National Bank of Hungary review: Delivering the promise

The National Bank of Hungary simplified its monetary policy toolkit, narrowed the interest rate corridor, and delivered on its promise with an effective rate cut of 100bp. We see a cautious and circumspect central bank in the coming months, with a positive real interest rate as the main target

The National Bank of Hungary in Budapest

Easing continues but changes are coming

The National Bank of Hungary (NBH) kept its promise at its September rate setting meeting. The base rate remained unchanged at 13%, while the Monetary Council re-symmetrised the interest rate corridor with a range of +/- 100bp. As a result, the overnight collateralised lending rate (the upper end of the interest rate corridor) was set at 14%, while the interest rate on the overnight deposit facility sits at 12%.

More importantly, the central bank lowered the effective rate (the overnight quick deposit tender rate) by 100bp, bringing it to the same level as the base rate. These measures mark the beginning of the second phase of monetary policy normalisation. The next major change in this new era is coming on 1 October, when the central bank is phasing out its overnight quick deposit tender. From then on, excess liquidity is expected to flow into the reserve account as excess reserves, where the interest rate is set by the base rate. This makes the reserve account as the main monetary policy instrument, as the reserve account will be available to banks without an upper limit.

As the banking sector remains over-liquid, the NBH is maintaining the overnight FX swap tenders (rate is the base rate minus 100bp), the one-week central bank discount bills and the long-term deposit facility (rates tied to the base rate) to provide a wide range of options to absorb the excess liquidity from the market. These tools will continue to help improve the monetary transmission and serve as a cushion at quarter and year-end to reduce interest rate volatility in sub-markets.

The forward guidance gets an update

September's action was fully in line with our latest expectations and the communication also contained no real surprises. In general, the tone of the statement and the press conference was hawkish, as the central bank highlighted several times the need to continue the fight against inflation. The Monetary Council's approach remains cautious and circumspect as well. The central bank will follow incoming data and inflationary risks and also consider the market stability (practically FX market) in its upcoming decisions.

Unlike in August, during the press conference, Deputy Governor Virág wasn't ready to comment interest rate expectations as clear as a month ago. This keeps the door rather open to every option from 0 to 100bp cut in October, in our assessment. To get a bit closer to the expected size of the cut, we think the key data point to follow will be the incoming September inflation print (release date: 10 October). Our conclusion based on the following sentence highlighted in the press conference: "With the acceleration of disinflation, the domestic real interest rate will move to positive territory in September, then it will continue to rise gradually".

Why we see a hawkish repricing

According to ING's latest forecast, September headline inflation could be around 12.4%, which will clearly close the door in front of a 75bp or a 100bp easing should the NBH see a positive real interest rate (ex-post) after its October decision. What can be a factor here as well is the EUR/HUF level and volatility. Shall we see a lower-than-expected September inflation print, that might reignite some dovish expectations and as the NBH reaction function contains market stability, such a move in FX might push the Monetary Council towards a more hawkish stance. Against this backdrop we stand pat, and we call for a non-consensus 25bp rate cut (or maybe 50bp) in October and November.

What makes the outcome of the September rate setting meeting rather hawkish is the updated inflation outlook and the mantra that the NBH will support growth via its fight to lower inflation in 2023 and 2024. This is the Hungarian version of "higher for longer" monetary policy mantra.

The updated GDP and CPI forecasts

The full macroeconomic assessment and outlook will be released with the September Inflation Report on 28 September. The NBH revised the short-term GDP growth outlook downward, incorporating the possibility of a full-year recession in 2023. After a (-0.5)-0.5% economic activity this year, the next two years growth could be balanced and around 3-4%. This is in line with what we were suggesting in our preview note.

The forecast range of inflation in 2023 was narrowed to 17.6-18.1% pushing the middle of the range higher than previously. There is a 0.5ppt upshift in the forecast range in 2024 to 4.0-6.0%, reflecting the carry-over effect of higher fuel prices. The central bank sees the consumer price index returning to the tolerance band in 2025.

Regarding the alternative scenarios, out of the six outcomes, four are pro-inflationary and among the most probable three risk scenarios, two are with higher inflation (faster recovery in consumption, capital withdrawal from emerging markets).

Our strategy

The NBH has formally completed the first phase of monetary policy normalisation, but it is clear that the forint will continue to be a key variable for further rate cuts. EUR/HUF is back to 390 following the press conference after a brief move down. However, we think the market needs some time for the dust to settle and digest the new NBH communication. In coming days, we can see higher volalitily and even touching higher levels with EUR/HUF closer to 393. But in the longer-term, the rate repricing already indicates a stronger forint in our view, with more rates repricing to come. The 2y interest rate differential against the euro has widened for the first time in a long time and is back to its level of ten days ago. We thus remain positive on the HUF and expect stronger levels later. Looking ahead, given our non-consensus call for less aggressive easing, we expect to stay on the hawkish side pushing further rates repricing, which should keep the forint supported.

The IRS market has moved up across the curve by roughly 8-12bp with a small flattening bias in line with our expectations, however, the main part of the story will come later in our view. Still the market is expecting more rate cuts in the 75-100bp range from October to the end of the year, which is way too much compared to our call. Thus, incoming inflation data, further NBH communication and the October meeting should be enough reasons for the market to reassess dovish expectations. So, for now, we are keeping our tactical bias for a higher and flatter curve, which we think has outpaced NBH normalisation with its steepening and will have to pull back a bit.

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