National Bank of Hungary review: Sticking to the script

The National Bank of Hungary continued its normalisation cycle in July. The 100bp cut to the effective rate matches consensus. The emphasis remains on cautiousness and graduality, while the NBH underscored predictability too. The latter means that easing will continue at the previous pace if market stability prevails

The National Bank of Hungary in Budapest

The National Bank of Hungary did not change the pace of normalisation in July, and thus cut the overnight collateralised lending rate (top end of the rate corridor) by 100bp to 17.5%. More importantly, the central bank announced that from 26 July, the interest rate of the overnight quick deposit tender will be lowered to 15%. This means a 100bp effective rate cut. A similar sized change is coming to the interest rate of the overnight FX swap tender. In general, the changes in the rates were well-telegraphed in advance, making no waves in the summer lull, matching our preview as well.

Going through the press release and listening to Deputy Governor Barnabás Virág, we feel that the most important goal of the central bank was to convince market players that predictability stands above everything. Predictability translated into practice means that the pace of interest rate cuts remains unchanged. Thus, a lower-than-expected inflation print won't change the central bank's mindset. In our view, monetary policy is now like an "on/off switch". If market stability prevails, then the NBH will cut the rate by 100bp. This can be seen as a clear hawkish message in a disinflationary environment. The importance of the message is clear as this is the only new element in the July forward guidance.

The National Bank of Hungary made it clear once again, that price stability and market stability are separated. The recent stage of monetary easing is focusing on and driven by market stability. Thus, the main policy tools in this stage are the overnight tools, mainly the quick deposit facility which plays the role of the effective rate. Any decision regarding the base rate will come only after the convergence of the effective rate and the base rate. In this regard, the NBH did not talk about the base during this meeting.

Based on the commitment just made by the central bank, this convergence is due at the September meeting at 13%, barring a major market turmoil. Along with the convergence, we can have answers to the single most important question in late September: what's next? As the central bank will step into a new phase of easing with the convergence, we could see a reshaped monetary policy set-up with a new (and probably longer-dated) effective instrument succeeding the overnight tools. But regardless of the identity of the main instrument, the effective rate and the base rate will move in parallel, according to our expectation.

The September rate setting meeting will be also key due to the new Inflation Report, containing the updated inflation outlook of the central bank. The new forecast will give the hinterland for the NBH to decide about and maybe reveal its master plan regarding the next phase of the easing. In the spirit of cautiousness, our base case scenario sees a verbal signalling in September about the upcoming new phase, continued with a symbolic step in October. With that the symmetry of the interest rate corridor will be reinstated, lowering the whole corridor by 100bp, but leaving the base rate unchanged. Then the first change to the base rate comes in November, starting the series of 100bp cuts, in our view.

Our market views

Today's meeting did not bring much new for our view, and it seems that today's NBH assurance that the cutting cycle will not be accelerated is not surprising news for the market either. Our market view thus remains unchanged. EUR/HUF remains flat or slightly higher after the press conference. However, we expect the next days should be positive for HUF given that NBH is making it clear to the market that it does not want to jeopardise the carry of HUF assets for the rest of the year. Moreover, we see some improvement in conditions at the global level. So overall, we remain positive on the HUF.

In the rates space, we found the IRS curve a bit steeper after the press conference. 2s10s spread widened a bit again. We can expect the global central bank story to step in during the coming days, but beyond that we expect the steepening trend to continue in the coming months.

Author

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

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

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