

National Bank of Hungary review: Rate cuts move to fast-track lane

The National Bank of Hungary took advantage of the structural improvements, scaling up the rate cut to 100bp in February. This acceleration in easing is temporary. The central bank is only frontloading, as its mid-year rate expectations did not change. We still see the terminal rate at 6.5%



The National Bank of Hungary cut the key interest rate by 100bp, up from a 75bp cut in January

9.00%

Key interest rate

ING forecast 9.00% / Previous 10.00%

As expected

The relative calm in the financial markets opened the window

In contrast to January, the National Bank of Hungary (NBH) was able to accelerate the cycle of interest rate cuts this time, thanks to the relative calm in the financial markets, which coincided with improving macroeconomic fundamentals. The noise in the financial markets was the main

problem in January, but in the view of the central bank these disturbing factors have disappeared, so this time it didn't hesitate to pull the trigger.

As a result, the Monetary Council decided to cut the key interest rate by 100bp to 9.00% at the February rate-setting meeting. While market participants were torn between the 75bp and 100bp options, we can't say that this was a big surprise. At the same time, the entire interest rate corridor was cut by 100bp, thus maintaining the symmetry of the +/- 100bp range.

The central bank is frontloading the easing

When it comes to the details, the press conference and the statement emphasised the same thing: this acceleration of the rate cut cycle is only temporary. Given the very aggressive pricing of rate cuts in the market, we think this is the single most important message. The Monetary Council also emphasised, that the interest rate level it expects for the middle of the year (end of June) has not changed. In our view, this means that the central bank is only frontloading the easing cycle.

Regarding the future path of interest rates, the NBH provided the markets with important nuggets. First, the Monetary Council is satisfied with the recent market pricing of the interest rate in the range of 6.00-7.00% by the end of the first half of 2024. This is fully in line with ING's base case of a 6.50% policy rate after the June rate-setting meeting.

The actual forward guidance in the statement was unchanged, as the expected level of interest rates at mid-year was also unchanged. The tone remained as cautious as possible, with the NBH emphasising the mantra "do not be complacent" and "focus must remain on price and market stability". Today, the central bank proved once again that it is dynamics and not nominal levels that matter when it comes to market stability.

We expect the easing to continue until June

Where levels really matter is in the inflation outlook. The central bank has emphasised that the near-term inflation outlook has been downgraded by around 0.5ppt, giving monetary policy more room to manoeuvre. Of this extra 50bp room, 25bp was used up by the February rate cut upscale, suggesting that while the menu will remain unchanged in March (75bp or 100bp cut), barring a major surprise, the base case is now a 100bp cut, in our assessment.

The central bank leaves no doubt that it is prepared to deviate from this size in the future. All meetings are live and all decisions are made on a case-by-case basis. In this respect, a crucial message is that the March Inflation Report will be particularly important in assessing the pace of further rate cuts in the second quarter of 2024.

In our view, this reinforces our call that the decision in March will be between 75bp and 100bp, but after that a whole new 'menu card' will come into force. As we see inflation stabilising around recent levels in the coming months, while expecting two rounds of reflation with headline inflation at 5.5-6.0% year-on-year at the end of the year, we think that this menu card will include smaller rate cuts (50-75bp).

Recent market pricing of second half of 2024 rate cuts looks overdone

Against this backdrop, our base case is now a 100bp easing in March and a continued easing cycle

until June to reach 6.50%. After that, we see a new chapter beginning. Our year-end inflation forecast for December is around 5.7% YoY, which leads us to believe that the terminal rate cannot go lower, especially as we know that the central bank is inclined to maintain a positive real interest rate environment.

In this respect, we expect the NBH to pause for a while after June, which is why we see the 6.50% policy rate at the end of June as a mid-cycle terminal rate. This level of the policy rate would still maintain a positive real interest rate environment, supporting HUF assets. Against this background, we believe that the recent market pricing of interest rate cuts in the second half of the year is exaggerated.

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