

Hungarian inflation reading brings both good and bad news

Headline inflation came in below market consensus but has nonetheless accelerated further. Yearly price changes reached double-digit territory in 40% of the consumer basket



We expect the interest rate cycle to be continued by the National Bank of Hungary in the coming months

8.5%

Headline inflation (YoY)

ING forecast 9.1% / Previous 8.3%

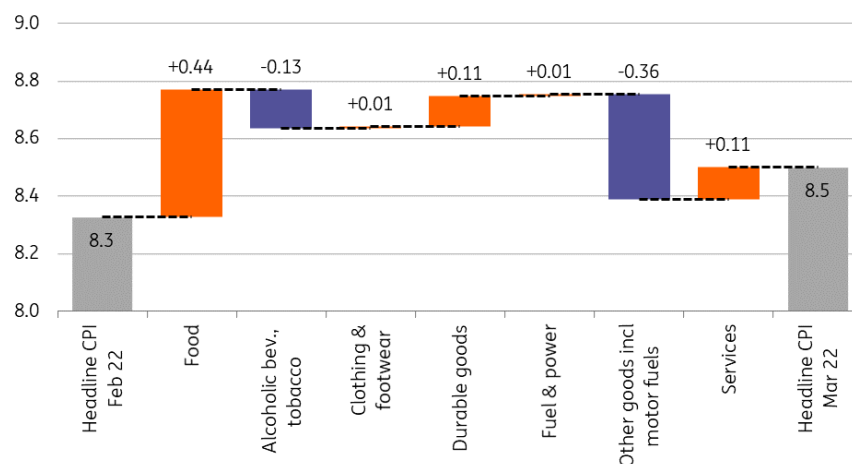
Lower than expected

Surprise inflation reading

We have mixed feelings after seeing the March inflation reading in Hungary. The 1.0% month-on-month increase and the 8.5% yearly based price change are lower than the market expected. But the good news pretty much ends there. Repricing has remained strong in the economy as 70% of

the consumer basket measures an above 5% inflation reading and 40% is showing an above 10% inflation print. The downside surprise versus market consensus and ING's above-consensus call stems mainly from food and services.

Main drivers of the change in headline CPI (%)

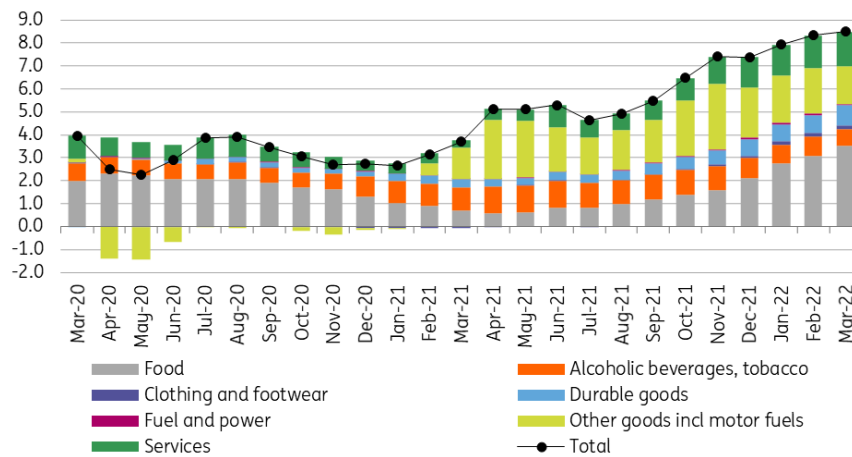


Source: HCSO, ING

The details

- Food inflation came in at 13% year-on-year, showing a significant acceleration even though the price of some basic food has remained capped. But we expected stronger inflation mainly based on the pro-inflationary impact of the war in Ukraine and the weaker Hungarian forint. It seems that the spill-over is slower and/or weaker than we initially expected. Yet there is a strong repricing in food: the monthly inflation is two-three times higher than usual. This is a result of several supply-side shocks (transportation, agricultural commodities, energy, wages, etc).
- Services inflation accelerated by 0.5ppts reaching 6.0% year-on-year in March. The monthly price increase was again significantly higher than usual in the third month of the year and it was a phenomenon seen across a wide range of services. A quarter of the services basket is now showing a double-digit year-on-year price increase. These pressures will probably remain with us for a while based on the shocks resulting from a combination of rising energy bills, elevating labour costs, and more expensive consumables. Service providers are eager to pass these costs on to consumers as demand remains buoyant.
- With the forint reaching a new record high level at 400 versus the euro and being weaker throughout March compared to February, it is hardly surprising that the price increase in durables accelerated as well. The 1% month-on-month increase translated into 9.5% year-on-year. We will probably see a double-digit inflation print in durable goods next month due to the impact of further supply chain issues caused by the war and sanctions.

The composition of headline inflation (ppt)

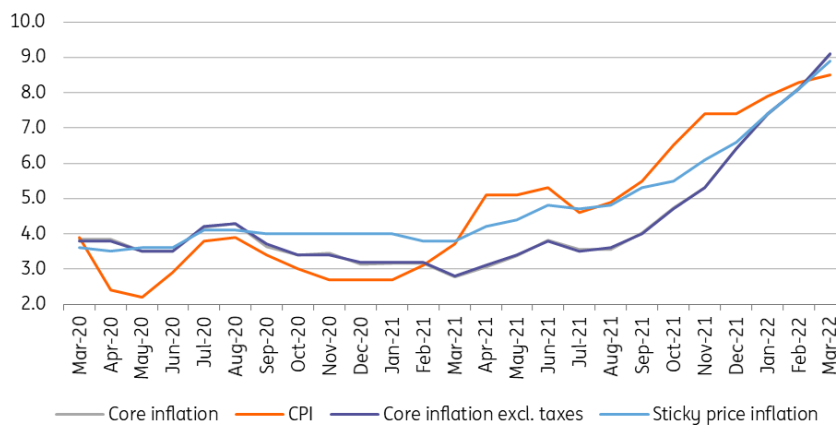


Source: HCSO, ING

Underlying inflation accelerates quickly

Even if the headline inflation reading did not show a significant acceleration, the underlying inflation pressure increased further. With the core inflation accelerating by 1.0ppt compared to February, the yearly-based March reading ended up above 9% for the first time since the summer of 2001. So-called sticky price inflation (which shows the prices of components of the consumer price index which are slow to change, and therefore are good predictors of medium-term developments in headline inflation) spiked to 8.9% year-on-year, a new record.

Headline and underlying inflation measures (% YoY)



Source: HCSO, NBH, ING

Double-digit inflation probability reduces

Forecasting inflation for the coming months remains highly challenging due to the war and sanctions, and the uncertainty regarding the anti-inflationary measures introduced by the government. But today's lower-than-expected print increases the chance that Hungary might be able to avoid double-digit inflation this year. Particularly if we take into consideration Prime Minister Viktor Orbán's pledge that he is trying to find a way to maintain the anti-inflationary measures which are ending in May (fuel and basic food price caps).

Against this backdrop, it is difficult to estimate when and where inflation will peak, but even with an extension of the price caps, we see inflation peaking in June or July at close to but below 10%. Regarding the 2022 inflation outlook, with risks still skewed to the upside, we maintain our call that average inflation could be around 9%.

Central bank tightening continues

We expect the interest rate cycle to be continued by the National Bank of Hungary in the coming months. With inflation expectations rising further and being well above the inflation target, we expect the effective interest rate to rise to as much as 8.00-8.25% by the middle of this year. With that in mind, we see a chance for a positive real interest rate by the end of this year, which could give a helping hand in reducing/anchoring inflation expectations again. But this could go either way depending on the course of the Ukrainian war. Despite today's surprise, we consider it unlikely that inflation will return to the 3% target in 2023 with any realistic assumption of central bank tightening.

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