Hungarian disinflation continued in July

While food deflation was weaker than expected, price pressures in other items showed a more marked easing. The July inflation figure does not change the big picture as we anticipate that disinflation will continue

17.6%

Headline inflation (YoY)

ING estimate 17.3% / Previous 20.1%

Higher than expected

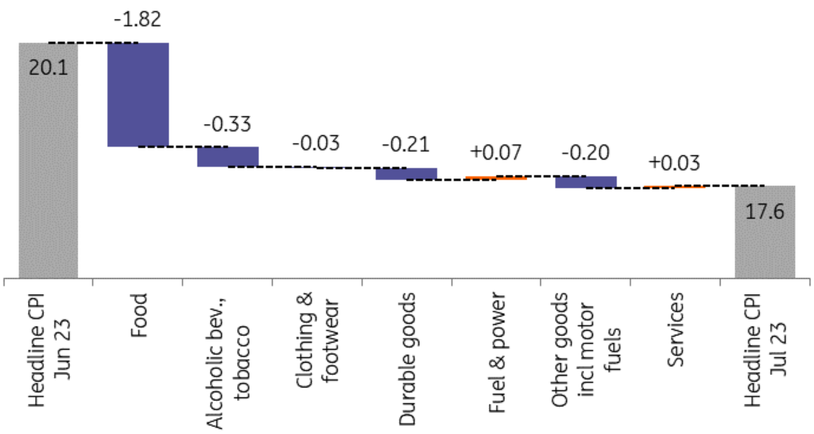
Wide range of items shows slowdown in price increases

The disinflationary process continued in July, as expected, with headline inflation dropping to 17.6% year-on-year. In addition to base effects, this was the result of a 0.3% month-on-month increase in price pressure. While at first sight this says that monthly repricing is still relatively strong, we have some positive developments as well. The pace of monthly repricing in July 2023 was the same as we have seen every July since the 2000s on average, meaning that the current monthly inflation was no stronger than the historical data.

However, many analysts, including ourselves, had forecast a much lower rate of month-on-month inflation, expecting prices to fall on a monthly basis. It seems that the deflation in food prices derived from the government's online Price Monitoring System does not correspond to reality, or more precisely to the official inflation figure based on the Hungarian Central Statistical Office's methodology.

Focusing on the positives, however, there are several elements behind disinflation and while food is the key driver, abating price pressures are more widespread than anticipated. This is a welcome outcome and explains why core inflation posted a more marked deceleration than the headline reading.

Main drivers of the change in headline CPI (%)

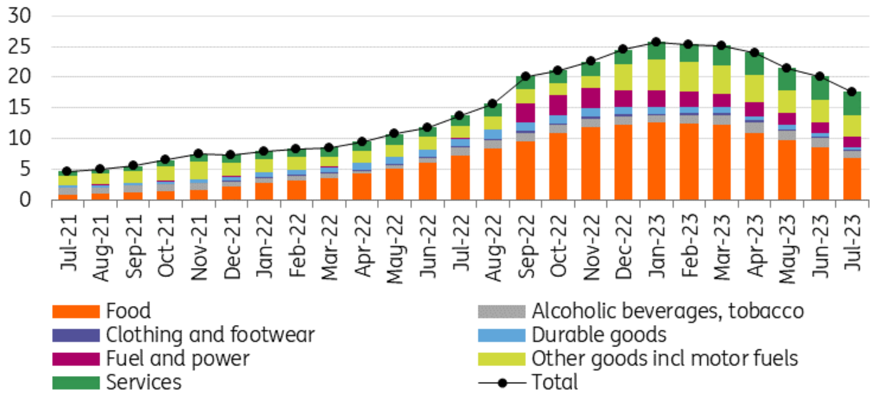


Source: HCSO, ING

The details

- Food inflation continued to moderate for the seventh consecutive month, as the annualised index retreated to 23.1% YoY. The monthly reading is likewise promising, as food prices fell by 0.9% between June and July, reflecting price changes in both unprocessed and processed food items, but mainly in the former. The collapse in retail sales is therefore clearly helping to contain inflation. Competition between retailers for households' overall shrinking disposable income is intensifying.
- The global disinflationary trend, retreating shipping costs and a stronger forint (versus the second half of 2022) helped to lower the price of consumer durable goods. Though dropping consumption might be also a force here and the same can be said about clothing items.
- While the drop in domestic demand was reflected in disinflation and the other goods segment (household goods, pharma products, goods for recreation and education), there was one important exclusion in this group: fuel prices moved higher by 1.1% MoM, reflecting higher oil prices.
- The continued rise in services inflation to 14.6% YoY was roughly in line with expectations, while the single most important upside surprise stems from household energy. We saw an increase in prices, mainly on gas. Those who have paid a flat rate received the final balance at the end of the heating season, which showed a payment shortfall, so the bill may have been higher than usual.

The composition of headline inflation (ppt)

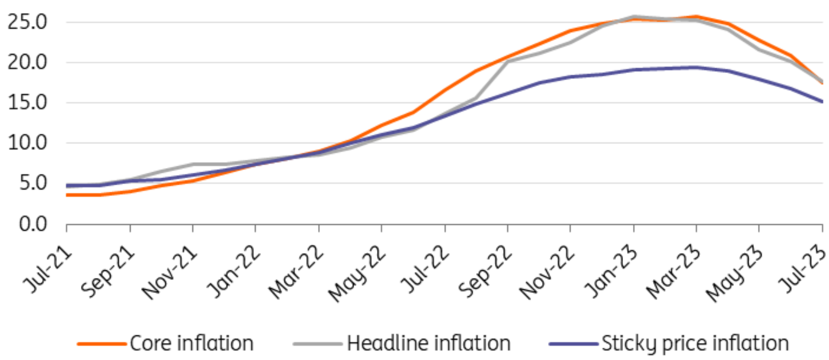


Source: HCSO, ING

Underlying price pressure eases at a fast pace

As upward pressure in inflation mainly came from fuel and energy items in July, and disinflation was more widespread than expected, this explains why we see a stronger deceleration in core inflation than in the headline print. The core reading moved lower by 3.3ppt to 17.5% YoY in July and with that, core inflation is now lower than the headline print for the first time since February 2023. Other underlying indicators, like the sticky price inflation calculated by the National Bank of Hungary, are showing further promises as well, implying that there is a continued turnaround in price pressure in the deeper levels of the economy. Hungary is slowly but surely coming out of the woods.

Headline and underlying inflation measures (% YoY)



Source: NBH, ING

Single-digit inflation by November

In light of today's data, a single-digit inflation rate at the end of the year looks certain. In fact, if there is no further price shock, we could see a sub-10% rate as early as November. As for average annual inflation, we have not changed this forecast either, and we are looking for an inflation rate close to but below 18% in 2023 as a whole.

Looking ahead to next year, we expect average inflation to be around 4.5-5.0%, with upside risks. This signals that the risk of a persistently high inflation environment has not yet been averted. The very dynamic wage outflows could translate into positive real wage growth even as early as September. A combination of the companies' typically retrospective pricing behaviour in Hungary (carrying out price increases based on past inflation data) and the rise in real wages could trigger further repricing. On the other hand, we might get away with this if households focus on replenishing their depleted savings accounts rather than start consuming again.

We see no change in monetary strategy

In our view, the July inflation indicator is unlikely to have a significant impact on monetary policy. Given that the central bank still distinguishes between market and price stability, and that the current easing cycle is essentially a reflection of market stability, the more important question is to what extent the weakening of the forint will rewrite the central bank's view.

Primary, post-data market reactions also suggest that investors are dismissive of the possibility that the central bank will cut rates more aggressively in response to the disinflation it has seen. Perhaps this is why we have seen the forint begin to strengthen again. Although, the surprisingly wide trade surplus in June might be a factor as well. If this strengthening continues, we see no significant obstacle to another 100bp rate cut in August and September as well. With that, the merger of the base rate and the effective rate will be done in September.

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