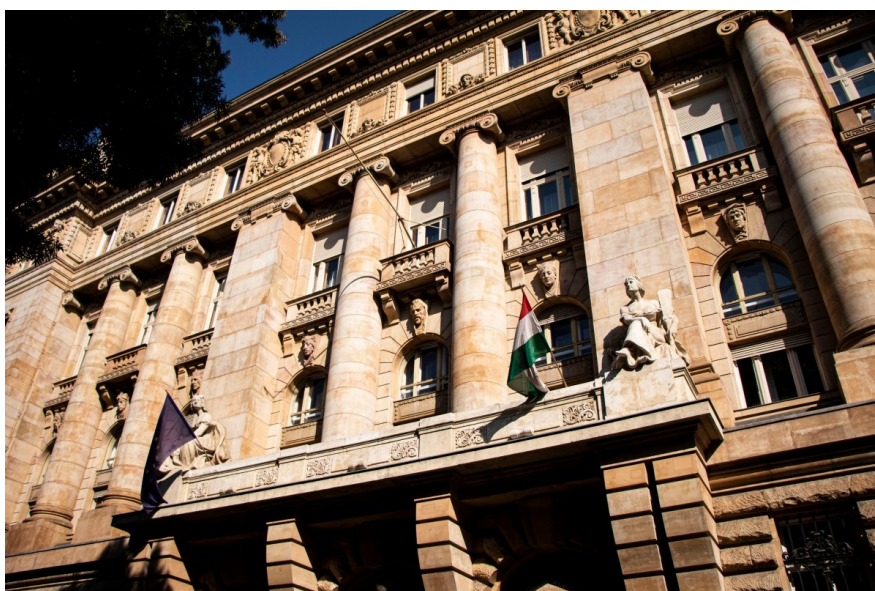


## National Bank of Hungary Review: A new beginning without commitment

The National Bank of Hungary walked the talk, beginning its dovish pivot with a rather symbolic step. The 450bp technical cut in the top end of its rate corridor might be followed by cuts in the effective rate in the coming months, based on the re-tuned forward guidance. Nonetheless, the fight against inflation continues



The National Bank of Hungary in Budapest

### Walking the talk

On 19 April, Deputy Governor Barnabas Virág sent a crystal clear signal that the Hungarian central bank's dovish pivot was around the corner. On 25 April, the Monetary Council walked the talk and cut the overnight collateralised lending rate (top-end of rate corridor) by 450bp to 20.5%. However, other rates in the interest rate complex remained on hold. We see this first step as a symbolic, inaugural move, which reflects a cautious and prudent approach.

The central bank could have cut more as a first step. The fact that it didn't suggests that while policymakers may welcome the recent positive developments, red flags remain. This is reflected in the NBH's explanation for its decision: "in response to the reduction in the risks of extreme scenarios, the Council has decided to narrow the interest rate corridor." With the recent cut, there is a 250bp difference between the effective rate and the top-end of the corridor, which

matches the situation before the emergency measures introduced in mid-October.

## Fight against inflation continues

The central bank continues to differentiate between the issues of price and market stability. The former will be cured by the base rate and the Monetary Council highlighted that the 13% base rate is still on permanent hold. Decision makers also warned against stickier-than-expected price pressures in several countries and the possibility of a longer recovery based on core inflation indicators. If inflation risks warrant it, a higher-for-longer scenario is possible in Hungary as well, a clear hawkish commitment, in our view. Market stability is managed by the overnight tools (previously known as temporary, targeted tools), especially the quick deposit tender at an 18% interest rate. As only market stability has shown convincing improvement, the central bank remains committed to its fight against inflation.

## Cautious and prudent, the newest catchwords

The NBH referred several times to improving risk sentiment and cited the easing concerns about the US and European banking sectors, the inflow of capital into emerging markets and the approaching end of the Federal Reserve and the European Central Bank rate hike cycles. In parallel, the reversal of energy prices and the improving external balances also pointed towards a marked improvement in risk sentiment both globally and towards Hungary.

In general, we can say that it was a rather cautious first step towards easing without any clear commitment. As the forward guidance notes: “The central bank will take into account the persistence of improvements in risk perceptions at the following policy meetings before making a decision to setting the interest rate conditions of overnight instruments”.

The central bank stands by its cautious and patient approach and highlights that even if conditions are right, the easing will be gradual. Deputy Governor Virág specifically mentioned that any rate cut decision will come only at a rate-setting meeting, even if we are talking about the overnight tools. Also, the central bank continues to value the importance of clear and forward-looking communication, while it will constantly monitor market reactions and forward-looking rate expectations.

In this regard, Virág noted while answering a question that the market is pricing a merging of the base rate and the effective rate by autumn and that this seems like a fair assumption. However, he immediately added that the convergence will be gradual and will depend on risk sentiment. Again, this reflects the recent NBH mantra about cautiousness and prudence.

## Our market views

Given the market reaction, it seems that the market expected more from the NBH today and the central bank prefers to be on the cautious side. Given that the market has been pricing in swift rate cuts for a long time and has been waiting for this moment basically since the beginning of the year, it may not be that painful for the forint. Moreover, the EU story is developing in a good direction. At the global level, conditions for the region remain generally positive, with the forint benefiting the most among its CEE peers. At the local level, FX carry in Hungary remains by far the highest in the CEE region after today and nothing will change in the coming months on this front. Thus, overall, we believe the right conditions persist for the forint to continue to retain market interest. On the other hand, the market's position is probably already long despite last week's sell-

off and the direction of monetary policy is clear after today. Thus, given the NBH's cautious approach, we can remain positive on the HUF, but we cannot expect a continuation of the rally as in recent weeks but rather a sideways move in the current range of 370 and 380 EUR/HUF depending on the progress in the EU story and the NBH's boldness in the coming months.

In the rates space, the IRS curve moved up slightly again after the press conference, indicating that the market was expecting more. However, even so, it appears the market may be disappointed again later that monetary policy normalisation is not proceeding as quickly as priced in, just as we saw in the first quarter. The direction at the moment is clear - a lower and steeper curve, but market volatility and liquidity may be tricky again in this case. On the Hungarian government bond (HGBs) side, although we see some fiscal risks, funding is safely under control. According to our calculations, the debt agency (AKK) has secured about 28% of the planned HGBs issuance since the beginning of the year. However, if we take into account the strong activity in retail and FX bonds, AKK has roughly secured about half of its total borrowing needs for this year. Thus, the combination of funding under control, monetary policy normalisation and a positive EU story can be expected to generate more interest from real money investors and HGBs can benefit the most from this situation.

### Hungary's bond issuance needs under control

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