# National Bank of Hungary Review: 13 is the lucky number

The National Bank of Hungary surprised markets at its September meeting, hiking the base rate by 125 basis points to 13% and announcing the end of the hiking cycle. The goal now is to maintain the achieved strict monetary conditions and the focus shifts to tighten liquidity and improve monetary transmission

The National Bank of Hungary in Budapest

13.00%

Hungary's base rate

+125bp

Higher than expected

## Central bank announces end of rate hike cycle

The Hungarian central bank made a somewhat perplexing decision for those who were focused only on one part of the latest official communication which raised the opportunities of 50bp, 75bp or 100bp step sizes at the next rate setting meeting. In contrast, the Monetary Council decided to hike the base rate and the interest rate corridor by 125bp. A sudden-stop to the cycle was also mentioned in its communication, though it wasn't creating a lot of stir or headlines. The above-consensus tightening eventually moved the base rate to 13.00% and the 1-week deposit rate will sit at this level as well after Thursday's tender.

In parallel with this 'big bang' move, the National Bank of Hungary announced the end of the rate hike cycle. In the Monetary Council's assessment, with the new level of the base rate, interest rate conditions have become sufficiently strict, which ensures the achievement of the inflation target.

The central bank examined four conditions and found adequate and satisfactory progress to end the interest rate hike cycle after its September move.

1. The real interest rates (based on forward-looking data) became positive, giving a strong anchor to inflation expectations.
2. Based on the new economic assessment, the central bank sees that inflation risks have become balanced with lowering pressure from imported inflation and due to the expected narrowing of domestic demand.
3. The government made progress, getting closer to making a deal with the EU, which is a positive note.
4. Monetary transmission improved significantly in the FX swaps and bond markets.

The new staff projection will be revealed in detail on 29 September, but the Deputy Governor has already revealed the key numbers. The central bank raised its inflation forecast to 13.5-14.5% in 2022 and sees next year's average inflation in the range of 11.5-14.0%. Inflation is expected to get back to the target range during the first half of 2024. The economic outlook became gloomier as the NBH downgraded this year's GDP growth to 3-4%, while cutting next year's economic activity forecast to 0.5-1.5%. We are a bit more pessimistic regarding 2023, seeing only a 0.5% GDP growth in 2023 (with significant downside risks) and pencilling in an above 15% average inflation (with slight downside risks stemming from growth risks).

According to the new forward guidance, tight monetary conditions will be maintained over a prolonged period, while the focus now shifts on draining liquidity and improving monetary transmission. In this regard, even though **the central bank stopped the hiking cycle, it continues the tightening cycle with the new measures coming into force from 1 October.** These measures are the regular 1-week central bank bill auctions, the longer-dated deposit tool with floating rate and the stricter reserve requirement regulation.

## FX and rates markets reaction

The NBH decision found the market unprepared, including us, and at first blush the market seems to believe that the hiking cycle is truly over. In the blink of an eye, the entire IRS curve has moved down 15-40bp, resulting in a massive bull-steepening. The priced-in terminal rate has shrunk to 13.25% and we can expect re-pricing to continue in the days ahead. Long-term expectations for NBH rates have moved to 6-7%. We can probably go a bit lower, but combined with rising core rates, the move should be limited. So, normalisation of the inverted curve will now be a major topic, earlier than expected, joining the Czech National Bank and the National Bank of Poland. And looking at CEE peers there is a lot of room for steepening ahead.

In the bond market, Hungarian government bonds (HGBs) have finally returned to fair asset swap levels. However, the current global sell-off coupled with local uncertainty associated with EU money will make it hard to find buyers at these levels and combined with today's NBH decision, we can expect more of a sideways move with pending developments on these themes.

The forint has moved to its strongest level in a week, but we think the support from the NBH's surprisingly large move will be short-lived. On the other hand, in hindsight, the overall picture results in a further decline in the interest rate differential to early June levels. In the short term, the question is what effect the NBH's new liquidity measures unveiled earlier will have, from which the central bank has high hopes to improve monetary transmission and stabilise the forint. In the longer term, the topic of EU money remains on the table and will be with us until at least mid-November. Overall, we can thus expect more volatile weeks ahead around the 405 EUR/HUF level depending on incoming headlines. Moreover, we see HUF to remain in the grip of global energy price swings as well due to the country's vulnerability provided by its current account position.

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