Hungary: Temporary relief in inflation

Headline inflation in July showed a significant slowdown. The majority of the easing is related to base effects. Underlying inflation remained strong and therefore we expect the central bank to continue its rate hike cycle

Shoppers in Budapest

4.6%

Headline inflation (YoY)

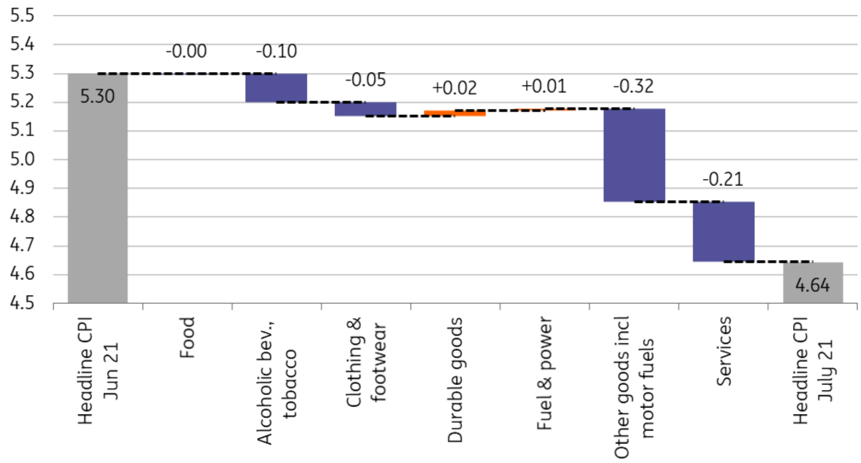
ING forecast 4.7% / Previous 5.3%

Lower than expected

Inflation eases on base effects

The headline inflation reading showed a remarkable slowdown in July compared to June. This hardly counts as a surprise though, as the market consensus was united in expecting the inflation rate to ease. The 4.64% year-on-year rate reflects a 0.7ppt slowdown from the previous month. The monthly based price change remained strong at 0.5%, so we still can't relax about price pressures, especially because the main reasons behind the deceleration are related to base effects.

Main drivers of the change in headline CPI (%)

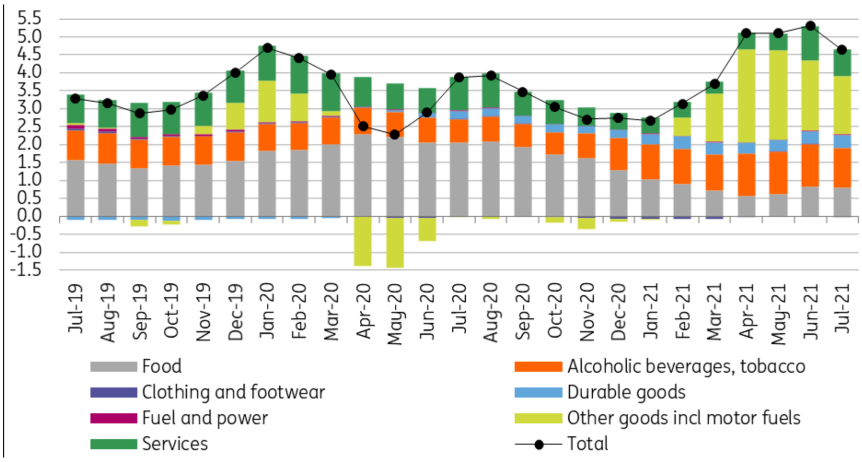


Source: HCSO, ING

The details

- Inflation in services came in at “only” 2.9% YoY, which shows a major deceleration compared to the previous month’s 3.8% rate. The main reason behind the slowdown is the different timing of the reopening in 2020 and in 2021. Last year, the economy reopened in July, so the related demand-driven inflation popped up in that month. This year, the reopening started earlier, and the demand-driven price pressure was visible in June. Thanks to this base effect, easing services inflation explains 0.2ppt of the slowdown in headline inflation.
- Another major factor was fuel. Although the monthly price increase came in at 4.2% in July 2021, monthly inflation was 8.1% in July 2020. Due to the base effect, fuel inflation decelerated to 19.8% on a yearly basis. This change shaved off 0.3ppt from the headline inflation rate in a month.
- Besides services and food, tobacco and clothing are the other main product groups where the price changes weighed on headline inflation. But again, as last July brought an excise duty change in tobacco products, the slowdown in inflation this July is only technical.
- When it comes to groups which added to price pressures, the only main category which stands out is durable goods. A 0.5% MoM price increase translated into a 3.8% YoY inflation rate, matching the highest reading of this year. The pro-inflationary effect of the global value chain disruption, along with significant cost increases in labour, inputs and transportation pushed manufacturers to change output prices, passing the costs onto consumers.

The composition of headline inflation (ppt)

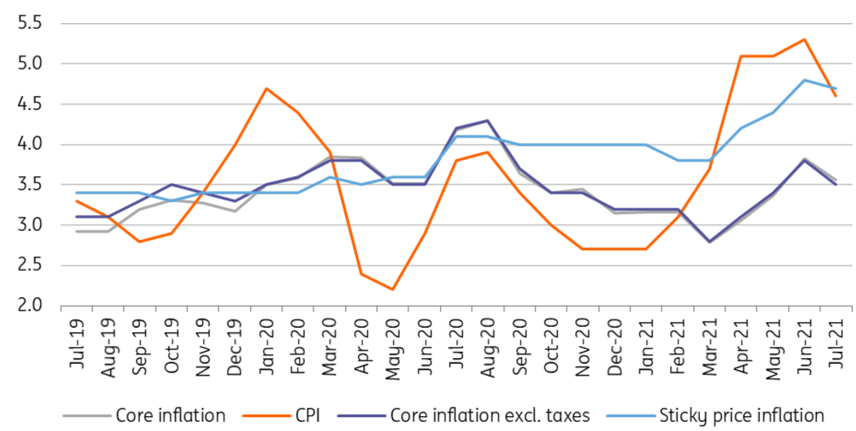


Source: HCSO, ING

Underlying price pressures remain strong

Given all of the above, it is hardly surprising that core inflation decelerated by just 0.2ppt to 3.6% YoY. This shows us that the underlying price pressures remain quite strong. The core inflation rate excluding indirect tax sits at 3.5% YoY, while so-called sticky price inflation was also able to ease a tad to 4.7% YoY, which is still a remarkably high reading.

Headline and core inflation measures (% YoY)

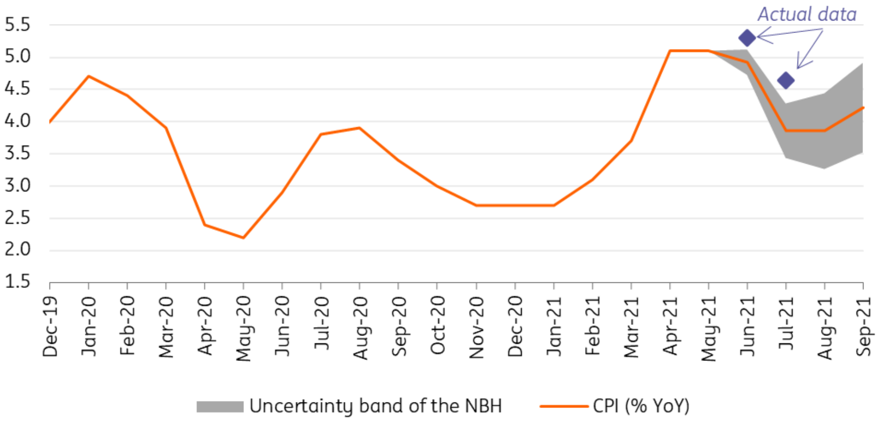


Source: HCSO, NBH, ING

Rate hikes to be continued

Despite the easing of the inflation rate in July, it still significantly exceeds even the top end of the National Bank of Hungary's forecast band published in June (4.6% vs 4.3%). As a result, there can be little doubt that the incoming inflation data will not bring any substantial change in the direction of monetary policy. In light of this, we expect another 30bp rate hike at the August rate setting meeting, which would raise both the base rate and the one-week deposit rate to 1.5%.

The central bank's near-term inflation forecast



Source: NBH, ING

A new peak in November

Regarding our inflation forecast, as the July data was broadly in line with our expectations, we maintain our forecast of 4.5% headline inflation in 2021 on average. This means that inflation may ease in the coming months, but the annual rate of price increase may again be substantially above 5% towards the end of the year, on base effects. Moreover, the inflation rate could be even higher than the 5.3% peak measured in June. We see the biggest chance for that record to break in November.

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