

Hungarian inflation peak is behind us

Compared to the previous month both headline and core inflation retreated in February, and the structure of inflation looks better, too. Nevertheless, key challenges remain, and that's why we believe the central bank will stay on course



Shoppers in Budapest

25.4%

Headline inflation (YoY)

ING estimate 25.4% / Previous 25.7%

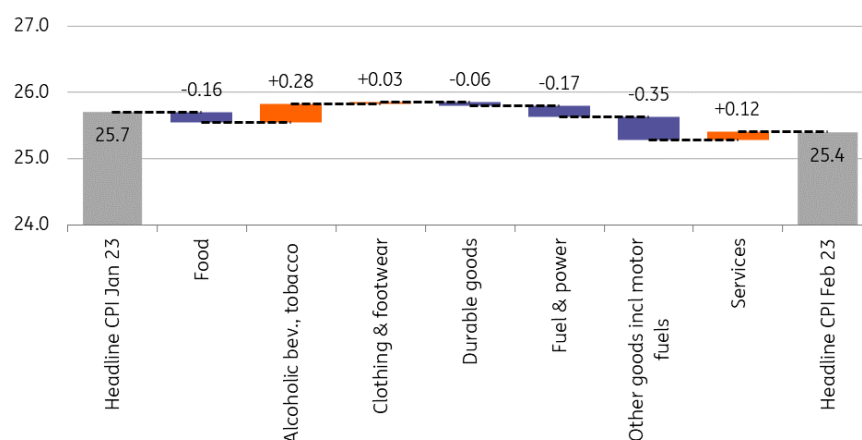
As expected

Inflation mildly decelerated in February

For the first time since December 2021, prices mildly decelerated as headline inflation registered a 25.4% year-on-year reading in February, down from January's 25.7%. We believe that we have already seen the peak in inflation in January and that a gradual and slow moderation in inflation can continue in the coming months. The still-elevated yearly price index was the result of monthly inflation at 0.8% in February, which was the lowest pace of price growth since the end of 2021. Moreover, the structure of inflation also improved in February as core inflation managed to

moderate as well, albeit by only 0.2pp, to 25.2% YoY.

Main drivers of the change in headline CPI (%)

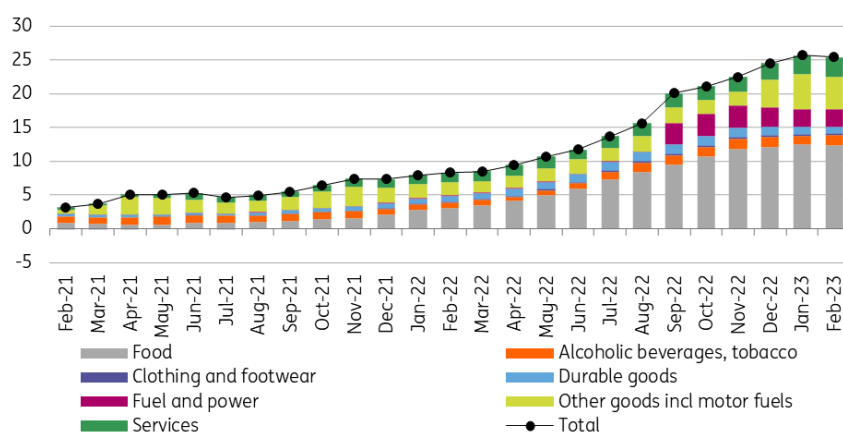


Source: HCSO, ING

The details

- Food inflation continued to moderate for a second month. Although the pace of the price increase was still generally high at 1.7% on a monthly basis, this represented a further decline in the annualised index, down to 43.3% YoY. According to the National Bank of Hungary's calculations, processed food prices registered a 1.0% monthly increase, while the price of unprocessed foods rose by 2.3% month-on-month. Overall, the deceleration in food inflation was mainly driven by the decline in dairy prices, which are likely to fall further in the short term as supermarkets have announced price cuts. Altogether the deceleration in food prices shaved off 0.16pp from February's headline release, which was the second biggest cooling factor in price moderation after the motor fuel component's -0.35pp contribution.
- With fuel price caps being phased out in December, fuel prices in February were influenced purely by market movements. Against this backdrop, fuel prices also moderated compared to January, as expected in light of recent price developments at petrol stations, thanks to a stronger forint and lower oil prices. The decline was 3.6% MoM, but the average market price is still well above the capped level compared to the same period of the previous year. In parallel with fuel prices, household energy prices likewise retreated, due to a decrease in household energy consumption, which lowered the weighted average unit price of piped gas.
- On the other hand, prices of alcoholic beverages and tobacco have picked up, which was likely the result of a carry-over effect of tax changes at the beginning of the year and an ongoing start-of-the-year repricing due to last year's cost side pressures. Besides these components, services prices jumped by 11.6% YoY which is the result of a 1.0% monthly rise in prices. However, this increase is less than what markets had expected and much lower than in January. Altogether we believe that the prices of food, durable goods and energy could decelerate due to retreating global energy prices and recent forint strength, which likewise had a cooling effect on core inflation.

The composition of headline inflation (ppt)

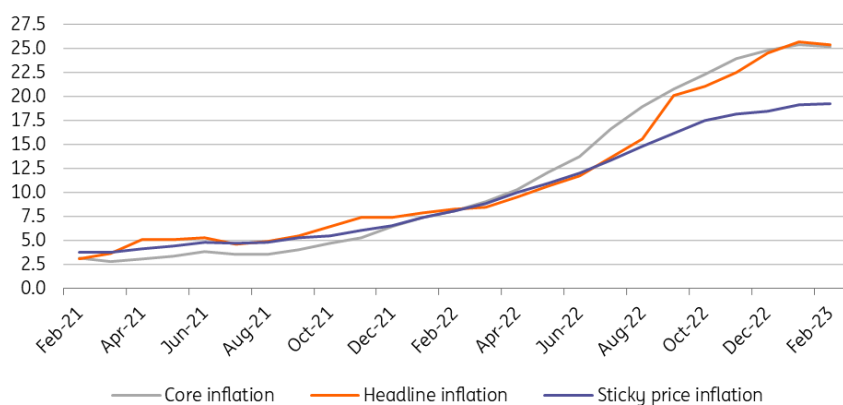


Source: HCSO, ING

The structure of inflation has started to improve

Core inflation in February retreated to 25.2% YoY down from January's 25.4%, which in our view was the peak. The main factor behind the drop was the lower-than-expected increase in processed food and services prices, but challenges remain as the NBH's sticky price inflation index did not budge. In fact, it increased by 0.2pp compared to January, signalling that underlying price pressure remains elevated in general.

Headline and underlying inflation measures (% YoY)



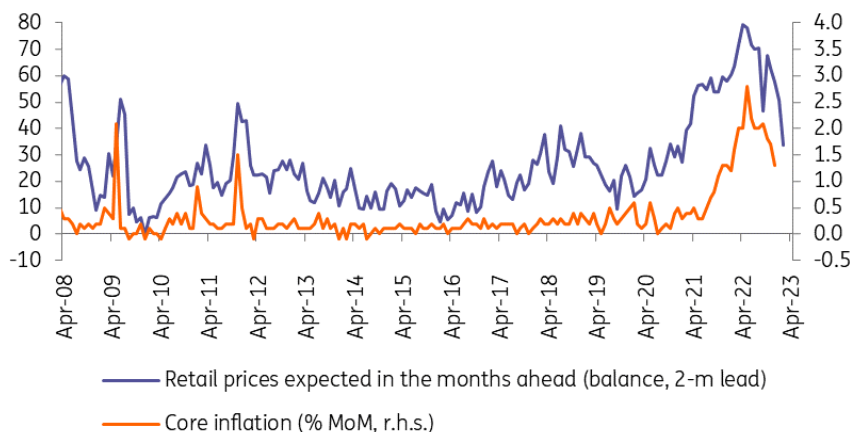
Source: HCSO, ING

Marked deceleration will start from April

Going forward, our personal experiences and anecdotal evidence suggest that inflation will be more markedly contained for some products, specifically regarding food, fuel, and consumer durables. Given wage dynamics, services are the only component where we're expecting further price increases, but this will be offset by favourable developments in other items. In the coming months, the year-on-year headline and core inflation figures could therefore continue to decelerate at a very moderated pace. A more pronounced downturn in inflation is likely to take place from April, when base effects will also contribute to a substantial decline.

The strengthening deceleration might be also fuelled by the fiercer competition between retailers. With demand destruction coming from high inflation and dropping purchasing power, more and more retailers are saying that their pricing power is fading. As retail price expectations are falling, monthly core inflation will decelerate accordingly.

The correlation between retail price expectations and core inflation



Source: Eurostat, HCSO, ING

In 2023, ING continues to expect full-year average inflation to be at 19%, which is significantly higher than last year's 14.5%. However, we believe that December's figure will dip below 10%. But the risk of a persistently high inflation environment has not been averted yet. The very dynamic wage growth (15% YoY increase in 2023 per our forecast) could translate into positive real wage growth in the second half of this year. On one hand, this could support the economic recovery from the current technical recession. On the other, it risks companies regaining their price-setting power, which would trigger further repricing. So, we believe that policymakers will continue to be patient in monitoring the incoming data and wait a bit more to start the rate-cutting cycle.

In our view the NBH will stay on course

Today's inflation release confirmed both ING's and the National Bank of Hungary's expectation that January marked the peak in price pressures. However, we believe that a one-month positive development will hardly be enough to trigger a swift policy turnaround. Not to mention the fact that there is still considerable uncertainty about EU funds, and market participants are becoming increasingly pessimistic about the negotiating outlook, keeping the forint in limbo. In addition, major central banks have also drifted towards a tighter monetary policy outlook, thus higher interest rates, and delaying the start of an easing cycle. Overall, despite the start of a pivot in inflation, we do not expect the NBH to start its rate-cutting cycle earlier than May or June.

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