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HUNGARY

National Bank of Hungary Review: A smooth end to a difficult year

It was a wild ride, but the National Bank of Hungary's latest rate-setting meeting has come to an expected end. The central bank cut its key interest rate by a further 75bp. While caution remained the buzzword, we've picked up some hints of a possible shift to more rapid easing in the coming months.



The National Bank of Hungary in Budapest

10.75%

As expected

Key interest rate

ING forecast 10.75% / Previous 11.50%

Expected change with an unexpected twist

The National Bank of Hungary (NBH) reduced its base rate by 75bp to 10.75% at its December rate-setting meeting. At the same time, the entire interest rate corridor was lowered by 75bp, maintaining the symmetry of the +/- 100bp range.

The decision was once again unanimous but the Monetary Council deliberated over a different menu of options compared to the October and November meetings, meaning that rate-setters chose between a 75 or 100bp cut (the 50bp option from the previous meetings was dropped). While the statement and press conference pretty much reiterated the central bank's familiar cautious stance, there were some minor tweaks to the messaging - just enough to meaningfully open up the possibility of a dovish shift in the easing cycle.

The dismissal of the possibility of a hawkish shift from previous meetings is entirely justified, as incoming macroeconomic data has pointed to continued improvement. Hungarian inflation came in as low as 7.9% year-on-year, with the underlying monthly repricing showing patterns similar to price stability (using the annualised quarterly price index). Moreover, the inflation outlook has also improved somewhat with lower commodity prices, ongoing global disinflation and falling longer-term bond yields in core markets.

Cautiousness remains a cornerstone

In terms of future risks, the central bank pointed to the same external threats that were mentioned a month ago. Geopolitical tensions and sanctions are still with us, and we can't rule out another shock to energy and commodity markets (see the recent Red Sea crisis). The armed conflicts in Ukraine and Gaza mean the economic landscape is highly unpredictable. On the macroeconomic side, there are ongoing labour market tensions and recessionary fears in the international environment.

And while the NBH tried to stick to its cautious approach, it was hard not to see a slight shift in tone towards dovishness. A key story here was the progress made on the EU fund agreement and the emphasis placed on the possible dovish shift by the Federal Reserve and the European Central Bank in 2024. Against this backdrop, the Monetary Council maintained its cautious approach but also opened the door to a more dovish pace of easing in the near future.

The alternative scenarios have got a dovish update

Though we don't want to go so far as to say that the move from 75bp to 100bp is a sure thing in January, the central bank has definitely put the writing on the wall. Our three main points of emphasis here would be the following:

1. The indication that the policy rate could be in single digits *in the near future* is an important new message, as it is less explicit than the previous forward guidance that it would be in single digits *in February*. With 100bp of easing, we could reach single digits as early as January.
2. Speaking of forward guidance, the last sentence has also changed. It now includes a reference to a decision on the optimal pace of cuts, noting that in its data-driven approach, the central bank might be ready to consider shifting the pace of easing (on the dovish side) if the situation warrants it.

3. Regarding alternative scenarios, the NBH presented six possibilities, of which three were identified as main scenarios. Of these three, two see possibilities for lower inflation than in the baseline. As a result, the central bank now sees the risks to the inflation outlook as tilted to the downside. This is a new development compared to the previous Inflation Report, which highlighted two pro-inflationary scenarios against a single disinflationary one.

Overall, while the actual outcome of the December rate-setting meeting was in line with expectations and provided a smooth end to a difficult 2023, it also brought a new, dovish spark. If market stability is maintained, domestic macroeconomic indicators continue to improve and risk sentiment also improves, we see the next meeting as being live, with policymakers deciding between a 75bp or 100bp rate cut.

The updated GDP & CPI forecasts

The full macroeconomic assessment and outlook will be published with the December Inflation Report on 21 December. The NBH revised down the short-term GDP growth outlook in line with the latest incoming data, forecasting a full-year recession in 2023. The outlook for 2024 has also been revised downwards by 0.5ppt to 2.5-3.5%, mainly due to risks related to external demand.

The forecast range for inflation in 2023 was narrowed to 17.6-17.7%, with the middle of the range slightly lower than before. There was a small (dovish) change in the forecast range for 2024, with the upper end of the range being lowered by 0.5ppt. This puts the new projection in the 4.0-5.5% range. While the central bank sees the CPI returning to the tolerance band in a sustainable manner in 2025, this is the same forecast as in September.

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