National Bank of Hungary preview: The moment of truth

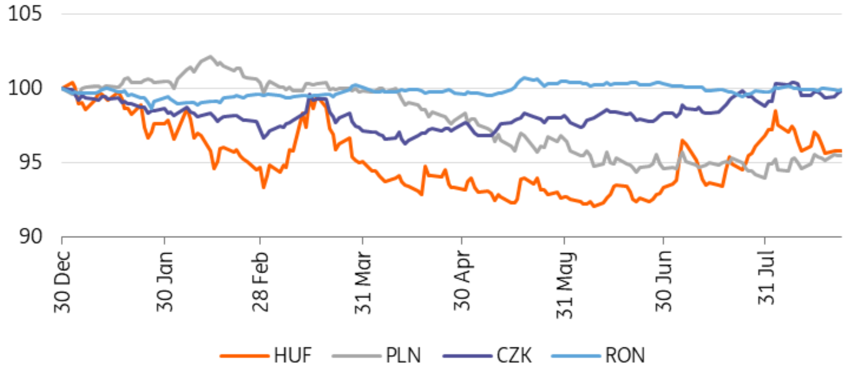
With the expected merger of the base and effective rates next month seemingly a done deal, the time has come to think ahead. We see the National Bank of Hungary (NBH) using its meeting next week to manage market expectations for monetary policy in the fourth quarter. Plus, we expect an effective rate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

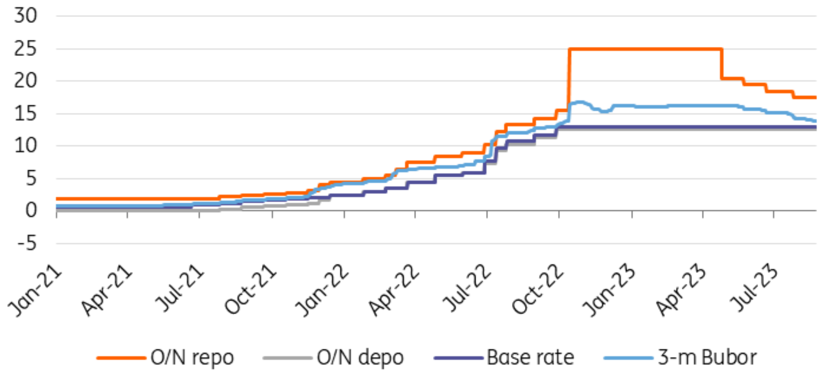


Source: NBH, ING

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.

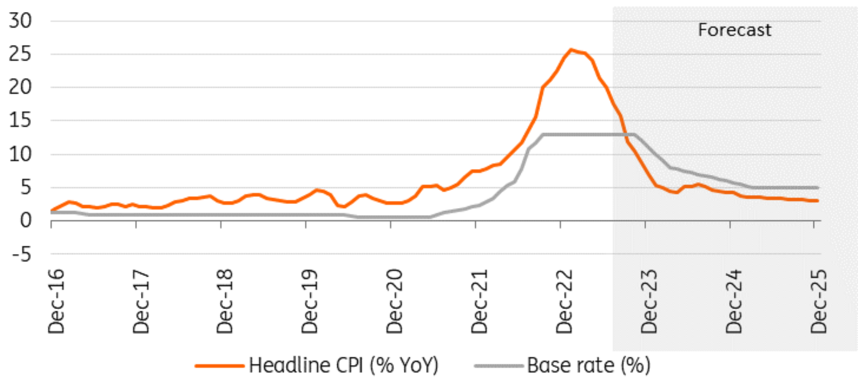
Moreover, as recent market history has shown that markets can be very volatile at the end of quarters and even more so at the end of the year, the National Bank of Hungary may use this rate-setting meeting to try to anchor expectations (and market rates) for the coming year-end.

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.

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