

# Our analysts' views on this week's central bank meetings

Interest rate decisions are due from the Federal Reserve, European Central Bank, Bank of Canada, Sweden's Riksbank, and the National Bank of Hungary this week. Here's what our analysts are expecting

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### Federal Reserve set for an extended pause

The Fed has signalled it needs evidence of economic weakness and more subdued inflation prints to justify further policy loosening

By James Knightley, Padhraic Garvey, CFA and Chris Turner

|                                       | Inflation outlook                                                          | Growth outlook                                                                    | Interest rates                                                             | EUR/USD | 10Y Bund |
|---------------------------------------|----------------------------------------------------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------------------------------|---------|----------|
| Current stance                        | Inflation is fluctuating in the near term, with around 2% in medium term   | Economic activity is supported by the rise in real wages. Risk is to the downside | Depend 50bps, data-dependent, meeting approach                             | 1.045   | 2.55%    |
| Dovish                                | Bank of inflation underbidding target in 2025 and beyond                   | Q3 production or tangible risk to growth may call for frontloaded cuts            | 50bp cut. Larger cut wks on the table. Strong hints of more cuts to follow | 1.045   | 2.50%    |
| Moderately dovish<br>ING<br>base case | Overlooking sticky inflation of past months. Expecting 2% this year        | Unchanged. Balance of risks for growth remains tilted to downside                 | 25bp cut. Unchanged dovish-leaning message. Data dependency                | 1.050   | 2.50%    |
| Neutral                               | Greater near-term upside risk for inflation but medium-term risk unchanged | Some tentative improvement in PMIs, but US tariff risk remains                    | 50bp cut. Strengthening dovishness. Slightly more cautious on growth       | 1.058   | 2.55%    |
| Hawkish                               | Higher oil prices can lead to upward revision in inflation projections     | Downgrading US production risk, albeit view on growth                             | 25bp cut. Market expectations for easing are too high                      | 1.063   | 2.65%    |

## FX

### January ECB cheat sheet: Expect the expected

ECB members have given strong hints that this Thursday's decision will be a 25bp rate cut

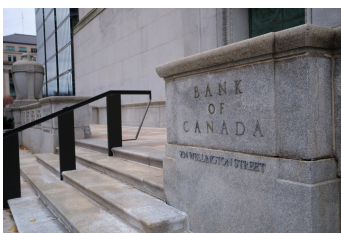
By Francesco Pesole, Benjamin Schroeder and Carsten Brzeski



### An ECB rate cut next week looks like a no-brainer

ECB set to cut rates again at January meeting

By Carsten Brzeski



## FX | Canada

### Bank of Canada set to tread carefully with a 25bp cut

The BoC is likely to cut the policy rate 25bp, but with potential US trade tariffs weighing on the growth outlook, we could see a return to more aggressive 50bp moves later

By James Knightley and Francesco Pesole



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Expect another rate cut this month and another in either March or May

By James Smith and Francesco Pesole



Hungary

## NBH Preview: New year, same story

Given the current fragile state of financial markets, we do not see any room for rate cuts in Hungary in the near future

By Peter Virovacz and Frantisek Taborsky

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Article | 23 January 2025

## Federal Reserve set for an extended pause

After 100bp of rate cuts the Fed has signalled it needs evidence of economic weakness and more subdued inflation prints to justify further policy loosening. President Trump's low tax, light-touch regulation policies should be good news for growth, while immigration controls and trade tariffs provide upside risk for prices, suggesting we could have a long wait for the next cut



Federal Reserve Chair Jerome Powell

### President Trump's policy thrust set to keep the Fed mildly hawkish

The December FOMC meeting saw a 25bp rate cut, as expected, but the accompanying press conference and forecast update indicated that 2025 would see a slower, more gradual series of interest rate cuts with perhaps just 50bp of easing in total. The economy has been performing well and inflation has proven to be stickier than expected so the general view was that there was less need to lower the policy rate as aggressively in 2025 as previously signalled.

In fact, the risk is that the Fed is actually more hawkish than they indicated. The convention has been that potential government policy changes aren't typically factored into forecasts until they have been implemented. However, with President Trump having just won re-election and his policy

plans differing so starkly from President Joe Biden's, Fed Chair Jay Powell acknowledged that some felt the need to incorporate the potential policy shifts into their December 2024 projections ahead of time. However, not all did and since his inauguration, there has been little sign of any moderation in Trump's key policy thrust.

## Fed funds target rate mid-point and market expectations for the path forward (%). September 2024 versus latest pricing



Macrobond, Bloomberg, ING

## Higher Treasury yields and dollar strength could yet force the Fed to cut

President Trump wants to ensure a low taxation environment with light touch regulation in order to boost growth prospects while implementing tariffs to improve US manufacturing competitiveness and promote re-shoring of economic activity. At the same time, trade protectionism will raise prices in the near term while immigration controls could prompt some labour shortages in sectors such as agriculture and construction that also add to inflation pressures. Consequently, Fed officials will likely need to see a marked slowdown in job creation and cooler inflation pressures to justify cutting rates further.

That means no change to monetary policy is a certainty on 29 January and it makes our previous call of a March rate cut look unlikely – currently just 6bp of a 25bp move is discounted by financial markets.

We are still forecasting three rate cuts for 2025 though. The jobs market is cooling and next month's annual benchmark revisions to non-farm payrolls could see significant cuts to the numbers originally reported. Wage pressures appear to be moderating quickly. At the same time, rapid increases in Treasury yields have pushed both consumer and corporate borrowing costs sharply higher and the dollar has strengthened more than 8% on a trade-weighted basis since September. This is all counteracting the Fed's 2024 rate cuts and our worry is that US Treasury yields continue to rise on debt sustainability concerns – the US is still running a fiscal deficit of 7% of GDP – and this becomes an intensifying headwind for economic activity that also works to

dampen inflation. Therefore we take the view that the Fed may need to push harder and cut rates a little further than currently priced by markets, but that is more likely to be a second half of 2025 development.

## Rates: Some focus on reserve management is possible from this “no change” meeting

The minutes from the December meeting noted that usage of the overnight reverse repo facility remained on a declining trend, reflecting money market fund reallocation to Treasury bills and private-market repo, which offered slightly more attractive market rates. This occurred against a tightening in market repo conditions, and continued increases in net Treasury bill issuance. At that meeting, the Fed also reduced the rate it pays at the reverse repo window by 5bp, back to flat to the funds rate floor. This adds to the attraction of market repo, and should correlate with further falls in the use of the reverse repo window. Our view is that usage of the reverse repo window will ultimately fall towards zero, barring some temporary spikes around month end.

The Fed may or may not comment on the above. It will also be interesting to see whether the Fed comments on the resurrection of the debt ceiling since 2 January 2025. While it's too early to expect a material market focus on it, the technical aspects of it are impactful. As long as the debt ceiling remains in place and the Treasury employs extraordinary measures to avoid breaching it, there is a tendency to spend down the cash balances that it holds at the Fed. As these get spent down, they add to reserves in the system which in turn acts to counter the tightening effect of the ongoing quantitative tightening (QT) programme. In effect, hitting the debt ceiling forces the Treasury to be a net supplier of liquidity to the system.

Despite these complications, the Fed may well lay the groundwork for ending QT at some point in 2025. This is the case as excess liquidity (which we define as bank reserves plus reverse repo balances) is likely to hit levels that the Fed would prefer not to go below from the middle of 2025 onwards, partly depending on how the debt ceiling saga evolves. The key number here is US\$3tn for reserves, representing about 10% of GDP. We are currently at US\$3.5tn. So we're comfortable. At the same time, the reverse repo balance is running at US\$125bn, and if that were to hit zero, then we'd hit some degree of tightness. That's close, as QT is running at US\$60bn per month. QT may have to end by mid-2025 based on a simple extrapolation of this.

## The inflation-adjusted dollar is back to 1985 levels



Source: US Federal Reserve

## Hard to see the FOMC hurting the dollar

December's FOMC meeting certainly added support to the dollar bull run and as James discusses above, it is hard to see the January FOMC event risk being read more dovishly for the Fed. True, market pricing of this year's Fed easing cycle is more modest than last December's 50bp median of Fed projections. Yet we doubt the Fed is ready to push back against those market expectations. This should keep dollar rate spreads relatively wide and argues that the FOMC will not be the reason the dollar corrects lower - if it does at all.

Instead, the FX market is enthralled by President Trump's incoming agenda and particularly by the harm to be meted out to major trading partners - especially those running large trade surpluses with the US. We're not sure the Fed will mention it in the January FOMC - and Chair Powell will be quick to refer any dollar questions to the US Treasury if he is asked - but the dollar is starting to look very strong now. Adjusted for inflation differentials it is back to 1985 levels - hence the speculation over some Plaza-like agreement to get it lower. We cannot see that happening this year, although Washington may try to find a way to get trading partners to strengthen their currencies under the threat of tariffs. Such a policy could just about be read as consistent with also wanting to maintain the dollar as the pre-eminent reserve currency.

For the time being, however, the narrative of US exceptionalism is alive and well, the tariff threat remains real and we doubt the Fed will knock the dollar off its perch.

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# January ECB cheat sheet: Expect the expected

ECB members have given strong hints that this Thursday's decision will be a 25bp rate cut, and we don't think this will be a market-rocking event. Our baseline is that a reiteration of the broadly dovish message can pave the way for lower eurozone rates. While the ECB remains a negative for the euro, the dollar correction might have a bit more to run

|                                           | Inflation outlook                                                        | Growth outlook                                                                 | Interest rates                                                             | EUR/USD (1.052) | 10Y Bund (2.53%) |
|-------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------------|----------------------------------------------------------------------------|-----------------|------------------|
| Current stance                            | Inflation to fluctuate in the near term, settle around 2% in medium term | Economic activity to be supported by rise in real wages. Risks to the downside | Depo at 3.00%. Data-dependent, meeting-by-meeting approach                 |                 |                  |
| Dovish                                    | Risks of inflation undershooting target in 2025 and beyond               | US protectionism a tangible risk to growth, may call for frontloaded cuts      | 25bp cut. Larger cut was on the table. Strong hints of more cuts to follow | 1.045           | 2.40%            |
| Moderately dovish<br><b>ING base-case</b> | Overlooking sticky inflation of past months. Expecting 2% this year      | Unchanged. Balance of risks for growth remains tilted to downside              | 25bp cut. Unchanged dovish-leaning message. Data dependency                | 1.050           | 2.50%            |
| Neutral                                   | Greater near-term upside risks for infl. but medium-term view unchanged  | Some tentative improvement in PMIs, but US tariff risk tangible                | 25bp cut. Stressing data dependency, slightly more cautious on easing      | 1.058           | 2.55%            |
| Hawkish                                   | Higher oil prices can lead to upward revision in inflation projections   | Downplaying US protectionism risk, upbeat view on growth                       | 25bp cut. Market expectations for easing are too dovish                    | 1.063           | 2.65%            |

ING Research

This article is part of our European Central Bank coverage. Please refer to our [January ECB preview for details](#).

This Thursday's ECB decision will almost certainly be a 25bp rate cut. Governing Council members have given very strong hints that rates would be lowered again in their latest comments, most recently in Davos. Our baseline view is that President Christine Lagarde will broadly repeat December's communication and her Davos forward guidance. That includes reiterating that rates will remain in restrictive territory and while not pre-committing to a specific easing path, sticky December inflation should not prevent the policy message from staying dovish, signalling further

gradual easing this year.

## Rates: Risks of lower yields

The rates market is viewing a cut at the upcoming meeting as a near done deal. The same goes for the following March meeting, with a total of 47bp of easing discounted by then, which would take the deposit facility rate to 2.5%. This is all in tune with comments from ECB officials pointing to further gradual easing. But it's beyond the first quarter that the outlook gets less certain. The market sees the ECB at 2.25% in June with a decent chance of another cut to 2% before the end of the year.

Expectations late last year had seen the ECB cut down to at least 1.75%. Since then, to a degree spillover effects from the US but also a refocus on stickier inflation and energy price dynamics had turned the pricing more hawkish. After Friday's better-than-expected eurozone PMIs, markets found another reason to price a more cautious advance by the ECB as the neutral territory is approached. But we have already seen some expression of doubts surrounding the December forecasts in the ECB minutes. More hints along those lines could push rates lower again.

Overall, we believe the balance of risks points towards lower rates again at these levels. With the ECB only starting to enter the broader range of neutral estimates, the expectations of the next couple of cuts will serve as an anchor. The upside appears more capped by the uncertainty stemming from US policies.

## FX: Euro not counting on the ECB for another rally

EUR/USD is retesting levels above 1.050 as markets have now priced out a good portion of the protectionism risk premium associated with President Donald Trump's tariff threat. Things on this matter can change overnight, as Trump often switched from friendly to hostile towards his trading partners without warning, but the longer eurozone and China are spared tariffs, the harder it will be for USD to regain momentum.

If the tail risk of US protectionism is getting thinner, there are lingering dampening eurozone-specific factors that will, in our view, prevent the euro from rallying much beyond the positioning re-adjustment. Eurozone growth remains concerning and political events this year can easily unnerve markets. Most importantly, we expect Thursday's ECB decision to show a resolutely dovish Governing Council that will keep a lid on any hawkish repricing of rate expectations even if inflation proves sticky at the next release.

We expect EUR/USD to hover around 1.050-1.060 in the short term, although the ECB could trigger a small correction on Thursday.

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## An ECB rate cut next week looks like a no-brainer

In what's been a very calm run-up to next week's meeting, we've been getting pretty clear signals from European Central Bank officials in Davos that rate cuts will continue



ECB President, Christine Lagarde, has been in Davos Switzerland this week

Contrary to the run-up to the ECB's December meeting, the preparation for next week's has been relatively quiet, at least in public. There haven't been any controversial views about the next steps. Instead, there seems to be a growing consensus about the need for further rate cuts. Today's comments by ECB president Christine Lagarde suggest that a 25bp rate cut at next week's meeting is a no-brainer and that the rate cut cycle will continue.

### Rate cut next week despite higher inflation

Remember that the minutes of the ECB's December meeting already showed a growing easing bias at the European Central Bank based on doubts about the growth forecasts and the growing risk of inflation undershooting. With little new hard data since the December meeting, the ECB is currently looking at a mild version of stagflationary tendencies: continued sluggishness of the economy and accelerating inflation. Still, the ECB seems to be looking through this temporary acceleration of inflation, and even the hawks sound dovish.

The main reason for the ECB's increased dovishness is that the December forecasts used a terminal rate of below 2%. Just to deliver the December forecasts' outcomes, the Bank will have to cut rates by a total of 100bp. Add to that the increased risks for eurozone growth stemming from the potential economic policy choices of the new US administration, and you can understand where officials are coming from.

## Rate cutting will continue beyond next week's meeting

At 3%, the deposit interest rate is still restrictive and too restrictive for the eurozone economy's current weak state. The recent surge in bond yields has also worsened financial conditions in the eurozone. Even if some argue that monetary policy can do very little to solve structural issues, political instability and uncertainty in many countries will force the ECB to continue doing the heavy lifting.

Also, as long as the current inflationary pressure is anticipated to diminish over the year, the Bank is likely to overlook the present inflation resurgence. While the experience of being slow to address rising inflation will deter the ECB from adopting ultra-low rates, the desire to stay ahead of the curve remains a compelling reason to return interest rates to neutral as swiftly as possible.

This means that the ECB will continue to cut rates. Bringing them at least to the upper end of estimates for the neutral interest rate, i.e. 2.5%, seems like a no-brainer. However, if the eurozone economy remains weaker than the ECB's December forecasts predict, cutting rates further will become unavoidable.

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## Bank of Canada set to tread carefully with a 25bp cut

The Bank of Canada is widely expected to cut rates on 29 January with a 25bp move looking as the most likely outcome amidst tepid growth, benign inflation and an unemployment rate that's trending higher. US trade tensions present downside risks to growth and could force the BoC to cut deeper later this year. For now, CAD will anyway continue to respond almost only to Trump's tariff threat



We expect the Bank of Canada to resume cutting interest rates this year, potentially even twice

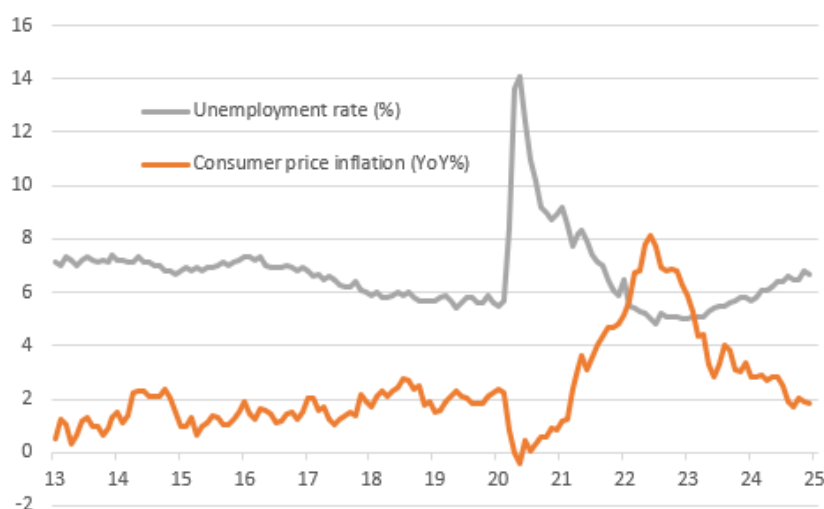
### Widespread expectations for a 25bp BoC rate cut

A 25bp interest rate cut from the Bank of Canada, leaving the overnight rate at 3%, is the widely held view in the market for next week's BoC monetary policy decision meeting. Only one out of 15 analysts surveyed by Bloomberg expect the policy rate to be held at 3.25% with one person going for a 50bp cut and another going for a 75bp cut. We also expect a 25bp move after two consecutive 50bp cuts. This would bring the cumulative policy easing to 200bp since the early summer.

Economic activity has been disappointing with fourth quarter GDP expected to come in at an

annualised 1.5% rate after 1% growth in the third quarter. At the same time the unemployment rate has been trending upwards to stand at 6.7% versus a 2022 low of 4.8%. This indicates excess supply in the economy that is helping to depress price pressures. Headline inflation is currently just 1.8% year-on-year with core (ex food and energy) measures at around 2.5%, although this has been helped by the temporary sales tax holiday on food, beverages, eating out, children's clothing, games, toys and books. That said, the chart below implies the inflation and jobs dynamics justify additional support for the economy in an environment where business surveys point to ongoing subdued activity.

## Canada inflation (YoY%) and unemployment rate (%)



Source: Macrobond, ING

## Escalating trade tensions heightens the risks for Canada's economy

The meeting comes at a point when the Canadian economy is under more intense scrutiny now that President Trump is back in office. His threat of 25% tariffs on imports from Canada into the US from as soon as 1 February is causing significant concern for business leaders and politicians alike. The US is by far and away Canada's most important trading partner, taking in 76% of Canada's exports with the value equivalent to around 20% of Canadian GDP. The proposed tariffs will undoubtedly hurt the competitiveness of Canadian products with the clear risk that substitution away from Canadian-sourced items leads to an economic downturn.

There is the prospect that US importers try to front run tariffs and that boosts the very near-term Canadian export story. Meanwhile, the potential for retaliatory tariffs on US exports into Canada – around 65% of Canadian imports come from the US – may push up price levels for Canadian consumers and prompt faster inflation. The weakness of the Canadian dollar, which is down around 5% on a trade-weighted basis since September also adds to price pressures through higher imported prices. This is a key reason why we expect just a 25bp cut next week.

Until there is clarity on what is happening on the US-Canada trade policy front the BoC is likely to tread carefully. Nonetheless the risks to our view that the Bank for Canada policy rate bottoms at

2.75% appear to be skewed to the downside given the relatively subdued economic backdrop and the clear threat to growth and jobs from potential US trade tariffs.

## CAD: All about tariffs

The Bank of Canada plays for now a secondary role for the loonie. Trump's threat to impose 25% tariffs by 1 February is preventing CAD from rebounding as much as other tariff-sensitive currencies like EUR, AUD and NZD. That said, USD/CAD is down almost 1% since last Friday, and our assessment is that, at 1.440, it is well short of pricing in the full extent of the US tariff impact.

We currently estimate a 2% short-term overvaluation in USD/CAD, but one of the key variables in our fair value model is the short-term swap rate gap between the two currencies, which has plenty of room to widen further if the BoC cuts rates more aggressively to temper a North American trade war.

At this stage – and regardless of this January BoC 25bp cut – the loonie continues to face very binary outcomes. Should Trump scale back the tariff threat, then there is an approximate 2% downside room to cover for USD/CAD. Should tariffs be imposed in the near term, we expect a dovish repricing in BoC expectations to compound with a greater risk premium and take USD/CAD well above 1.45.

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## Sweden's Riksbank rate cut cycle nears its end as economy shows signs of life

The Riksbank has cut rates more aggressively than most over the past couple of years and we expect another cut on 28 January. But while 2024 was characterised by sluggish growth and elevated unemployment, a recent rebound in sentiment and housing activity hints at a better 2025. A global trade war remains a major risk, but for now, it looks like the Riksbank will cut rates just once more later this year, in either March or May. Anyway, there is a case for EUR/SEK volatility to recover from the current lows



We expect the Riksbank to cut rates twice more, including once this month

Sweden's interest rate-sensitive economy was hit harder than most by the series of rate hikes in 2022/23. But following 150 basis points of rate cuts, the Riksbank's policy easing is showing early signs of bearing fruit.

Sentiment indicators – be it consumer confidence, the purchasing managers indices, or the economic tendency survey – have shown steady improvement through 2024. The housing market

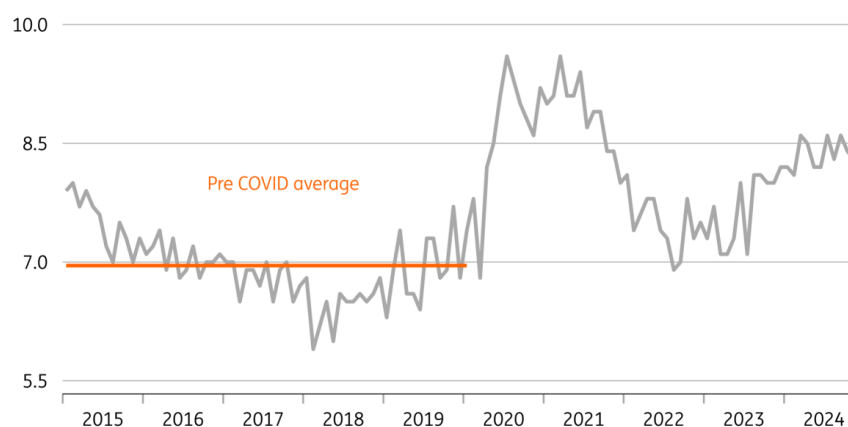
is rebounding too. Remember that Sweden has a particularly high prevalence of variable-rate lending, which means that rate hikes hit more quickly than in countries, notably the US, where fixed-rate debt is more common. The same is true in reverse, and the swift delivery of rate cuts has boosted transactions, confidence and prices.

So far, that's not been widely reflected in the hard economic data. Unemployment is no longer rising but remains relatively high, settling structurally above the pre-Covid average. Household consumption bounced in November, though it's too early to say that this is the start of a trend.

In short, while the Riksbank is expecting a recovery in demand this year, it's still early days. Meanwhile, inflation has continued its recent tendency to undershoot Riksbank forecasts. CPIF excluding energy came in at 2% in December, below the Riksbank's most recent projection.

Add in the risks from US President Donald Trump's trade war for Sweden's relatively export-orientated economy, and we think there's scope for both a cut next week and one more this year, ultimately taking the policy rate to 2%, slightly below the Riksbank's forecast for the year.

## Unemployment remains elevated



Source: ING, Macrobond

## Is a weaker SEK that undesirable?

Both historical and implied EUR/SEK have continued to plummet to 2021 levels, with markets struggling to find a catalyst for divergence. One reason is the relatively similar conclusions for the impact of US tariffs – where the krona would just follow the euro in depreciating against the dollar as it has done for the past couple of months. The other reason is that both the Riksbank and European Central Bank have conveyed a sense of predictability around the next policy moves.

Markets are pricing in around 20bp for this meeting, and we therefore see some upside potential for EUR/SEK next week and some signs of life in volatility. More importantly, the lingering uncertainty around global trade should keep the Riksbank leaning dovish. That should allow markets greater flexibility to price in additional cuts in Sweden based on the direction of Trump's protectionism.

The Riksbank spent the past two years lamenting a weak currency, but the decline in inflation,

focus on growth and risks of a shock to exports may well make the Riksbank more tolerant of fresh SEK depreciation.

All in all, we see some upside risks for EUR/SEK, which we could see move back to 11.60 on the back of greater market volatility in the first weeks of Trump's presidency.

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## NBH Preview: New year, same story

In our view, the interest rate complex will remain on hold at the first meeting of the National Bank of Hungary in the new year. Some early red flags on the macro side, combined with high financial market volatility, are set to keep the door shut on conventional easing in the coming months

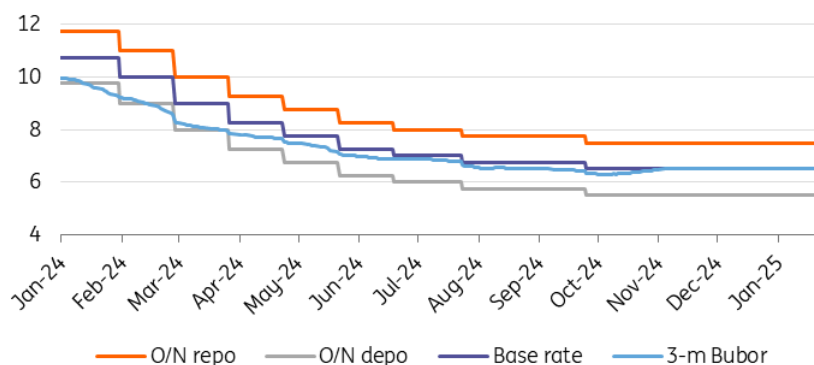


The National Bank of Hungary

### The central bank kept its rates unchanged in December

As expected, the National Bank of Hungary kept its key interest rate unchanged at 6.50% [in December](#). The interest rate corridor also remained unchanged, with a range of +/- 100 bp around the key rate. In line with its stability-orientated approach, this decision was again influenced by geopolitical tensions, risks to the inflation outlook and, most importantly, volatile financial market developments, i.e. the significant weakening of the Hungarian forint. Although the macroeconomic background would have supported some change, the decision was not unexpected by the market given the instability. We expect something similar in January.

## The main interest rates (%)



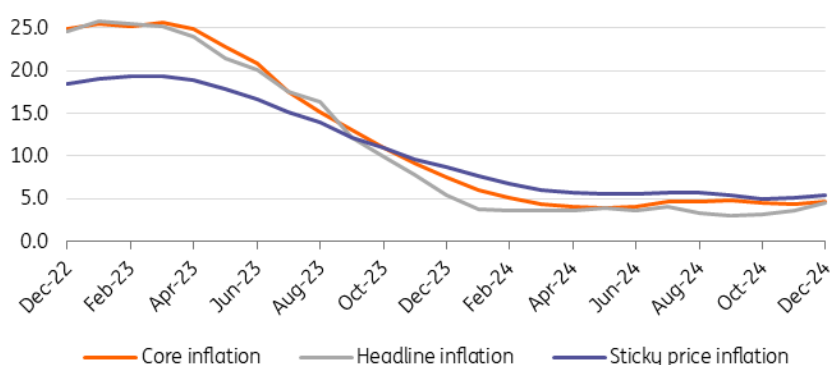
Source: NBH, ING

## Some early red flags on the macro horizon

Headline inflation accelerated in December, rising to 4.6% year-on-year (YoY). The acceleration was mainly driven by further increases in food, fuel, household energy prices and durable goods, due to the further significant depreciation of the forint. Although underlying inflation is also on the rise (core inflation rose to 4.7% YoY in December), this is not overly worrying data. Especially as the annualised three-month-on-three-month core inflation fell. The bigger problem is that the items whose prices rose the most are also the items that have the biggest impact on perceived inflation, and these also have a negative impact on household confidence.

In terms of risk perception from a monetary policy perspective, the December budget deficit was low compared to recent years, and thus the annual budget remained below the modified cash flow deficit target. However, the accrual-based deficit was higher than targeted, making it even more difficult to meet the 2025 fiscal plan. As for the external balances, we have not seen an alarming deterioration, but the strengthening import activity is clearly reducing the surpluses. In short, we are not talking about earth-shattering changes, but these factors call for caution.

## Headline and underlying inflation measures (% YoY)



Source: HCSO, NHB, ING

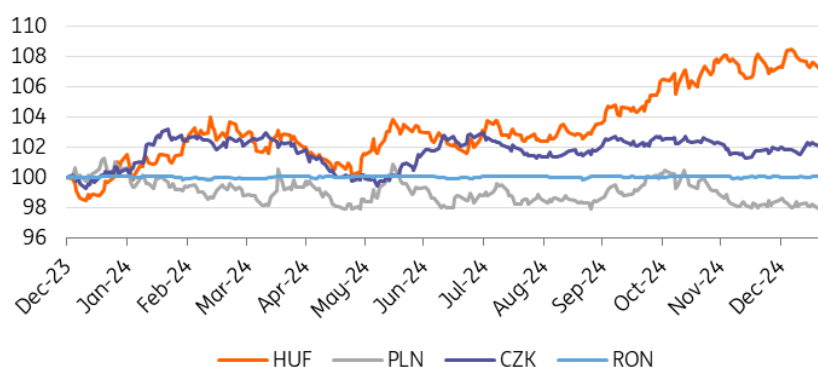
## Financial market instability remains the real deal

The early red flags mentioned above alone should not scream out for a fully defensive stance. However, the ongoing instability and high volatility in the financial markets have once again closed any kind of debate before it had even started.

The EUR/HUF exchange rate remains the central bank's focus when it comes to financial stability. Since the December meeting, the exchange rate has been in the 410-415 range. Although there has been a downward trend since the peak in early January (416), the forint is still significantly weaker than its 100- and 200-day moving averages. Moreover, the past few weeks (the run-up to President Trump's inauguration and the first few days) have seen significant intraday volatility. In this environment, it is better to be safe than sorry if you need to manage a high-beta currency.

But this time it is more than just FX. Core rates have moved significantly higher over the past month, although this has mainly affected the long end of the US yield curve, which rose by around 20bp by 22 January. The short and long ends of the Bund yield curve have also moved up by around 20-30bp, with a steepening bias. As a result, the yield on 10-year Hungarian government bonds jumped by 45bp. The risk premium also increased, as the spread between 10-year HUF and PLN government bond yields widened by 40bp compared to the December meeting. In such an environment, it is hardly surprising that the central bank's communication continued to focus on a cautious, patient and stability-orientated approach. Moreover, this has been complemented by a similar tone from the future central bank governor Mihaly Varga. The market's expectation is therefore crystal clear: no room for a rate cut at the start of the new year.

### Performance of CEE FX versus EUR (end-2023 = 100%)



Source: NHB, ING

## Our call

All things considered, we see no room for the central bank to ease monetary policy in the short term. In our view, the National Bank of Hungary will leave the interest rate complex unchanged at its next rate-setting meeting on 28 January. This will leave the key rate at 6.50%, which is a high conviction call. We also expect the Monetary Council to leave both ends of the interest rate corridor unchanged.

It is important to note that this is the penultimate meeting of the current Monetary Council. Governor Gyorgy Matolcsy's term ends in March, as does that of Council member Gyula

Pleschinger. Vice-President Mihaly Patai's term also ends in April. Despite the expected personnel changes, we do not expect any rate cuts in the first quarter. However, the March meeting will be very interesting.

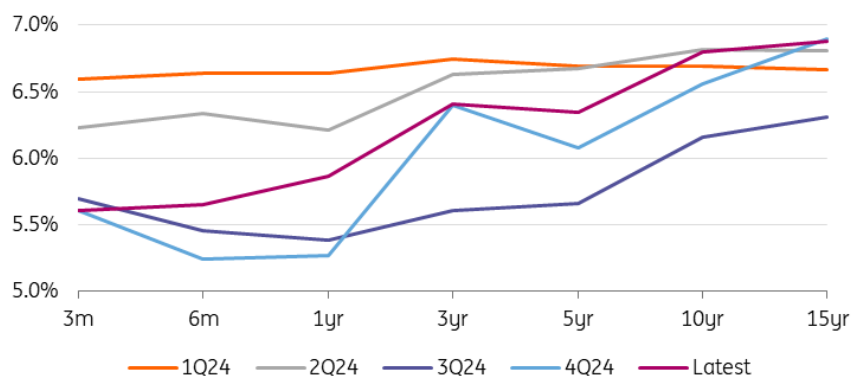
In the second quarter, the new Monetary Council could take action if the situation warrants it, but this is far from a high conviction call. Nevertheless, based on our forecasts for the European Central Bank's and the regional central banks' rate paths, we believe that a total of 75bp of rate cuts could be implemented this year in Hungary, starting in June at the earliest, which would be in line with the average size of easing cycles in the region.

## Our market views

EUR/HUF remains in the market spotlight and seems to be the main driver of monetary policy and HUF assets. Realised FX volatility has declined significantly since December but still remains well above CEE peers. In particular, positioning rebalancing in global markets after President Trump's inauguration has brought visible relief for the forint, allowing a return to 410 EUR/HUF in recent days, which we believe is consistent with the levels indicated by the rate differential in our models (410-412).

A pause in global pressure in the EM space and a cautious tone from the NBH should provide some reassurance in EUR/HUF. However, medium term we expect EUR/USD to move lower again and the market's dovish bias in HUF rates will combine to push EUR/HUF higher again. Thus, we maintain our end-1Q forecast at 420. The wild card on the positive side here may be some progress in the Ukraine-Russia conflict and any peace deal discussions should support CEE FX, which could benefit the HUF significantly through the channel of lower commodity prices and the general openness of the Hungarian economy.

## Hungarian yield curve



Source: GDMA, ING

With the lower EUR/HUF, risk-on sentiment towards fixed-income assets has returned to the market. The rates market is currently pricing in roughly two 25bp NBH rate cuts within a year and pricing is quickly returning to rate hikes in the longer-term horizon. Looking further out the curve remains very flat. While we cannot expect any dovish surprises from the NBH in the near term given FX volatility and higher inflation in December, we still believe the IRS curve offers good value within CEE peers. Moreover, the calmer FX market in recent days will, in our view, attract receivers

back into the belly curve in particular, with the 5y IRS around 6.50%, matching the policy rate. HGBs, which have seen significant foreign outflows in recent months, seem equally attractive. In January in particular, we saw a significant widening of spreads vs most CEE peers, resulting in more attractive valuations. This year we should see a noticeable increase in HGB issuance given the debt agency's greater focus on local funding, but against that, we should see demand coming from high redemptions of HGBs, T-bills and the retail bond market which should cover most needs.

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