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National Bank of Hungary preview: Cutting the rate cut debate short

Although we could find plenty of reasons to support a slight dovish shift in the Hungarian central bank's November rate decision, we look for a 75bp rate cut, a repeat of last month.



The National Bank of Hungary, Budapest

The rate cut debate was over before it began

Barnabás Virág, deputy governor of the National Bank of Hungary, cut short the debate before it had even begun. The central banker was speaking at an event in Budapest on 16 November, where he pledged to maintain the current pace of monthly interest rate cuts. Given that the central bank operates in data-driven mode and that the Monetary Council discussed several options (a 50-75-100bp rate cut) at its last rate-setting meeting, it was (would have been) reasonable to speculate on the size of a November rate cut. But not any more.

Plenty of reasons to support a dovish fine-tuning

Assessing the incoming information (data and events) in the last month in isolation, it was not inconceivable that the central bank would make some changes to the pace of rate cuts. Geopolitical conflicts have not disappeared, but at least have not escalated, and that is a glass half full. Globally, inflation has continued to ease, especially with a better-than-expected

reading in the US. Global commodity prices have also moved in a more favourable direction since the previous rate setting meeting in October.

The same positive story line can be formed from the Hungarian inflation situation. It was a significant pleasant surprise that the October inflation figure had already fallen below 10% and the underlying indicators also showed better-than-expected improvement. External balance indicators are going through a more dynamic recovery than expected, with a positive current account balance in 2023 now a fair call. In the meantime, economic activity came in below the central bank's latest forecast. Last but not least, market sentiment has also improved dramatically - consider the forint or the movement of core market and local yields.

So everything is in place for base rate cutting that started in October to continue. The pace could even have been fine-tuned towards the dovish side. However, with less than a week to go before the decision, the central bank has essentially publicly committed to a 75bp cut. The fact that the data-driven NBH is committing itself in advance is somewhat surprising, as current circumstances could have encouraged policymakers to cut rates more boldly.

One argument above all

So, what happened? In our view, politics has intervened. The central bank appears to have weighed the potential gains and losses - and the balance does not support a larger rate cut than last month. Politicians and other decision makers outside monetary policy circles have put pressure on the central bank and in so doing may have shot themselves in the foot.

While there appear to be many solid reasons for accelerating the pace of rate cuts, a large proportion of foreign investors might see this as a capitulation to political pressure. The possibility that this line of thought might be running through investors' minds is now acting as an important deterrent. Quite rightly, we think. Indeed, monetary policy would like to avoid even the slightest appearance of being influenced by politics. The NBH has been under constant pressure in recent months and, in such a situation, accelerating the pace of monetary easing - even with more than sufficient professional justification - would carry too great a reputational risk.

Against this backdrop, the only really low-risk but meaningful reward option in this situation appears to be a 75bp reduction of the base rate. This is still a sizeable easing, while sticking to the previous pace. This could bring the policy rate down to 11.50% after the rate setting meeting. We also expect the Monetary Council to lower both ends of the interest rate corridor by 75-75bp.

No change in the outlook

Looking further ahead, we expect the level of rate cuts to remain at 75bp in the coming months, with a significant change only in the spring of 2024. After the first few months of the

new year disinflation should slow considerably, as base effects will no longer be as supportive. At the same time, monetary easing may slow -in order to maintain sufficiently high positive (ex-post) real interest rates. Eventually the policy rate may be pegged at 7% for a prolonged period. In the longer term, economic agents should be prepared for the central bank to maintain an above-inflation interest rate environment, to keep the economy from overheating and reduce the risk of deflation.

Our market views

EUR/HUF has moved significantly lower since the last NBH meeting and the market seems to be on the side of the central bank. HUF is stronger despite further pricing in rate cuts and adjusting to the new path indicated by the central bank. So, a 75bp rate cut next week should not be negative for FX and we remain positive on HUF. Long positioning by the market is probably the main limiting factor in the short term for further strengthening. This will also depend on the EU money story, which should bring some headlines soon. If everything goes in a positive direction then we believe EUR/HUF will move into the 370-375 range. On the other hand, we have to keep market positioning in mind - with probably a quick reaction if something goes wrong in the rest of the year. Looking ahead, in our FX Outlook we have pencilled in 375 EUR/HUF for the year-end and 365 in the middle of next year. For now, it looks like we could get there a little earlier this year.

In the rates space, markets are pricing in a 75bp rate cut for next week and that seems to be the consensus for this meeting. Since the last meeting, FRAs pricing has moved significantly to a new trajectory of 75bps each meeting but there is probably still some small room to go even further down. On the other hand, looking at the 1-2y horizon, the market seems to be pricing in too much in rate cuts for the first time in this cycle, with the current terminal rate at 5.75-6.00% on a one year horizon. Looking forward, we mentioned in the last NBH review that we see the biggest mispricing in the belly and long end of the curve. Since then, the 10y IRS has moved down about 80bps and we see room to continue. Overall, we see that still the direction here is to be received in rates but at the short end of the curve we see the room for another leg down as limited. The long end should continue to rally if global conditions allow. Some flattening of the curve is also suggested by the 2s10s, which has come within reach of the CZK curve - this seems premature at this level of policy rates.

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