National Bank of Hungary Review: Normalisation seasoned with hawkishness

The National Bank of Hungary cut the effective rate by 100bp to 17%, stepping into the era of effective normalisation. However, this normalisation remains a condition of the persistence of market stability. The central bank insists on a cautious and gradual approach

The National Bank of Hungary in Budapest

Normalisation has started in line with expectations

On 23 May, the Hungarian central bank started effective normalisation, which shouldn't surprise anyone who has been listening to the bank's communication since the previous rate setting meeting. The move and the tone were in line with our expectations as well.

The Monetary Council decided to cut the overnight collateralised lending rate (top-end of the rate corridor) by 100bp to 19.5%. More importantly, the central bank announced that from 24 May, the interest rate of the overnight quick deposit tender will be lowered to 17%. This means a 100bp effective rate cut. Similar changes are coming to the interest rate of the overnight FX swap tender.

The National Bank of Hungary's communication – based on the statement and the press conference – has remained cautious and hawkish, in general. So, despite the easing measures, we see a central bank which keeps defining the series of normalisation steps ahead as a function of financial market stability. In our view, this means that nothing is carved in stone, every meeting is a live meeting, where incoming data and changes in market sentiment are important.

However, if the trend-like improvement in market stability prevails, we think the gradual approach in the normalisation means that the step size of the rate cuts will remain at 100bp.

Inflation remains the number one public enemy

It was impossible not to notice how strongly the central bank emphasised the separation of market stability and price stability, yet again. The clearest sign of this was that both Governor Matolcsy and Vice Governor Virág several times repeated during the press conference that inflation remains the number one enemy and the fight against inflation must continue. In parallel, tight monetary conditions must prevail to reach price stability over the monetary policy horizon. Thus a cut in the base rate is firmly not on the table, maintaining the current level of the base rate over a prolonged period is necessary.

What we also evaluate as a hawkish remark – though this is not necessarily a new message – that by the end of the year, the real interest rate will turn to positive territory, which is a must to support the disinflation process next year. In our assessment, this also suggests the perseverance of the tight monetary conditions, supporting the message of a permanent hold in the base rate, maybe extended into the period when the base rate and the effective rate will be merged.

The series of hawkish remarks continue with a new message in the press release as well. “Looking ahead, strengthening monetary policy transmission is also an important factor of achieving price stability. For this reason, the central bank will use the instruments to absorb interbank forint liquidity on a long-term basis in the coming period”. This means, that monetary tightening via the liquidity channel remains intact as well.

Weighing all important messages and steps by the National Bank of Hungary at its May rate setting meeting, our bottom line is that this was a strongly hawkish-flavoured rate cut.

How will the easing cycle be shaped?

According to our expectations, the central bank – if everything goes according to plan – will merge the base rate and the effective rate at 13% at its September rate-setting meeting. This would mean a series of 'copy-paste' decisions based on the May moves. In accordance with this merging, the interest rate corridor with a width of 300 basis points that existed before mid-October will also be restored. This would translate into an interest rate corridor with the repo rate at 15.5% and the depo rate at 12.5%.

Looking further down the road, before the first cut to the base rate (which we see in December 2023), we give a significant chance to have another indicative or symbolic decision, which will precede the actual base rate cut: making the interest rate corridor symmetrical again around the base rate a month before the cut to the base rate.

Our market views

After the end of the press conference, we found the IRS curve significantly lower especially at the short end resulting in a significant bull steepening. The steeper and lower curve has been our view since Deputy Governor Virág's interview in mid-April when the start of monetary policy normalisation was signalled, and we believe this will be the story for the months ahead. We will see the dust settling in the coming days and the release of inflation in two weeks should confirm the NBH's commitment to continued normalisation, as lowering inflation will help to preserve or improve financial market stability. Looking at 2-10y spreads across the region, we see that Hungary still has a large gap to close. Moreover, at the long end of the curve rates are facing upward pressures from the current wave of global hawkishness.

On the Hungarian government bond (HGBs) side, although the fiscal side poses some risks, as in the rest of the CEE region, the funding seems fully under the control of the debt agency. The increased issuance of HGBs in recent weeks has almost closed the gap between Hungary and the CEE region, covering about 41% of the planned issuance. Together with retail and FX issuance, we thus estimate that the agency has secured roughly 57% of this year's total needs. This, in our view, will thus allow HGBs to rally further when pressure from core rates eases.

The Hungarian forint remains unsurprisingly on the weaker side after the NBH press conference, but remained close to earlier levels, suggesting that the market is satisfied with the pace of monetary policy normalisation. The EUR/HUF level will thus continue to allow the central bank to continue in this direction. We continue to see a working framework for the coming weeks in the 370-380 EUR/HUF range and believe that the market will use the current weaker levels as a new entry point to build positions in the forint to benefit from still very attractive carry. Moreover, given the rather pessimistic market expectations, we see potential upside risks on the EU funds side of the story. Overall, we thus expect EUR/HUF to move rather below 375 EUR/HUF and if we see positive surprises, we may even return to 370 but we see a more significant move below this level only later this year.

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com