National Bank of Hungary Review: Shifting gears on an uphill

The National Bank of Hungary raised the base rate by 50bp in May, signalled a 30bp hike in the 1-week deposit rate with a pre-commitment to hike in a similar fashion in June. We maintain our 8.25% terminal rate call with upside surprise potential. We saw a hawkish central bank, but as we expected, this wasn't enough to erase market scepticism

The National Bank of Hungary in Budapest

5.90%

Hungary's base rate

ING forecast 6.00% / Previous 5.40%

Pace of effective tightening remains unchanged

The Hungarian central bank raised the base rate and the whole interest rate corridor by 50 basis points at its May meeting. It fits the past weeks communication which flagged a coming shift from aggressive to gradual tightening. Now the base rate sits at 5.90%. The central bank made a pre-commitment to hike the 1-week deposit rate by 30bp to 6.75% on this Thursday. This means a maintained pace of effective tightening.

On top of that the NBH is committed to repeat these steps at its June rate setting meeting, raising the 1-week deposit rate to 7.05%. This can be seen as a new element in the forward guidance. In our assessment, the NBH was as hawkish as possible despite its emphasis put on graduality. The Monetary Council is prepared for a lengthy fight against inflation with probably higher rates for longer.

At its briefing, the central bank made it clear, that the end of the convergence of the base rate and the 1-week deposit rate won't mean that the tightening cycle has come to an end. The bank continues tightening until inflation won't reach the target in a sustainable manner over the monetary policy horizon, which means according to the Monetary Council's recent understanding that tightening continues in the second half of 2022.

For us, a key hawkish message and a difference-maker remark was when the NBH underscored, that stopping the tightening cycle is not an option in the foreseeable future and this option is not even close to be on the table. In general, today's decisions and communication are in line with our view. Thus we maintain our call for an 8.25% terminal rate or even higher if inflation risks worsen for which we see a significant chance.

FX and rates markets need time to digest

As we expected (see our NBH Preview), flipping the market's scepticism could prove very difficult and would take a masterstroke of communication to trigger such a turn immediately. Though we interpret the latest communication as more hawkish, yet it wasn't bold enough for investors to trigger an instant strengthening of the forint. Against this backdrop, we see EUR/HUF around 390 in the short run with a possible quick move to 380 should one of the external factors (war, rule-of-law debate, etc.) show early signs of improvement, reducing the risk premium.

On the rate side, since our NBH preview, the entire IRS curve has moved up 15-20bp in the last few days, resulting in a flatter curve. However, we still see room to go higher, and the coming CPI prints may be a good trigger. With the longer-end of the curve pricing in a NBH rate of around 6%, we see more value at the shorter end and in further flattening of the curve. FRA payers still makes sense for us, however, low liquidity and high cost of holding may be a problem these days. Therefore, it may be more beneficial to look beyond the currently priced terminal rate horizon, meaning the 1y-3y segment with neutral or positive carryroll. Although we believe the NBH will deliver a rate cut sooner than the market currently thinks, we are far away to get any official remark to this to change the market direction in our view.

On the bond side, the focus will eventually shift to the improved fiscal balance, thus a lower risk of excessive financing needs. This, along with our view that the looming rule-of-law debate will be settled, with positive news of an agreement starting to trickle in possibly in mid-3Q, could be good news for Hungarian government bonds. As we expected, the significant movement in the IRS curve in recent days has tightened asset spreads even further. It will likely take a few more days for the dust to settle, but we expect HGB yields to start catching up to the current IRS move and bring a modest spread widening soon.

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