Hungary caps fuel prices, but don’t get too excited

The Hungarian government is capping fuel prices for three months from 15 November. That should damp down major inflation risks, but it's only a short-term measure

480

Capped fuel price in HUF

Both for non-premium petrol and diesel

The Hungarian government has just announced that it will cap fuel prices for three months from Monday. So how will this impact inflation both in the short and long-run? It'll also have implications for the budget and possibly for monetary policy.

Inflation

The share of fuel is 6% in the 2021 consumer basket. The cap on fuel is set at HUF 480 from mid-November, which means a roughly 6% price drop compared to the recent levels seen at fuel stations. However, statistically speaking, we need to compare this HUF 480 price to the official average price in October released by the Hungarian Statistical Office. Based on this, the price of non-premium, unleaded, 95 octane petrol is HUF 487. When it comes to the non-premium diesel prices, it was HUF 499 on average in October. Against this backdrop, the cap means only a 2% month-on-month drop in fuel prices. As such, this will reduce the MoM headline inflation reading by only 0.1ppt in November. When it comes to the year-on-year reading, there is now an increased chance that Hungary will avoid an above-7% inflation reading in November.

So the short-term impact will be rather limited statistically speaking, but it could have a more significant implication in the longer run. As fuel prices will be capped for three months, this will reduce a major upside risk to inflation in the coming months. So should the global oil price tick higher, or HUF depreciate versus the dollar, fuel prices won't add to inflation. Moreover, this should magnify the impact of base effects, thus dragging down inflation at a slightly stronger pace from December.

The decision could impact pricing decisions in the business sector. With a capped fuel price, customers are now more cushioned against a possible significant pass-through of elevated fuel prices into consumer prices. This could alleviate the possible upside risks of price hikes from January in several services (notably, of course, transportation) and also in goods, mainly in the fast-moving consumer goods category.

Budget

When it comes to the effects on the budget, according to our calculations based on fuel sales statistics in 2021, this means roughly a HUF 1bn drop in sales tax revenue on a monthly basis. As the capped level is not significantly below the average price in October, this means only a small drop in sales tax on one litre of fuel, particularly as our calculation doesn't count the positive effect of the price drop on volumes (which will increase both sales tax and excise duty tax revenues) and also doesn't count the impact of increased fuel tourism at the borders.

With this cap, Hungarian fuel prices will be cheaper than equivalent prices in neighbouring countries. In a nutshell, the budgetary impact of capping the fuel prices is negligible, especially with the fact that the government won't compensate fuel retailers for losses.

Monetary policy

In our view, this decision won't have a major impact on the central bank's monetary policy decision when it comes to the full rate hike cycle. Central banks don't usually react to price changes in high volatility items (e.g. energy, fuel, agricultural prices), but rather look for the second-round effects of these. In this respect, the fuel price cap won't change how the National Bank of Hungary sees the recent economic environment. As this cap is for three months (but can be lengthened of course, especially with a general election approaching in April 2022), this could have some impact on the longer-term pricing decisions, thus reducing some upside risks and alleviating the risk of second-round effects. However, even with such a cap, the central bank needs to remain on high alert and be careful not to overreact to this short-term economic policy intervention, just as it applies caution to spikes in inflation.

If anything then, we see an even higher chance (which we think was already high) that the NBH will not follow its regional peers (Czech and Polish national banks) with a huge rate hike next week. However, we still see the need to increase the step size of the forthcoming hike from the previous 15bp to 30bp, thus we expect the base rate to be set at 2.1% as the outcome of the November rate-setting meeting.

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