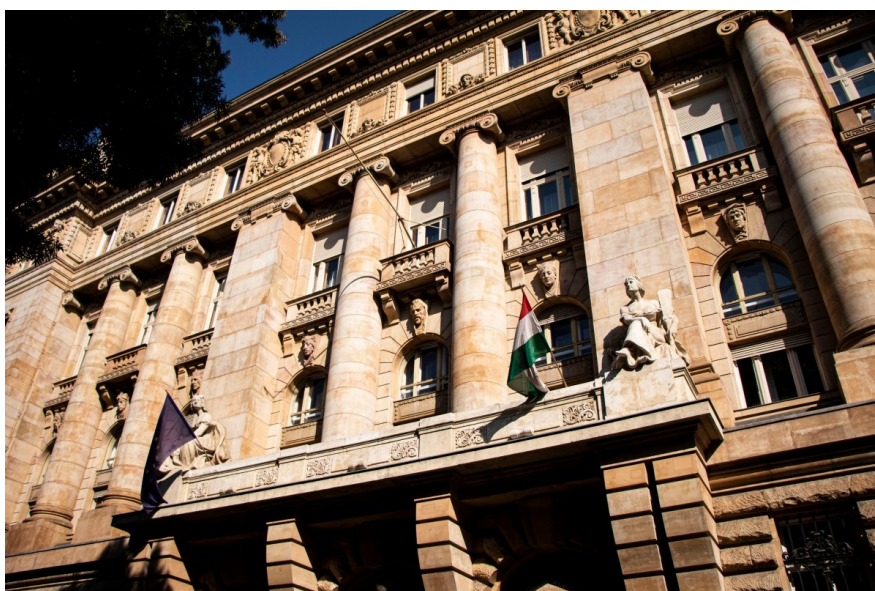


National Bank of Hungary Review: A careful compromise

The National Bank of Hungary cut its base rate by 75bp, making a compromise in view of the strong disinflation and the general increase in risks. We see this step size as the baseline for the future, with any fine-tuning dependent on factors affecting the inflation path and the risk environment



The National Bank of Hungary in Budapest

12.25%

Key interest rate

ING forecast 12.50% / Previous 13.00%

Lower than expected

A 75bp compromise

The National Bank of Hungary reduced its base rate by 75bp to 12.25% at its October rate-setting meeting. At the same time, the entire interest rate corridor was lowered by 75bp, maintaining the symmetry of the +/- 100bp range which was restored at the September meeting.

This move can be considered a careful one as it represents a slowdown from the previous pace of easing. The press release emphasised several aspects that justified the caution. Among others, the intensification of geopolitical tensions, the deterioration in risk appetite, the “higher for longer” policy stance of major central banks and the slower global disinflation process in core inflation measures suggest that achieving price stability will be challenging everywhere.

On the other hand, there were a number of factors – particularly related to the Hungarian economy – that contributed to a rather rapid pace of easing. According to the Monetary Council, strong disinflation in September and a reduction in the country’s vulnerability allowed the central bank to lower the base rate. In addition, there has been a surprisingly solid improvement in the country’s external balances, with both the trade and the current accounts in surplus.

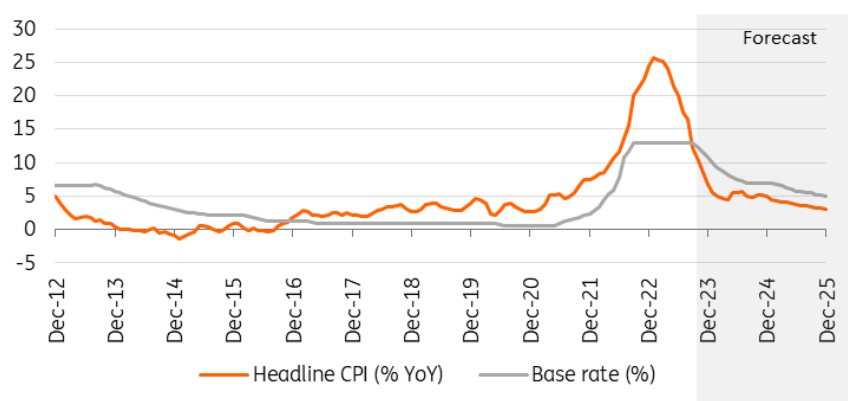
Given these pros and cons, it is hardly surprising that the actual rate cut was, in our view, a compromise. In response to a question, Deputy Governor Barnabas Virág mentioned that there were several options on the table, ranging from a 50bp to a 100bp cut. Although the decision was ultimately unanimous, it shows that the differences of opinion between individual members of the Monetary Council could widen slightly.

We see the October move as the baseline

In this regard, we believe that the size of the October rate cut (75bp) will determine the baseline pace of further rate cuts, as we pointed out in our preview note. So, we expect 75bp of easing at the November meeting and again in December. However, as the NBH is taking decisions step-by-step in a data-driven manner, we can expect small deviations from this baseline, depending on the factors influencing the inflation path and developments in the risk environment. This is in line with Deputy Governor Virág’s statement that recent market expectations of the policy rate of around 11% by the end of this year are “realistic”.

The NBH was rather upbeat in its assessment of the general economic situation. Hungary has emerged from recession based on the high-frequency data for the third quarter, and GDP growth will pick up in 2024, although this will be gradual and balanced. Against this backdrop, disinflation will continue, and the central bank expects inflation to reach single digits towards the end of the year. This view is supported by better-than-expected core inflation in September as well as improving annualised three-month inflation readings. However, the risks still point to higher inflation, which is why the Monetary Council has repeatedly emphasised the need to continue disinflation in 2024. In order to support this process, the NBH aims to maintain a positive ex-post real interest rate environment, thus continuing its hawkish stance.

ING's inflation and base rate forecasts for Hungary



Source: HCSO, NBH, ING

Our monetary policy view for 2024

Looking a little further out from the short term, and thus from 2023, we expect the central bank to continue to lower the policy rate and the interest rate corridor as disinflation continues early next year. We wouldn't be surprised to see the Monetary Council maintain the recent pace of easing, keeping ex-post real interest rates above 350bp, and then slowing the pace in a way that helps maintain a 200bp positive ex-post real interest rate. Given our inflation forecast, which sees inflation hovering around 5% in 2024, we see the policy rate reaching 7% around the summer and then remaining on hold until the end of the year.

Our market views

The forint reacted to the larger rate cut move by weakening but is back around 382 EUR/HUF after the press conference. However, the market is already repricing expectations towards larger rate cuts in the future, which is likely to continue in the days ahead. This should further undermine the forint and make it vulnerable in the coming weeks. In addition, the US dollar is again heading towards stronger levels, which can only support a move into the 384-386 EUR/HUF range in the short term. In the medium and long term, probably not much has changed after today's meeting, and the forint should continue to strengthen depending on the success of the NBH delivering rate cuts and the EU money story. We expect 375 EUR/HUF at year-end and 365 EUR/HUF in the middle of next year, supported by the highest positive real rate and carry in the region.

In the rates space, if we consider the baseline to be a 75bp pace of cutting for the coming months, the FRA curve still has room to move down. At the moment, the market is pricing in a roughly 50bp move for the next meeting and a bit less for the meeting early next year. However, the biggest mispricing we see is more at the belly and long end of the IRS curve, where the market sees a terminal rate well above 6% right now. On the other hand, high core rates are unlikely to allow any significant bull-flattening of the curve at the moment.

Authors

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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