

Our latest calls on the National Bank of Hungary

Based on the latest information, we're revising our previous forecasts for the National Bank of Hungary's upcoming rate-setting meeting



Gyorgy Matolcsy,
governor of the
National Bank of
Hungary

The annual congress of the Hungarian Economic Association took place on 21-22 September, where members of the National Bank of Hungary (NBH) made important comments on the monetary policy outlook. The information that came to light contradicts our calls in our [previous NBH note](#) (published before the congress). As a result, we are now revising our call.

What remains unchanged is that at the September rate-setting meeting the effective interest rate and the key interest rate will be merged at 13%, and that monetary policy will thus enter the second phase of normalisation.

The National Bank of Hungary announced that, as a result of the simplification of the monetary policy toolkit in September, the effective interest rate will become a "deposit-like" instrument. At the same time, the central bank made it clear that it will pay the base rate on excess reserves as of 1 October. These signals suggest that the overnight deposit tender will be lowered to 13% as the effective rate at the rate-setting meeting, but will be phased out from 30 September. From October, the effective rate will become the policy rate, as most of the excess liquidity will flow into reserve accounts.

This effect is the result of the other important announcement: that the central bank sees the symmetry of the interest rate corridor as part of the normalisation, with the corridor being plus/minus 100bp around the key rate. In this context, we expect the Monetary Council to lower the overnight deposit rate (the floor of the corridor) to 12%, and the overnight lending rate (the ceiling of the corridor) to 14%. With these changes, excess liquidity is expected to flow into reserve accounts as excess reserves after the quick deposit tender is phased out, making the base rate the effective interest rate again.

The biggest challenge in this major overhaul of the monetary policy framework is communication. The central bank needs to make it crystal clear that the effective interest rate will remain at 13% after the quick deposit facility is withdrawn.

With this new setup, we also change our forecast for the interest rate path in such a way that we still see the year-end base (and effective) rate at 12%, but the path to getting there will be different. Rising volatility and market uncertainty in the coming months (changing monetary policy set-up, EU funds and fiscal policy uncertainties) could lead the NBH to be overly cautious, resulting in only 25-25bp of rate cuts in October - November. After that, the expected positive outcome of the EU debate and the possible avoidance of rating downgrades in December set the stage for a series of 50bp rate cuts.

Our market views

The National Bank of Hungary's monetary policy is approaching a turning point, and the Hungarian forint will continue to be a key variable. The central bank seems committed to maintaining positive interest rates and a high carry for Hungarian assets, which should sustain market demand. Implied FX yields remain almost double in Hungary compared to the rest of the CEE region. Given the dovish market expectations, we see room for upward repricing here when the market realises that NBH is not going to continue the set pace of rate cuts in previous months. Overall, we remain positive on the HUF despite higher volatility and lower EUR/USD.

In fixed income, we see that the market has fully switched into dovish mode, and the coming months may be disappointing for the market. With the IRS curve almost fully normalised and the 2s10s close to CEE peers for the first time since the middle of last year, we see a chance for some upward correction, especially at the short end of the curve. Moreover, the massive carry for payers at the short end of the curve could attract market attention if this is the case.

On the Hungarian government bond (HGBs) side, we have heard a lot of noise in recent weeks due to the fiscal risk, as in other countries throughout the region. On the positive side, we believe that the increase in borrowing needs should cover at least most of the state budget problem. After the increase in needs, we estimate that the debt management agency has already covered around 77% of the planned issuance of HGBs. The supply side should therefore remain under control.

On the other hand, excessive dovish expectations, the EU money issue expected to return to the table in the coming weeks, and the uncertain fiscal picture all create an uncomfortable mix of risks. Most of this year's positive Hungary story has already been played out in our view, and with current valuations with 10y trading at ROMGBs level, HGBs do not have too much to offer at the moment.

Authors

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.