutting cycle.

In this context, we would expect two more rate cuts of 25-25bp over the rest of the year, the timing of which is highly uncertain. However, we would rather see the possibility of the easing being linked to meetings that provide new forecasts. Against this backdrop, if there is any room for easing, it would be in September and December, with the policy rate alternatively moving to 6.50%.

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