National Bank of Hungary Review: Tightening continues

The National Bank of Hungary moved the base rate by +100bp to 10.75%. The forward guidance remained unchanged, favouring our view that the terminal rate could be around 13-14%. Market reaction was muted, showing that politics and geopolitics are the real drives of asset prices

The National Bank of Hungary in Budapest

10.75%

Hungary's base rate

+100bp

Central bank remains committed to tightening

Although market expectations were quite scattered about the size of this hike, the Hungarian central bank delivered on the hawkish ("decisive") side of the spectrum. The base rate was raised by 100bp to 10.75% and the central bank announced that the 1-week deposit rate will mimic this move later this week. In parallel, the whole interest rate corridor was moved up by 100bp. The last time, when Hungary saw a double-digit base rate was back in late 2008.

The tone of the briefing and the main messages of the press release have remained unchanged, which means hawkish. The central bank emphasised several times, that it will continue the tightening cycle at least until we won't be sure about the peak in inflation. Speaking about inflation, the central bank highlighted that the latest measures by the government are pro-inflationary. The change in the utility bill support scheme will have a roughly 3ppt additional impact (through 12 months starting from August) in the year-on-year inflation reading. However, as it (probably) won't have implications in the inflation over the medium-term (5-8 quarters), this won't change the monetary policy outlook.

When it comes to the economic outlook, the Monetary Council underscored that incoming high frequency data suggests a significant slowdown in GDP growth in June and July. However, the focus will remain on inflation as decision makers are seeing high inflation being a more toxic problem for the long run than a marked slowdown or recession. In our view, this means that despite Hungary perhaps facing a technical recession during the second half of this year, this won't hijack the central bank's tightening strategy.

In all, we see the outcome of the July rate setting meeting to be in line with our broader view. We affirm our call that decisive tightening will continue (with another 100bp hike in August) and the NBH will probably lower its step sizes to be in line with major central banks. We see the gradual slowdown in the tightening cycle with a 14% terminal rate with the last hike coming in December 2022.

FX and rates markets reaction

The NBH showed open arms to further rate hikes and confirmed the most open stance towards monetary policy tightening in the CEE region. If we abstract from the miserable summer liquidity and painful bid-offer spreads, Hungarian rates remain the only space for the region's rate payers, in our view. The market currently sees the terminal rate at 12.75%, well below our forecast. So, nothing changes on our view of the way up at the moment. However, outright trades in current market conditions could be very painful. Thus, we prefer to play the curve, 2s10s flattener, which could return to its record lows of mid-July.

Hungarian government bonds have richen significantly in nominal and relative terms following the recent rally and we can expect further tightening in ASW in the coming days as the market adjusts to the hawkish tone of NBH. In the longer term, HGBs will thus be trapped between rising rates and improving fundamentals on the fiscal and geopolitical side. However, we see the risk of a significant sell-off as limited at the moment due to the recent Fitch rating affirmation and positive news from the negotiations between the government and the European Commission.

The hawkish NBH and rising rate differential should protect the forint from another significant move above the 400 level, but on the other hand, it will not be enough for a strengthening below this level. Overall, we think this has reduced the forint's vulnerability to a possible dollar rally as a result of tomorrow's FOMC meeting or a meltdown in the European gas story, but it does not change the fact that its future path will be strongly driven by these issues. In parallel, early progress in negotiations with the European Commission could be positive factor. For now, however, we rather expect a stalling in place around the 400 EUR/HUF level.

Author

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

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

Disclaimer