Hungarian inflation spikes above 7%

November headline and core inflation jump to levels not seen since 2007-08. Widespread price pressure suggests that inflation is set to remain elevated in the coming months.

Shoppers in Budapest

7.4% Headline inflation (YoY)

ING forecast 7.3% / Previous 6.5%

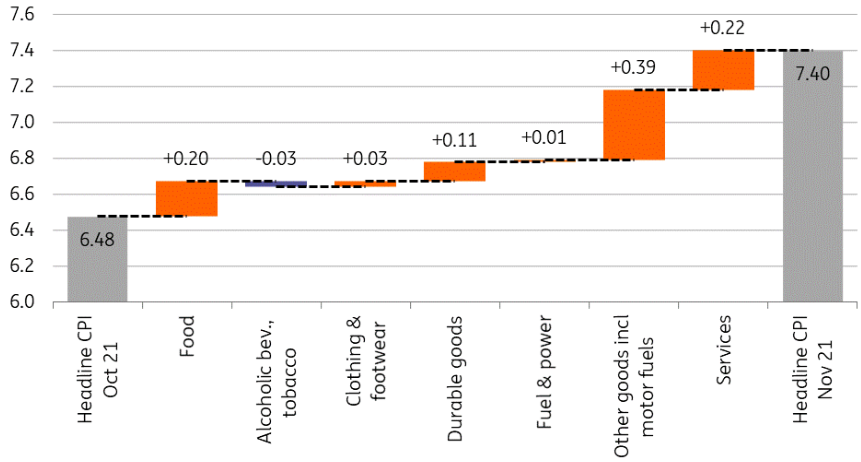
Higher than expected

Inflation passes 7% for the first time since 2007

After the significant jump in October, market expectations moved markedly higher for the November inflation reading. In this respect, the new reading didn't catch markets off-guard, although it came in a tad higher than the consensus. The 7.4% YoY headline inflation read is the highest since December 2007. It would be easy to blame base effects but, with monthly inflation coming in at 0.7%, it is clear that there is more behind this.

The extent of inflation pressure can also be ascertained from the share of items in the consumer basket showing price increases: 129 of 140 item groups in the consumer basket showed year-on-year price increase. The Statistical Office measured inflation in 92% of the item groups, indicating widespread price pressure. So, when we try to identify reasons behind the 0.9ppt acceleration in headline inflation between October and November, we don't have a tough task.

Main drivers of the change in headline CPI (%)

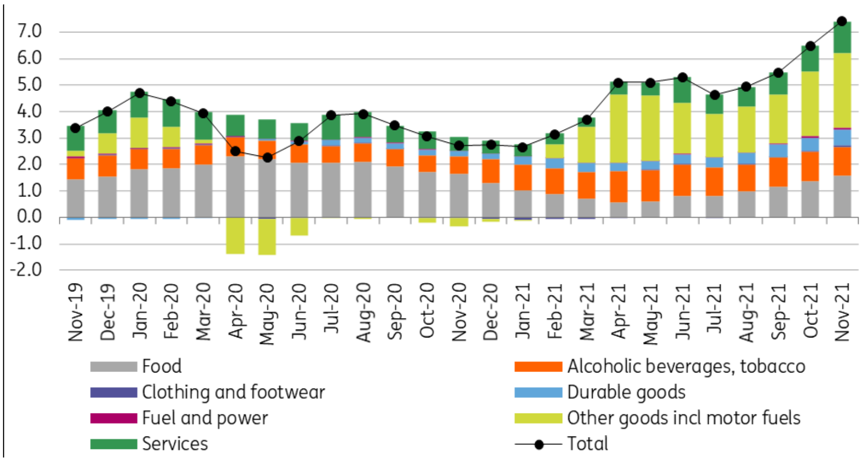


Source: HCSO, ING

The details

- The most obvious reason here is fuel prices, which reached record high levels in the first half of November. Despite the government capping fuel prices from 15 Nov, the Statistical Office's data gathering covers the period between the first and the twentieth days of the month. Therefore fuel inflation was 2% on a monthly basis and almost 38% year-on-year.
- The second biggest contribution to the acceleration came from services, where inflation came in 0.9ppt higher at 4.6% YoY in November. Transport, cultural and leisure activities contributed to the rise in inflation.
- Food was just a tad behind services in pro-inflationary impact. Both unprocessed and processed food saw acceleration in price increases as galloping agricultural producer prices spill over into consumer prices. Meats and meat products, dairy products, cereals and eating out saw significant price increases.
- Durables saw a 6.6% year-on-year reading (the highest since the start of the time series in January 2000).

The composition of headline inflation (ppt)

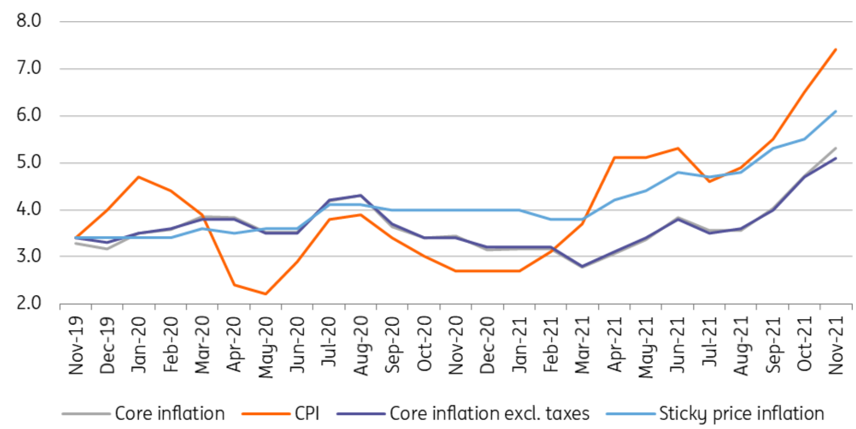


Source: HCSO, ING

Underlying price pressures point to medium-term issues

In all, there is widespread inflation pressure, with supply related price shocks mounting and showing up in consumer prices. Second-round effects have arrived and are pushing underlying inflation readings higher. Core inflation rose by 0.75% MoM, translating into a 5.3% YoY figure in November. This is the highest reading since 2008. "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 6.1% YoY, an all-time high.

Headline and core inflation measures (% YoY)



Source: HCSO, NBH, ING

Rate hikes must continue

Taking all of these into consideration, it is hard to argue with the latest indications for 2022. The government has just announced that it will raise pensions by 5% next year. This is a clear indication, that official inflation expectations are at that level. NBH Governor Matolcsy spoke at a hearing about a 4.8-5.1% inflation forecast for 2022 and warned the government that if fiscal stimulus continues, then it will create long-term inflation pressure. In this regard, we expect the central bank to continue the rate hike cycle and we see the terminal effective rate reaching at least 4.25% in 1H22.

2022 inflation could be even worse than 2021

It is clear that inflation is no longer driven by supply shocks, but by demand-related pressure and second round effects. Rising commodity and labour costs are increasingly being incorporated into consumer prices. The pricing power of companies is growing as aggregate demand continues to pick up while supply is limited. We can hardly expect a substantial change in this in the months ahead. The supply disruptions (energy crisis, transportation issues, labour shortages and lack of spare parts) will remain with us through the first half of 2022, at least.

Meanwhile, fiscal policy will further stimulate aggregate demand, and this will be coupled with significant wage growth. Based on this, we can expect elevated inflation in the coming months as well. It seems quite likely that inflation in December will remain above 7% but even in the first quarter of next year we could see inflation well above 6%. In this respect, next year's average inflation could be more than 5%, an acceleration compared to 2021.

Author

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

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