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# National Bank of Hungary preview: Room to cut, but caution prevails

Although the inflation outlook remains favourable, the Monetary Council will likely err on the side of caution at the 20 October meeting, amid uncertainty surrounding the 2027 budget and prevailing risk sentiment. However, we still expect a rate cut by year-end



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## Our call

The National Bank of Hungary (NBH) picked the cautious option last month, keeping the base rate unchanged. We haven't seen enough of a change since the September rate-setting meeting to think that this time will be different. Central bank representatives have repeatedly pointed to two key developments, and neither of them is inflation.

The inflation situation remains benign, shifting the focus to the 2027 draft budget and the medium-term fiscal consolidation plan. While the government handed the budget to the Fiscal Council on 15 October, the details are not yet public. The timing puts the central bank, and especially Governor Varga, in a delicate position. The Fiscal Council has three members: the chairman, the president of the State Audit Office and the governor of the National Bank of Hungary.

This means Varga and the NBH staff will have information on the 2027 budget, but it would look ill-advised to make a monetary policy decision based on it before the details enter the public domain. We wouldn't rule out the Fiscal Council publishing its opinion before the rate-setting meeting, followed by an announcement from the Ministry of Finance. Still, that won't leave enough time for the Monetary Council to gauge the market reaction before committing to a rate decision.

A sound and credible 2027 draft budget and a well-received medium-term fiscal consolidation plan could create a favourable idiosyncratic shock, reducing risk premiums on Hungarian assets. However, the durability of such a move would remain a question mark. Against a backdrop of elevated global uncertainty, and despite the prospect of lower local risk premiums, we expect the National Bank of Hungary to play it safe and keep rates on hold on 20 October.

Looking ahead, we still expect monetary easing before year-end. Our assumption is that domestic developments will open the door to a 25bp rate cut in December, leaving the base rate at 5.25% at end-2026. With expected structural market support from credible budget plans and inflation hovering around 2.0-2.5% YoY in early 2027, we expect further easing to follow. We forecast a terminal rate of 4.25% next year.

## Our market views

Hungary remains the key CEE story, with by far the largest long positioning across asset classes, driven by the idiosyncratic post-election narrative and prospects for euro adoption. Currently, the primary market focus is on fiscal policy and the draft budget for next year, rather than on monetary policy itself. In our view, market expectations regarding next year's fiscal deficit are shifting downward, and we believe that an excessive degree of optimism has already been priced in. Consequently, it will be difficult for the government to deliver a positive surprise, even though the overall narrative is clearly moving in a positive direction.

Given the global situation and massive long positioning, markets appear fragile; from our perspective, it makes little sense for the NBH to test the market in such an environment. Market pricing points to one additional rate cut, assuming that BUBOR returns to a level above the key policy rate by the end of the easing cycle. With global energy prices hitting new highs, it would not be surprising if the market were to price out these remaining bets on rate cuts, especially given the distinctly hawkish pricing seen elsewhere in the region, though we keep rate cuts in our own forecast.

A more hawkish market stance, combined with the government's ongoing steps toward euro adoption, should be positive for the forint. On the other hand, one cannot ignore adverse global conditions, such as higher energy prices, a strong US dollar, and troubles within the eurozone bond market. These factors make gains for the forint challenging to achieve, yet our FX outlook remains bullish.

From the perspective of euro adoption, trades involving rates and bonds and further spread compression are much more reliable bets than FX, based on the experience of previous euro adoption cases. However, the two most popular trades – long-end Hungarian Government Bonds (HGBs) and 5y5y IRS vs. EUR – are hitting their lows, suggesting that a significant amount of good news is already priced in. Regarding bonds, historical precedent indicates that the spread should settle in the 50-120bp range by the time of entry into ERM II. Currently, the spread has just hit 200bp, yet we are still more than two years away from ERM II entry. Overall, while the underlying narrative remains bullish, we prefer to buy on dips at this stage.

## Some background

Inflation developments remain supportive from a monetary policy perspective. Despite the global energy shock, headline inflation has remained subdued, inching up to just 1.6% YoY in September, while core inflation ticked down by 0.1ppt to 1.9% YoY. We expect price growth to remain below the central bank's target for the rest of the year and throughout the first half of 2027.

The forint has proved more resilient to recent global sell-offs than in previous episodes. While EUR/HUF briefly approached 370, this level proved to be a hard ceiling. After the volatility seen in early October, the forint regained its footing and strengthened below 364 again. We believe this partly reflects elevated expectations surrounding the fiscal plans, with markets anticipating a frontloaded consolidation and a deficit target below 5% of GDP in 2027. While this looks ambitious, we believe it is within reach, though by no means automatic.

Hungarian government bond yields have also absorbed the deterioration in global sentiment relatively well, supported by expectations of fiscal consolidation. If the government delivers, further convergence towards the eurozone could be priced in. This could give the NBH more room for manoeuvre, while lower refinancing costs would also ease pressure on the budget.

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