

National Bank of Hungary preview: The moment of truth

With the expected merger of the base and effective rates next month seemingly a done deal, the time has come to think ahead. We see the National Bank of Hungary (NBH) using its meeting next week to manage market expectations for monetary policy in the fourth quarter. Plus, we expect an effective rate cut of 100bp

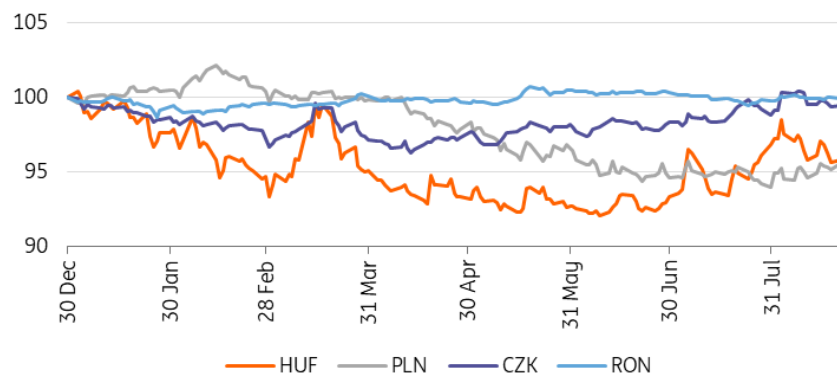


Gyorgy Matolcsy,
governor of the
National Bank of
Hungary

The story hasn't changed

We see no reason for the National Bank of Hungary (NBH) to change its recent monetary strategy. Even though the Hungarian forint has shown a lot of sensitivity to global factors, it has managed to remain in a roughly acceptable range since the central bank's July rate-setting meeting. The recent gravity line of 382 in EUR/HUF, combined with the settled rate cut expectations of the market, make the upcoming choice of the Monetary Council an easy one.

CEE currencies vs EUR (end 2022 = 100%)

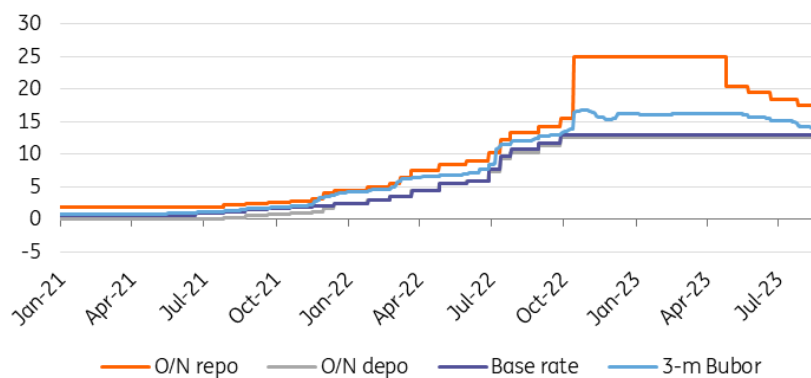


Source: NBH, ING

Since we are still in phase one of monetary policy normalisation, where the effective rate is closing in on the base rate, the focus is mainly on market stability. Price stability issues will come to the fore when we enter the next phase of normalisation, after the merger of the effective rate and the base rate at 13% in September. This call is also telling in terms of our expectations for the rate decision next Tuesday.

We think the National Bank of Hungary will cut the effective rate by 100bp to 14%, and we expect the O/N repo rate (the top end of the interest rate corridor) to be lowered by the same amount, reaching 16.5%. The central bank will replicate the 100bp rate cut in the FX swap tenders as well.

The main interest rate (%)



Source: NBH, ING

As this combination looks to be the market consensus by a wide margin, this outcome is unlikely to cause any surprises. What could be the wild card of the August meeting is the possible revelation of future monetary policy strategies. As a reminder, the Monetary Council's pledge when it started the easing cycle was four-fold:

- Cautiousness.
- Graduality.
- Constant monitoring of market reactions and forward-looking rate expectations.

- Clear and forward-looking communication.

If the central bank would like to live up to its pledges – which it has done so far – the August rate-setting meeting could be the perfect time to guide markets on what to expect after the September merger.

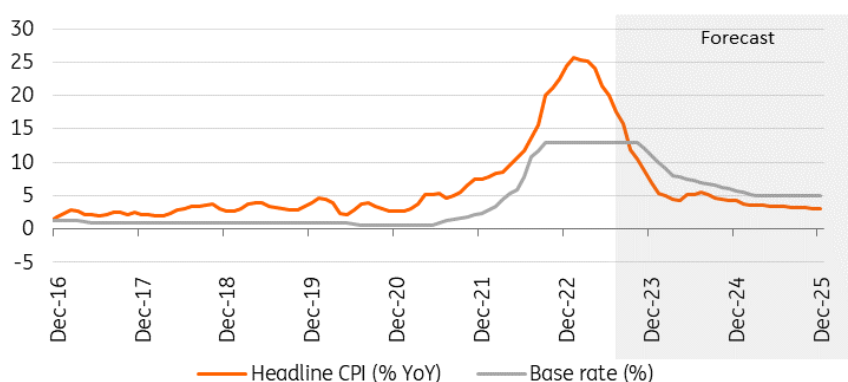
Moreover, as recent market history has shown that markets can be very volatile at the end of quarters and even more so at the end of the year, the National Bank of Hungary may use this rate-setting meeting to try to anchor expectations (and market rates) for the coming year-end.

The new era ahead requires an updated forward guidance

What exactly the central bank’s new forward guidance will be we cannot predict. However, recent global risk-off scenarios (a US credit rating downgrade, Chinese property woes, energy-related issues related to threatened LNG worker strikes in Australia that could impact gas prices, the collapse of the Black Sea grain deal, plus talk of further interest rate hikes by major central banks – even if they don't materialise) are adding a lot of unwanted uncertainty. In this regard, we won't be surprised if there is some extra hawkishness from the central bank, underscoring the need to be super-cautious in its second phase of policy normalisation. Such a speech could emphasise patience, leading to a possible (short) pause from September and/or a reduction in the pace of rate cuts.

In contrast with the growing uncertainty of market stability, price stability seems to be less of an uncertainty, at least in the short run. Headline inflation peaked at 25.7% in January and sat at 17.6% in July. Thanks to the base effects and collapsing domestic demand, disinflation will speed up in the coming months with the reading falling close to or even below 10% as soon as October. Such sharp disinflation will result in a massive positive real interest rate environment as the fourth quarter arrives. This clearly opens the door to base rate cuts, especially given the record-long technical recession, which has stretched out to four quarters after a significant downside surprise in economic activity in the second quarter.

ING's inflation and base rate forecasts for Hungary



Source: HCSO, NBH, ING

All of this will make the Monetary Council's decision on interest rates after September quite delicate. There are opposing forces, such as green lights on the inflation outlook and some red flags on the market stability outlook. This is the main reason why we think the National Bank of

Hungary will strike an extremely cautious tone in its revised forward guidance. It might try to steer investors to the hawkish side, as this seems to be a safer bet for the central bank in this environment.

Author

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@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 www.ing.com.