

National Bank of Hungary review: Back to 75

The National Bank of Hungary erred on the side of caution with a 75bp cut, slowing the pace of easing in March. The forward guidance is as hawkish as expected, pointing to a further slowdown in the rate-cutting cycle during the second quarter. We still see the terminal rate at 6.5%



The National Bank of Hungary cut the key interest rate by 75bp to 8.25% but sent a hawkish signal for the second quarter

8.25%

Key interest rate

ING forecast 8.25% / Previous 9.00%

As expected

Market stability made the difference in March

After a brief, temporary acceleration in February, the National Bank of Hungary (NBH) again erred on the side of caution at its March rate-setting meeting. While the macroeconomic fundamentals alone would have allowed the pace of easing to be maintained at 100bp, the unfavourable turn in

the risk complex over the past month was a deal-breaker.

As a result, the Monetary Council decided on 26 March to cut the key interest rate by 75bp to 8.25% and to maintain the symmetry of the interest rate corridor with similarly large cuts at both ends. Given that the median of market forecasts was ultimately in line with the actual decision, we can't call the outcome a surprise. If anything, the unanimity behind the 75bp move can be described as a surprise. And the fact that a 50bp easing was also on the table (alongside the 75bp and 100bp cuts) is very telling and suggests to us that the NBH is indeed shifting to a more hawkish stance even before the well-publicised change of era in the second quarter of 2024.

The central bank defines the boundaries of the playing field, sort of

While the statement and press release were generally orchestrated to send as many hawkish signals as possible, it did not go so far as to set in stone any forthcoming decision. The central bank has ended the era of rapid easing and remains cautious, disciplined and data-driven in its approach to future rate settings.

The telegraphed slowdown in the easing cycle in the second quarter could be seen as a sign that the NBH will reduce the pace of hikes at some point in the next three rate-setting meetings. This means that we can't rule out a repeat of the 75bp easing in April. During the Q&A session in the press conference, Deputy Governor Virág also avoided clearly ruling out the possibility of a 75bp move going forward. Last but not least, Mr Virág stressed at the press conference that the Monetary Council considers the 6.50-7.00% range (narrowing from the previous 6.00-7.00%) as the most realistic for the policy rate at the end of June. Connecting all the dots, it seems that the new menu card would include 50bp and 75bp moves as a base case.

The forward guidance shows only a nuanced but really important change, supporting the overall hawkish tone of the rate-setting meeting. The Monetary Council sees a temporary rise in domestic inflation from the middle of the year (which we fully agree with), but also sees the global disinflation process and international investor sentiment as key risks. As a result, a careful approach to monetary policy is warranted in the coming months. In our view, this is yet another (and additional) hawkish reference pointing to an approaching downshift in the decision-making process.

We expect the easing to last only until June

This new and narrower playing field (the 6.50-7.00% range for the policy rate by end-June) is still in line with our base case of a 6.50% policy rate after the June rate-setting meeting. To get there, however, we need to factor in another 75bp cut in April before the slowdown to 50bp. In our view, it is far too early to call the April move, so – at this stage – we leave our call unchanged, but raise the possibility of a 50bp move if warranted by incoming macroeconomic data and market stability issues.

As for the outlook further ahead, the central bank has wisely decided to keep its cards close to its chest. The only significant (albeit implicit) statement comes from the fact that the Monetary Council pushed back against the dovish extremes beyond the median range of year-end forecasts, implicitly suggesting a policy rate of 6.00-6.50% by the year-end. This means that a further slowdown in easing or even a pause in the cutting cycle in the second half of the year is on the

cards. This would be in line with our outlook for interest rates after June, which sees the policy rate at 6.50% as the mid-cycle terminal rate. This level of the policy rate would still maintain a positive real interest rate environment, together with a substantial risk premium over regional peers, thus supporting HUF assets.

The updated GDP and CPI forecasts

The full macroeconomic assessment and outlook will be published with the March Inflation Report on 28 March. The NBH revised down the short-term GDP growth outlook in line with the latest incoming data and deteriorating external demand, forecasting GDP growth of 2.0-3.0% in 2024, half a percentage point lower than in December. The forecasts for 2025 and 2026 remain unchanged. These moves are fully in line with our expectations and the forecasts are also in line with our baseline projections.

The forecast range for inflation in 2024 was also lowered by 0.5ppt compared with the December staff projection. As a result, the central bank sees the pace of price changes in the range of 3.5-5.0% on average this year, which contains our base case forecast (4.5%). Maintaining the relatively wide range means that the staff still sees considerable risks to inflation.

Speaking of which, in the March Inflation Report, the press release mentions three main alternative scenarios, two of which see downside risks to both GDP and the inflation outlook, meaning that the central bank is keeping the overall balance of risks tilted to the downside. This is no change from the previous communication. The central bank sees CPI returning to the tolerance band in a sustainable manner in 2025, the same forecast as in December and matching our view.

Our market views

EUR/HUF stabilised at 396 after the end of the press conference, which is stronger than previous days but still weaker than last week. The initial HUF strength and subsequent correction indicates that the NBH's hawkish tone did not resonate as much as one might think, which in our view leaves the HUF fragile. A little hope comes from the rates space where we see the entire curve slightly higher, which if we see more repricing tomorrow could support FX. Otherwise, however, we are more likely to see a re-weakening back to the 397-398 EUR/HUF range.

Looking further out the picture doesn't look rosy for FX either, especially going into the second quarter with the looming uncertainty regarding the European Parliament's lawsuit in relation to parts of the EU funds and the approaching EU and local elections. The NBH thus has to rely on the start of the global rate-cut cycle to keep FX in check if it wants to cut rates further in the coming months. Thus, we are likely to see higher volatility in the coming months than in the first quarter with our forecast of 405 for the end of the first half of the year.

The rates space picture hasn't changed much after today. The IRS curve has repriced up only slightly, however, looking at short-term expectations for this year we find the current market pricing fair with some likelihood of small cuts in the second half of the year. The market sell-off has gone too far in our view and the belly and long-end curves have moved too high pushing the long-term policy rate well above 6%. In particular, we find the long end of the curves attractive and

believe that once things calm down, market interest will return given the levels relative to CEE peers and core rates.

In the IRS space, we see room for more flattening of the curve due to the narrative of a slowdown and pause in the cutting cycle now, but more rate cuts later and at the same time still an attractive inflation profile within the CEE peers. Looking at 2s10s, we should see a flatter curve that also provides an attractive carry.

In the Hungarian government bonds space, we have seen significant frontloading and buybacks in recent weeks, to prepare for the upcoming increase in this year's budget deficit. However, the auctions met with significant demand, almost the highest in the CEE region in bid-to-cover terms. With the assumption of 4.5% of GDP for this year's deficit, according to our calculations, roughly 40% of the total issuance of HGBs is covered, which provides sufficient comfort for the bond market in case of the risk of further fiscal slippage, which is one of the reasons why we are positive on HGBs at the moment, especially the long end of the curve.

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