

National Bank of Hungary Preview: Compliance with pre-commitment

While internal factors support a rapid pace of easing, external risks remain abundant and warrant a cautious approach. Our base case remains for 75bp of easing. However, the Fed's recent pivot and progress in the EU funds case open the door slightly to a more dovish cut.



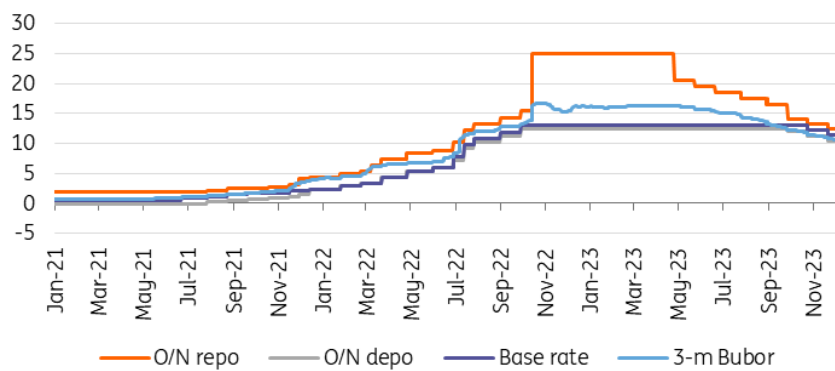
Shoppers on Váci Utca, the main shopping street in Budapest, Hungary

Source: Shutterstock

National Bank of Hungary decision in November

The National Bank of Hungary cut its key interest rate by 75bp to 11.50% in November. In the background discussion after the rate-setting meeting, Deputy Governor Virág made it clear that, based on the latest information, the policy rate could fall below 11% by the end of the year and could reach single digits in February 2024. Perhaps it's too much to call this a pre-commitment, but it looks the closest thing to it. Such a path would imply a continuation of 75bp cuts up to (and including) the February meeting.

The main interest rates (%)

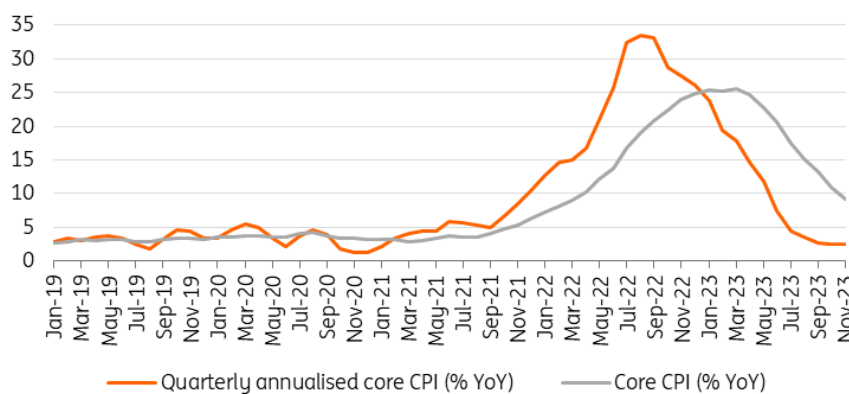


Source: NBH, ING

Internal factors are moving in the right direction

We can see many local macroeconomic improvements that support the continuation of the rather rapid easing cycle. Headline and core inflation both shrank by around 2ppt between October and November, with the former now below 8% year-on-year. More importantly, short-term price patterns look very encouraging. For example, quarterly annualised core inflation - showing what the annual rate of price increases would be if price developments over a year were as in the last three months - is already at a level consistent with price stability.

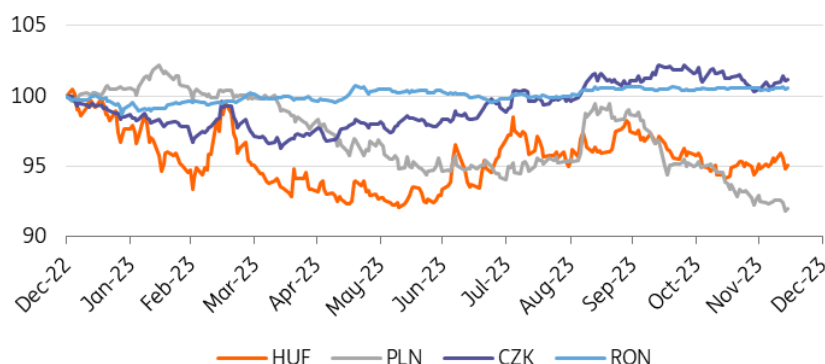
Underlying inflation indicators



Source: HCSO, ING

The country's external balances are also improving, as the trade balance has been in surplus for nine months, while the current account was also in positive territory in the second and third quarters of 2023. This, together with some other factors, is easing the pressure on the Hungarian forint. In this respect, we can say that much-needed market stability is also here.

CEE currencies vs EUR (end 2022 = 100%)

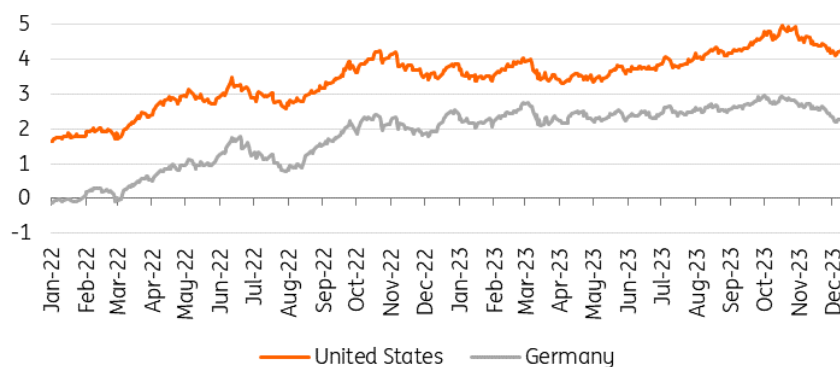


Source: NBH, ING

External factors are a mixed bag

The external picture is a mixed bag. On the positive side, risk appetite has improved considerably over the past month, as evidenced by the recent rally in bond markets. However, last month the central bank referred to the fact that yield levels in both the US and Germany are still quite high compared to a year ago. This hasn't changed much, despite the recent drop in yield levels. What also points to improved market sentiment is the VIX index hovering around 12, its lowest level since the end of 2019.

Developments in 10-year yields (%)



Source: FRED, Eurostat

On the contrary, the international risk factors highlighted by the National Bank of Hungary in its background discussion haven't necessarily moved in a positive direction. Geopolitical tensions and sanctions are still with us. The armed conflicts in Ukraine and the Gaza Strip haven't been resolved yet, preserving the possibility of escalation and thus the risk of further shocks in the energy and commodity markets. Meanwhile, the probability of recessions in the US and the Eurozone remains elevated according to market consensus (50% and 65% respectively) and labour market tensions, which pose global reflationary risks, are still apparent.

All in all, the economic landscape remains volatile and difficult to predict due to heightened risks - could provide sufficient impetus for the NBH to maintain its cautious approach.

Our call

Against this backdrop, we see the National Bank of Hungary sticking to its "pre-commitment" in this situation, i.e. a 75bp cut in the key rate on 19 December. This is still a substantial easing, but in line with the previous pace. This could bring the key rate down to 10.75% after the rate-setting meeting, while we expect the Monetary Council to also cut both ends of the rate corridor by 75bp.

What would it take for a dovish pivot?

In addition to the above-mentioned internal and external developments, other factors have emerged recently that could prompt the National Bank of Hungary to shift up a gear in the easing cycle. One of the key uncertainty factors has been removed with the positive decision of the European Commission on the horizontal enablers (judicial reforms). With Hungary now having access to around EUR 10.2 bn of Cohesion funds, this could increase risk appetite towards Hungary and support market stability.

The recent dovish pivot of the Fed and the acknowledgement of the upcoming easing cycle in the US might increase the probability that the National Bank of Hungary will follow through and eventually decide to switch from 75bp to 100bp in its ongoing series of rate cuts. On the other hand, the lack of such clear dovish guidance from the ECB in December keeps the picture blurry. As a result, we identify the 100bp rate cut as a low-probability risk scenario for the upcoming December rate-setting meeting.

New staff projections won't cause too much excitement

The National Bank of Hungary will publish its latest set of macroeconomic projections for the main measures (GDP and inflation) alongside the interest rate decision. The detailed December Inflation report is due on 21 December.

We see only minor adjustments to the outlook for 2023, with both the inflation and GDP forecast ranges moving slightly lower based on incoming data. As for 2024, we don't see any reason for the central bank to deviate from its September baseline. We expect a confirmation of the 4-6% inflation forecast range in 2024, with the inflation target being reached in 2025. In terms of economic activity, both the 2024 and 2025 forecast ranges look realistic at 3-4%.

Author

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

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