

National Bank of Hungary Review: Making it simpler

The National Bank of Hungary created a cleaner situation, levelling the base rate and the 1-week deposit rate at 7.75%. In our view, this was a necessary step to boost market confidence in the bank's hawkish aspiration. In turn, the 50bp effective rate hike cannot be called extreme, and other risk factors will keep Hungarian assets under pressure



The National Bank of Hungary in Budapest

7.75% Hungary's base rate
+185bp

Decisive continuation of the tightening cycle

The Hungarian central bank made a huge splash in the middle of a heatwave in June. It raised the base rate by 185bp to 7.75%. Alongside with that, the whole interest rate corridor was moved up by 135bp. This means that the O/N deposit rate was moved to 7.25%, which means the bank has

finally separated this deposit rate from the base rate. The upper band of the corridor, the O/N repo rate now sits at 10.25%.

The National Bank of Hungary (NBH) also made a pre-commitment to hike the 1-week deposit rate by 50bp to 7.75% this Thursday. This means a bit quicker pace of effective tightening as the last step size was 30bp. What is even more important, that from now on, the 1-week deposit rate and the base rate are at the same level. This makes the monetary policy toolkit – or at least the communication about that – simpler and easier to understand. With this decision, the NBH got rid of an element which has kept the market participants confused and less convinced about the hawkish commitment of the central bank.

This decision itself hasn't eliminated all the hurdles on this extremely difficult monetary policy obstacle course. And though a big one was made to disappear; it can hardly be considered a panacea. The looming rule-of-law debate between Budapest and Brussels, recession fears, the war and sanctions, security of energy supply, twin deficits and inflation are all remain determinant for markets.

Speaking about risks, the Monetary Council sees that the upside risks to inflation have strengthened further, while the latest staff projection shows a significantly higher path of inflation. This means an 11.0-12.6% average inflation in 2022 and a 6.8-9.2% range in 2023, according to the latest Inflation Report. The details behind the surprisingly high forecast will be released on Thursday, but we think the NBH's forecast contains the technical assumption of ending the price caps on 1 October (based on the latest official ruling).

The forward guidance became more hawkish, flipping the continuation of the tightening cycle to “decisive” from “gradual”. With this, we see a clear upside risk to our 9.25% terminal rate call, as the NBH committed to continue its decisive tightening cycle at least until inflation peaks. If 50bp step sizes remain the base case decision on a monthly basis, we will end up at 9.25-9.75% in September-October, where we see the highest probability for inflation to peak.

FX and rates markets reaction

The market has moved massively higher, especially at the short end of the curve today, resulting in a bear flattening to new record levels. However, the long end of the curve has only returned to previous levels or just slightly higher, confirming our earlier view that there is not much room to rise. So, the whole story is playing out at the short end, which will be the case for the months ahead as well. Our strategy thus remains unchanged. The FRA market remains illiquid and too expensive to hold. Therefore, we see more beneficial to look beyond the currently priced terminal rate horizon, meaning the 1y-3y segment with neutral or positive carryroll.

Hungarian government bonds (HGBs) have richen in ASW terms and it will take a few days for the dust to settle, but we expect HGB yields to start catching up to the current IRS move soon and bring a slight widening of the spread again. Although we can see some buying interest in the coming days, we believe the time is not yet right, especially with the summer months potentially bringing zero liquidity to the market. However, today's meeting has once again pushed the HGB market forward and, as with the forint, we believe their time will come soon.

The 2y IRS differential against the euro moved to new records after today's meeting and is the highest since 2008. However, the story is not changing. Despite the surprise today, the forint remains in the grip of external factors. In the short term, we expect the rate differential to widen

further in the coming days, adding some more support to the forint. However, we believe that under current conditions there is room for appreciation only towards the 395 level. In the long run, not much has changed in our view. The forint continues to be our least favourite currency in the CEE region, but we continue to watch headlines signalling a turnaround in the Rule of Law and EU funds disputes that should unlock the hidden potential of the forint in the second half of the year (perhaps in September).

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