Falling inflation in Hungary may prompt the central bank to rethink

Headline inflation in Hungary has dropped to the central bank's target and we expect further slowdown. Combine that with a stronger currency and the central bank might just have to re-evaluate things

3.0%

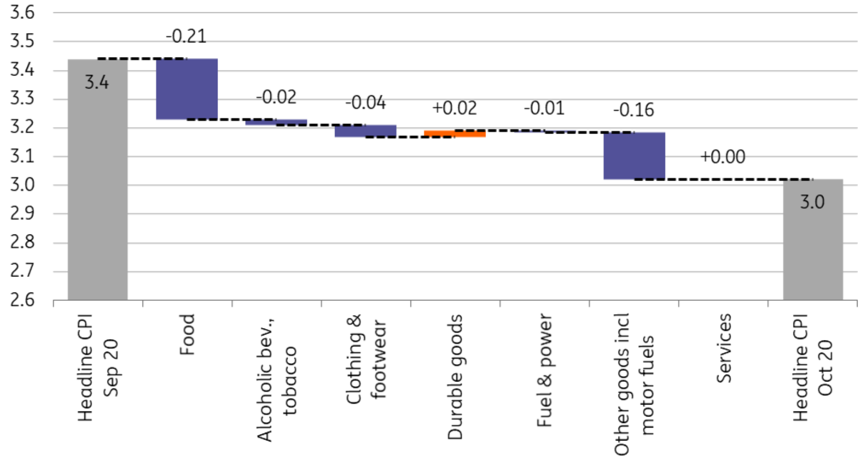
Headline CPI (YoY)

Consensus 3.1% / Previous 3.4%

Lower than expected

Hungarian headline inflation came in at 3.0% year-on-year in October, posting another significant slowdown compared to the previous reading. The drop below-consensus level was mainly driven by non-core factors, as deceleration in core inflation was softer than we expected.

Main drivers of headline CPI change (%)

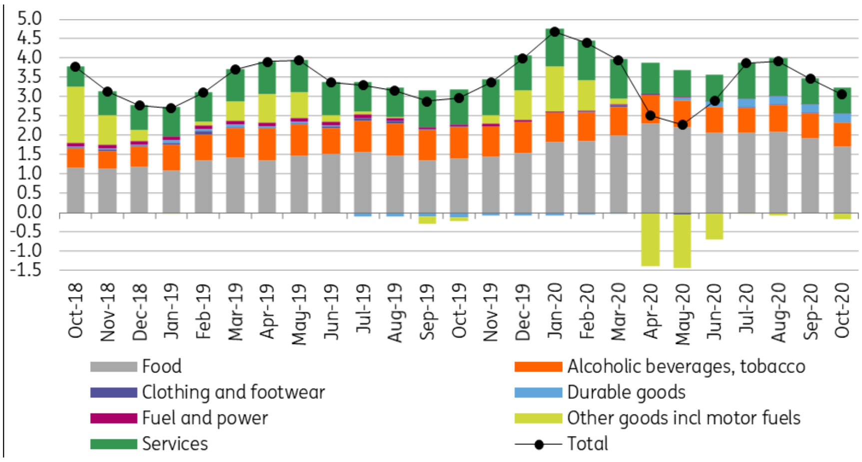


Source: HCSO, ING

What the breakdown shows

- Fuel prices decreased by 0.2% on a monthly basis, meaning a 5.3% year-on-year drop versus the -3.4% YoY reading in September. This move was the main driver behind the deceleration in inflation
- Another non-core factor depressing inflation was food prices. The monthly stagnation eased the yearly price pressure by 0.8ppt to 6.5% YoY. This was mainly driven by unprocessed food like potato, fruits, meat and milk.
- Inflation in tobacco prices eased somewhat on the high base caused by an excise duty hike last autumn, while the eased demand pushed clothing prices lower
- The main surprises on the upside affected core inflation elements, like durables and services. Durables prices rose by 2.9% YoY, which is an unusually high figure, probably driven by a quicker and stronger pass-through of forint weakening into import prices. Prices decreased at a slower pace in recreational services than expected, causing a flat 2.4% YoY inflation in services.

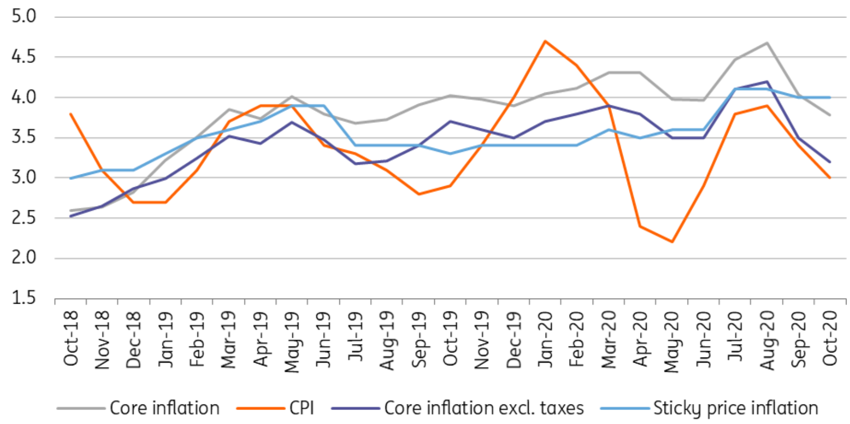
The composition of headline inflation (ppt)



Source: HCSO, ING

Against this backdrop, mainly core factors are responsible for missing our forecast as we expected an even bigger drop in headline and core inflation than the market consensus. Core inflation only eased by 0.2ppt to 3.8% YoY, but tax effect became even stronger. Core inflation excluding indirect taxes sits at only 3.2% YoY, so the two main indicators of the central bank (headline and core ex-tax) is just around the inflation target.

Headline and core inflation measures (% YoY)



Source: HCSO, NBH

What's next?

All this means, that from an inflation point of view, pressure has significantly eased on monetary policy.

On top of that, the recent risk-on mood in markets has helped the forint to strengthen and stabilise. The combination of these developments might open the door for policymakers to rethink some of the messages from December. Moreover, with the second wave of Covid-19 and curfew measures introduced in November, the economy might need more help.

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