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needs to make it crystal clear that the effective interest rate will remain at 13% after the quick deposit facility is withdrawn.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

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