National Bank of Hungary Review: Higher for longer

The NBH raised the base rate by 100bp, while committed to a longer and bigger tightening cycle. The forward guidance was as hawkish as possible. In our view, the central bank is far from the end of the tightening cycle and we maintain our above 8% terminal rate call. We expect money markets to also price in more aggressive tightening.

The National Bank of Hungary in Budapest

4.40%

Hungary's base rate

ING forecast 4.40% / Previous 3.40%

As expected

Higher inflation warrants higher rates

The National Bank of Hungary raised the base rate and the whole interest rate corridor by 100bp at its March meeting. With that, the base rate now sits at 4.40%. The step size is bigger than what we saw in the pre-war period and it reflects the central bank's commitment to fight inflation. As we suggested in our preview note, the NBH puts more emphasis on the upside risks in inflation than on the downside risks in economic activity.

In contrast with the previous regular rate setting meetings, the central bank didn't give any clear guidance regarding the one-week deposit rate decision on Thursday. However, the main message of the Monetary Council was clear: the monetary tightening needs to shift gears and the cycle will be longer and will move forward with bigger steps.

Despite the statement referring only to the base rate tightening cycle when it comes to hikes by a larger increment than before, we believe that this will be true for the one-week deposit rate hike cycle as well. We expect the National Bank of Hungary to raise the one-week deposit rate by 50bp, an upward adjustment from 30bp increments at regular monthly rate decisions.

We base our view on the latest macroeconomic projection which reflects the significantly changed inflation outlook, again. There have been ongoing upward adjustments since the Covid-reopening shock. Then came the energy price shock and the agricultural price shock and now we are facing another round of upside pressure stemming from the impact of the war and related sanctions.

We see the NBH's CPI outlook as realistic, with inflation set to came in somewhere in the 7.5-9.8% range in 2022. We see the actual outcome as much closer to the upper end of the range. But what is more important is the 2023 outlook, which sees average inflation in the 3.3-5.0% area. In line with that, the Monetary Council highlighted that it is expecting price dynamics to reach the 3% inflation target consistently only during the first half of 2024.

NBH Preview: Committed to tackling inflation

FX and rates markets to reflect the "higher for longer" pledge

The central bank's commitment to maintaining tighter monetary conditions for a longer period, and the continued pledge to being flexible with its decisions if money market moves warrant this, can provide strong support for the forint. The central bank will continue its FX swap activity to provide EUR liquidity to ensure a smooth transmission mechanism as well. In our view, even in a roughly unchanged risk-taking environment, the hawkish central bank will help HUF below 370 in the short run.

In the last two days, the market has boosted pricing again but we still see room, especially on a nine-to-twelve-month horizon, to move market expectations closer to our terminal rate in the range of 8.00-8.25%. On top of that, market pricing seems still lagging the recent "higher rates for longer" pledge of the central bank, probably pricing in a too early start and a too swift easing cycle.

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