An unpleasant surprise in Hungarian core inflation

Inflation took a new turn at the start of the year, with fuel and food prices continuing to climb. This data release poses challenges for monetary policy, but a more significant issue is the rise in perceived inflation, driven by the rapid increase in the prices of key items

4.6%

Higher than expected

Headline inflation (YoY)

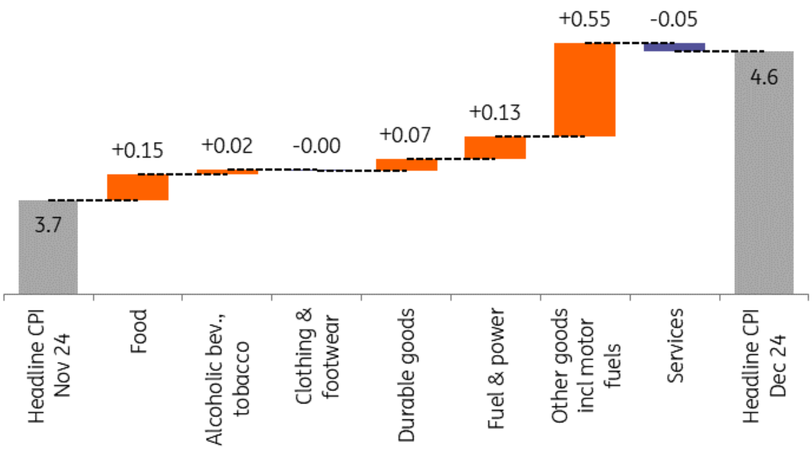
ING estimate 4.5% / Previous 3.7%

Higher-than-expected inflation in December

Inflation has once again provided an unpleasant surprise. The inflation report from the Hungarian Central Statistical Office (HCSO) showed a stronger-than-expected acceleration in inflation in December. The year-on-year indicator jumped from 3.7% to 4.6%.

The increase in inflation was partly driven by a significant 0.5% monthly rise in the average price level and a low base from last year. Although the monthly repricing met our expectations, the composition of the changes caused some surprises.

Main drivers of the change in headline CPI (%)

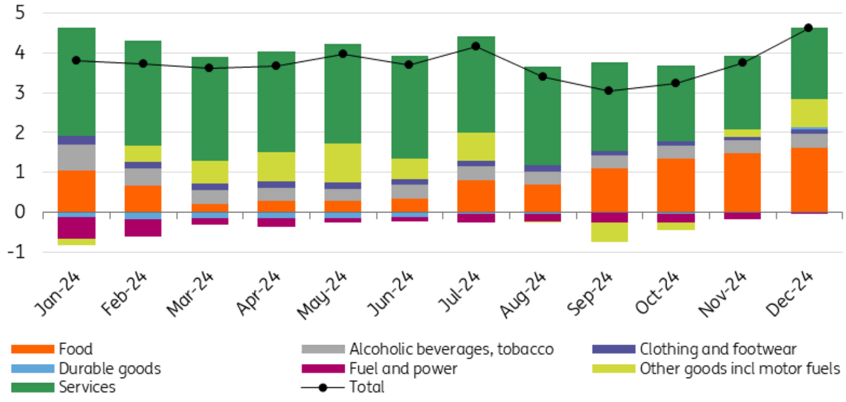


Source: HCSO, ING

The details

- Further increases in food prices were an important source of the strong one-month inflation. However, price increases were more moderate than in previous months and lower than expected. A bigger surprise, however, is that the Statistical Office recorded a 0.5% rise in the price of spirits and tobacco.
- What we missed in November occurred in December: a further significant depreciation of the forint was eventually reflected in the prices of consumer durables in the last month of 2024. According to the HCSO, this was the strongest one-month repricing (0.6%) of the year.
- The slightly colder weather in December compared with the previous year led to a significant increase in the average household energy bill, well above our expectations. Unsurprisingly, one of the most significant inflationary items was again the rise in fuel prices, with the average price up by 2.2% compared with November.
- In contrast, the change in services was somewhat milder than the year-end repricing of recent years. However, transport services, rents and insurance fees rose significantly in this category. This may also be due to the weakening of the forint, which is now being reflected in rising prices.

The composition of headline inflation (ppt)



Source: HCSO, ING

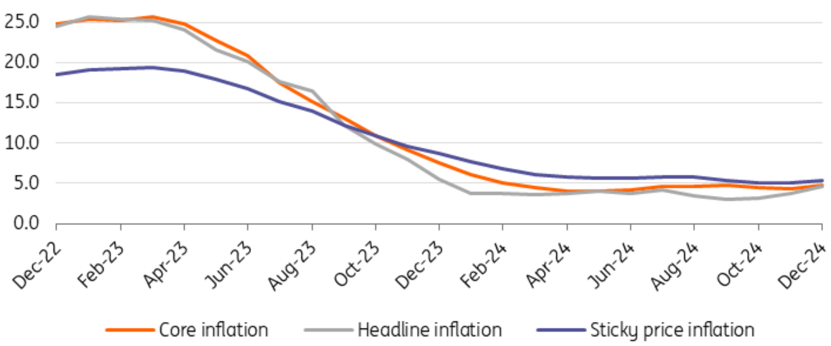
Core inflation also accelerates

In terms of the year-on-year indices, all components except services (where price pressures eased slightly on a yearly basis) contributed to the 0.9ppt acceleration in headline inflation. The main factor pushing up year-on-year inflation was the rise in fuel prices. This accounted for almost two-thirds of the acceleration. At the same time, the rise in the prices of processed food and consumer durables can also be seen as a significant contributor. As a result, core inflation rose from 4.4% to 4.7% in December, in contrast with the expected no-change.

Additionally, these items (food, fuel, and now rents and insurance charges) are significantly impacting perceived inflation, greatly contributing to the overall acceleration in inflation. In other words, household confidence is being impacted not only by the faster-rising official statistical data but also by the increasing perceived inflation, which is exacerbating the negative sentiment.

The National Bank of Hungary's analysis of inflation in December also showed that inflation expectations are becoming less anchored, as households' price expectations are rising in parallel with price expectations in the services and retail sectors.

Headline and underlying inflation measures (% YoY)



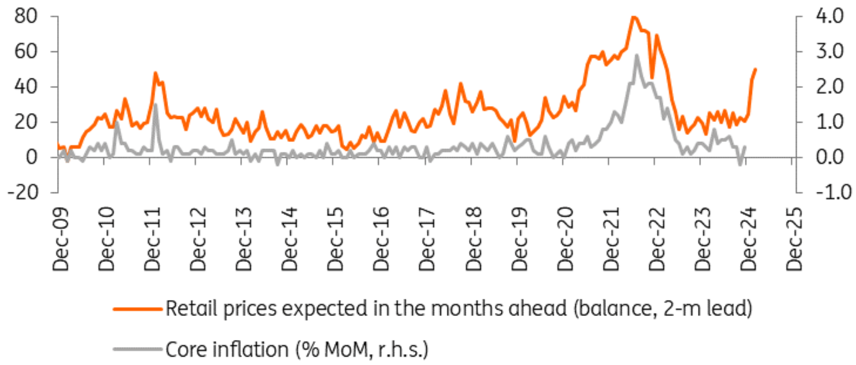
Source: HCSO, NBH, ING

We expect inflation to remain above the tolerance band for most of 2025

Looking at 2024 as a whole, consumer prices rose by an average of 3.7%, which is not only a significant improvement on the previous year, but also a better performance than the expectations outlined at the beginning of 2024. However, this positive development is overshadowed by the extremely weak performance of the Hungarian economy, which fell well below expectations and likely contributed to the inflation rise.

Looking ahead to 2025, we are likely to have a rather volatile year. The inflation rate could fluctuate between 3.7% and 5.1% during the year, while the average could be around 4.2%, according to our latest forecast. This means that the average rate of price increases could accelerate compared to last year. The combination of a weakening forint, higher global commodity prices (especially in food), economic policy measures (mostly tax hikes) and the expected high average wage increase in the private sector could, on average, keep both headline and core inflation outside the National Bank of Hungary's tolerance band of 2-4%.

The correlation between retail price expectations and core inflation



Source: Eurostat, HCSO, ING

From a monetary policy perspective, the December inflation figure is rather unfavourable. Not because of the rise in the headline indicator, but rather because of the rise in core inflation as the price changes of processed food, durables and services accelerate. In our view, the upside surprise in core inflation mostly came from the delayed impact of the weakening of the exchange rate. If this is true, this should certainly make monetary policymakers more cautious. Especially as the forint is still quite vulnerable and events in the coming months are more likely to lead to further weakening in the forint.

Moreover, perceived inflation could also lead to a further rise in inflation expectations, which is also a negative development from a monetary policy perspective. Against this backdrop, there is little chance of a resumption of interest rate cuts in Hungary in the short term.

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