Disinflation ends in Hungary

Headline inflation rose slightly in April and will probably continue to rise in the coming months, largely due to base effects. The monthly rate of increase is still well above what would be consistent with the 3% inflation target

3.7%

Headline inflation (YoY)

ING estimate 3.7% / Previous 3.6%

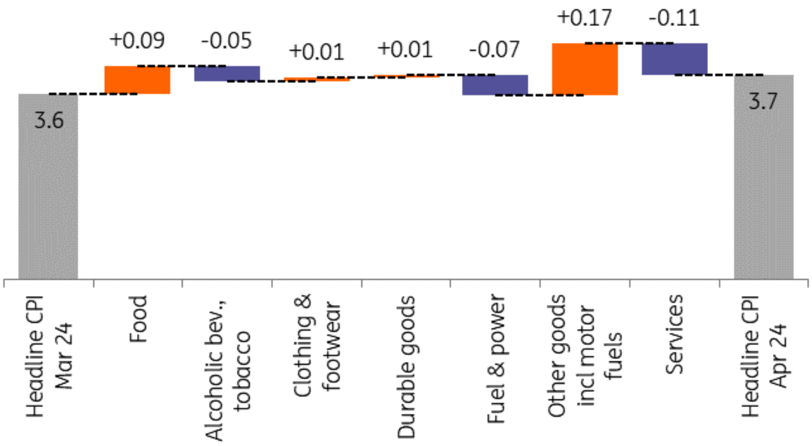
As expected

Disinflation off, reflation on from April

Inflation in Hungary slightly increased in April, matching our own expectations and the market consensus. Compared with March, headline inflation rose by 0.1ppt to 3.7% year-on-year, but at the same time, the monthly repricing was 0.7%, indicating a slight deceleration compared to the repricing seen in March.

While the thought of monthly deceleration might be appealing at first sight, it is important to emphasise that there are still significant inflationary pressures in the Hungarian economy. To achieve the 3% inflation target in a sustainable manner, monthly inflation would need to be in the range of 0.2-0.3%. In comparison, the current month-on-month (MoM) rate of 0.7% reported by the Hungarian Central Statistical Office (HCSO) is significantly higher.

Main drivers of the change in headline CPI (%)

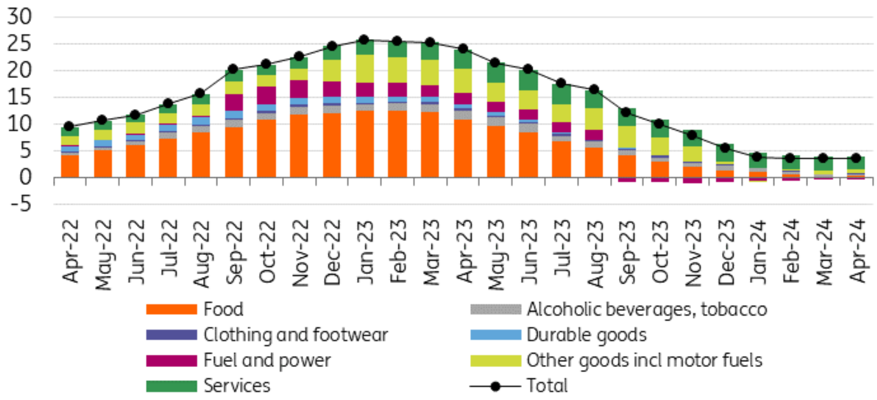


Source: HCSO, ING

The details

- Food prices rose only by 0.3% MoM, which brings the annual food inflation rate to 1%. On a monthly basis, prices of unprocessed food increased, while prices of processed food decreased, displaying a divergence within the food component.
- Fuel prices increased by 3.5% MoM, which was one of the most important drivers behind the monthly repricing. At the same time, household energy prices decreased on a monthly basis, which was in line with weather conditions.
- Prices of durable goods rose by a mere 0.1% on a monthly basis, but the annual index still points toward deflation for this component. At the same time, the prices of clothes posted a larger monthly increase than implied by seasonal factors.
- Services prices rose by 1.3% MoM, which brings the annual services inflation rate to 9.5%. This time financial services, holiday packages, and housing-related services were the biggest contributors, while the impact of telecom services repricing was muted. In terms of the annual headline inflation rate, the services component explains 68% of total inflation.

The composition of headline inflation (ppt)



Source: HCSO, ING

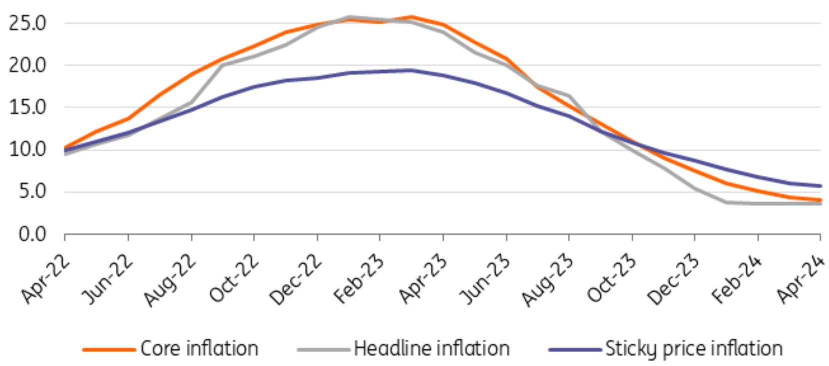
Core inflation drops, but the overall picture remains unfavourable

Core inflation decelerated by 0.3ppt to 4.1% YoY in April, while the National Bank of Hungary's measure of inflation for sticky prices also decreased, displaying a reading of 5.8% YoY. This is the result of a 0.8% MoM increase in core inflation, which matches the repricing seen last month. This particularly strong monthly reading further boosted the 3M/3M annualised core rate, which rose by 0.4ppt to 5.7% in April.

Of course, the biggest driver was services inflation, which alone accounted for 0.34ppt of the entire monthly repricing. As we've been continuously pointing out, March and April are particularly sensitive months to higher monthly services repricing due to retrospective repricing. In this regard, the bulk of the retrospective repricing took place in March, as evidenced by the relatively subdued repricing of telecommunications services.

In terms of tourism-related services, there was a divergence between the prices of outbound and domestic recreation. While prices for inbound tourism services have been decelerating on an annual basis, price changes for outbound tourism services are still quite high. This suggests that domestic demand is still subdued, and that demand is becoming increasingly skewed towards outbound trips, as the price gap between outbound and domestic holiday packages has narrowed due to the strong increase in the latter over the past year. As a result, the scope for further price increases by local tourism service providers is now limited.

Headline and underlying inflation measures (% YoY)



Source: NBH, HCSO, ING

The first round of reflation will start in May

Going forward, we expect the monthly repricing in May to be somewhat weaker than the figures observed in the past two months. This is primarily attributable to the seasonal price changes in food and clothing items, as well as the anticipated decline in fuel prices, which should significantly dampen the monthly inflation indicator. On the other hand, service price increases may continue. However, the most significant "problem" will be the base effect, as the monthly repricing was -0.4% (the lowest monthly base for the year) last May. As we expect a significant price increase this May, this will result in a nearly 1ppt rise in the annual consumer price index.

After that, the next major jump is expected from October onwards, when inflation could exceed 5% materially. Considering the current underlying processes – and given that both the main inflation and core inflation indicators evolved in line with our expectations in April – we maintain our forecast that inflation could range between 5.5-6.0% in December 2024, likely closer to the upper end of the range. However, it remains quite challenging to predict the second half of the year at this point.

The performance of the Hungarian economy appears to be weak, and the tightness in the labour market has eased, which limits wage pressure going forward, and also hinders the chances of a price-wage spiral. The precautionary motive remains present in the economy, and a significant uptick in consumption has yet to be seen. These factors fundamentally act as restraining forces on inflation in the coming months, thus posing a downside risk to our forecast.

The unfavourable turn in the inflation path justifies the patient approach

From a monetary policy perspective, the recent inflation data undoubtedly justifies the central bank's caution regarding interest rate policy. Interest rate cuts will continue over the next two months, and if favourable market conditions prevail in the coming weeks, they may allow for another 50bp interest rate cut in May.

However, the surge in inflation in May (which the HCSO will report before the June interest rate decision) and potential negative credit rating actions could lead to market turbulence, permitting only a 25bp interest rate cut in June. In our view, we will witness the central bank's last interest rate cut for the remainder of the year in June. Following this, a period of sustained inaction may ensue, as a relatively tighter monetary policy could ensure financial market and inflation stability over the longer term in an environment of rising inflation.

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