National Bank of Hungary Review: Rate hikes continue

The National Bank of Hungary pulled the expected, doing a copy-paste of the January decisions. The Monetary Council admitted the escalation of upside risks in the inflation outlook, increasing the chance of a lengthier tightening cycle. Despite the continued hawkishness, FX and forint assets remain vulnerable to external developments

National Bank of Hungary in Budapest

3.40%

Hungary's base rate

ING forecast 3.40% / Previous 2.90%

As expected

We move higher our call for the terminal rate

As we highlighted in our preview note, the National Bank of Hungary was indeed pushing the "Ctrl+C" & "Ctrl+V" buttons when it came to the rate hikes in February. The base rate rose by 50bp to 3.40% and the entire interest rate corridor moved up also by 50bp, like the January decision. Based on the press conference, this decision is going to be followed by a 30bp effective rate hike. Thus we see the 1-week deposit rate moving to 4.60% on Thursday.

The main message by the central bank was loud and clear: inflation risks moved further up. This is mainly based on the stronger-than-expected seasonal repricing in January, which was three-times more than usual. In addition, a wider range of goods and services were affected by this repricing than we used to see. As an icing on the inflation cake, both the retail sector and households' price expectations have been moving higher, suggesting further pipeline price pressure. And the cherry: economic activity is much stronger as well with labour market being close to full employment.

In this regard, the main target for the central bank remains the same: breaking the vicious cycle of self-strengthening inflation. To achieve this goal, the Monetary Council is ready to continue the tightening cycle which was accelerated in January. Moreover, the size of the rate hikes – as a base case – will continue to mimic the steps made in January and February. Alongside this, the central bank underscored that the convergence of the base rate and the 1-week deposit rate will continue.

We see the NBH moving the effective rate up by 30bp in each meeting in the coming months, accompanied with 50bp hikes in the base rate. This would mean a convergence of the two rates at 6.40% in August. This is now our base case scenario. Our view is backed by the hint coming from the NBH, that the higher-than-expected inflation path could result in a lengthier tightening cycle than initially calculated.

FX and rates markets remain vulnerable to external shocks

In our view, the February monetary policy decision won't be a game-changer for the EUR/HUF in the short run. For now, 355 will remain an anchor, especially as the central bank hinted at a lengthier tightening cycle. We wouldn't rule out a further acceleration in rate hikes based on the upcoming March Inflation Report, but there is too much noise out there: geopolitical tensions in Eastern Europe, the Fed's tightening cycle and the general election in Hungary. These risk events could push EUR/HUF temporarily back to the 360–365 area again, despite the ongoing tightening cycle.

Regarding the rates market, we don't see a significant chance that the NBH will under-deliver on recent rate hike expectations. In contrast, with the emphasis being put on the rising upside risks in the inflation outlook and taking into consideration the latest hint at the convergence of the base rate and the 1-week deposit rate, we see room for a repricing in rate hike expectations in money markets. We call the base rate and the effective rate to peak at 6.40% in August, while the market still expects the tightening cycle to top out at 6%. This means that both the short and the long end of the yield curve will move up further (the former to a greater extent).

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