

NBH Review: Rising inflation risks

The National Bank of Hungary left its key interest rate unchanged in January, the fourth consecutive month on hold. The Monetary Council stressed rising inflation risks on several occasions. We continue to expect rates to remain on hold for at least most of the second quarter



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

6.50%

Key interest rate

Unchanged

As expected

Interest rates unchanged for four months

In our [NBH preview](#), we emphasised that rising inflation expectations among both households and businesses argue for a hawkish hold. The National Bank of Hungary (NBH) delivered as expected, deciding to leave the interest rate complex unchanged for the fourth month in a row.

The Monetary Council, which held its penultimate meeting in its current composition, kept

Hungary's key interest rate on hold at 6.50% on 28 January. Policymakers also left the interest rate corridor unchanged, with a range of +/- 100bp around the key rate.

Unanchored inflation expectations must be avoided

As usual, Deputy Governor Virág assessed the macroeconomic situation at the press conference. He spent a lot of time analysing the inflation story, which in general showed a clear deterioration. The higher-than-expected inflation print in December is accompanied by rising risk aversion and ongoing geopolitical tensions, all of which affect commodity prices and the forint. Moreover, rising inflation expectations (in relation to both households and businesses) have been highlighted several times. The bottom line is that the Monetary Council sees these as clear warning signs regarding the inflation outlook.

An old message also surfaced: a divergence between the monetary policies of the Fed and the European Central Bank is expected in 2025, which could lead to increased risk aversion in emerging markets. As the forint is clearly exposed to such shocks, this is a hawkish message that has been used on previous occasions when the central bank wanted to point out the need for even more disciplined (and persistently tight) monetary policy in Hungary.

Monetary policy transmission was made a focus of the January meeting, with attention being drawn to the fact that on 20 December the NBH had raised the implied rate on its FX swap instrument by 50 basis points to 6.0%. In the Monetary Council's view, maintaining the FX swap rate at this level remains warranted in order to keep monetary conditions in this market on a sustained tightening path.

Forward guidance gets a hawkish fine-tuning

One can argue about semantics, but in the end what matters is that the central bank has fine-tuned its messaging and become more hawkish. We can call it a definitive end to the easing cycle or a period of sustained pause ahead.

To underline this message, Deputy Governor Virág announced that, unlike previous rate-setting meetings, the January decision of the Monetary Council was unanimous. The rate cut was not on the table as an option, and going forward, with incoming information all pointing to heightened inflation risks, a rate cut is clearly off the table for the foreseeable future and this drove the wording of the new forward guidance.

During the Q&A session, the Deputy Governor refused to comment on rate-cut expectations, which resonates well with the central bank's messages that volatility and uncertainty are too high in the current environment, creating a fog of war for longer-term interest rate views. What now seems certain, however, is that keeping the policy rates at recent levels for an extended period may be a must in order to achieve market and price stability.

In all, the careful, patient and stability-orientated approach remains in place and the increased upside risks to inflation justify the maintenance of tight monetary conditions. This is a deliberate change from the previous guidance, as it removes the reference to a pause in easing, thus removing the option of rate cuts for the foreseeable future.

Factors closely monitored by the central bank

Unsurprisingly, the developments that influence the central bank's decisions on monetary conditions have remained unchanged. Monitoring changes in the inflation outlook is a must with a focus on inflation expectations, the pass-through of exchange rate movements and commodity prices. In terms of risk perception, the central bank continues to monitor the evolution of external balances and the achievement of fiscal targets. The third set of factors includes the evolution of country-specific risks, the global interest rate environment and investor sentiment, referred to as financial market stability.

We expect rates to remain on hold for at least most of the second quarter

With some twists and tweaks here and there, the big picture has remained the same for us. We continue to agree with the central bank that in the current situation there is no room for monetary policy cuts in the short term. Of course, the current situation does not mean that there will be no opportunity to resume the cycle of rate cuts in the future. And this will have nothing to do with the change in the Monetary Council from March. It has more to do with the global interest rate environment.

If the European Central Bank cuts by a total of 125bp throughout 2025 (our base case) and the Fed cuts by 75bp during this year (somewhat less likely, but still our base case), and regional central banks also ease monetary conditions, the National Bank of Hungary could act as early as 2Q25 (probably in June) without endangering the forint, in line with its stability-orientated approach.

We think a total of 75bp of rate cuts this year is realistic in Hungary, which would be roughly in line with the average size of expected easing cycles (between 75bp and 100bp) in the region. However, if price pressures surprise to the upside and inflation expectations become less anchored, 2025 could also pass without a single rate cut.

Our market views

The upgraded hawkish message from the NBH today is a positive signal for FX, in our view. Ahead of the NBH meeting, EUR/HUF was grinding lower for the last three weeks. Of course relief on the global side is a major factor here, but the steady and cautious NBH tone helps as well. In our view EUR/HUF has a chance to hold lower levels for longer and potentially test new lows, however there is little point chasing a HUF rally here given the likely rebound EUR/USD lower, which again should put some pressure back on EM currencies in general.

At the moment on the local side we see that the relationship between interest rate differential and FX has reversed since the US election and lower market rates indicate a stronger HUF. This may be typical for temporarily stressed markets. So for now we believe the hawkish tone of the NBH is actually supportive for FX. However, as the HUF market normalises and at the same time pressure on EM currencies returns, we believe EUR/HUF will head higher again in the medium term with the prospect of future rate cuts, which for now we don't have much timing conviction on, but markets are increasingly pricing in that they will come one day.

Rates markets were left with mixed results after the meeting. The IRS curve is 2-3bp higher at the short end while the long end is up to 5bp lower in the spot market, resulting in further flattening. This confirms our view that although NBH rate cuts seem unclear in the short term, the belly and long-end of the curve are mispriced at current levels and we should be pricing more cuts in the medium-term horizon than the very short-term. The FRA curve in the annual horizon is pricing two 25bp rate cuts. Still, most of the IRS curve is trading very close to BUBOR rates, which we think will continue to be attractive levels for the market as long as EUR/HUF stays in check. We should thus see further compression in the elevated premium vs core rates in our view.

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