

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.

Author

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.