Hungary's inflation is trending up

Despite the negative monthly repricing, headline inflation rose in May, driven by base effects. Going forward, it is highly likely that general price pressure will remain above the central bank's tolerance band for the remainder of 2024

West End City Center shopping centre in Budapest, Hungary

4.0%

Headline inflation (YoY)

ING estimate 4.2% / Previous 3.7%

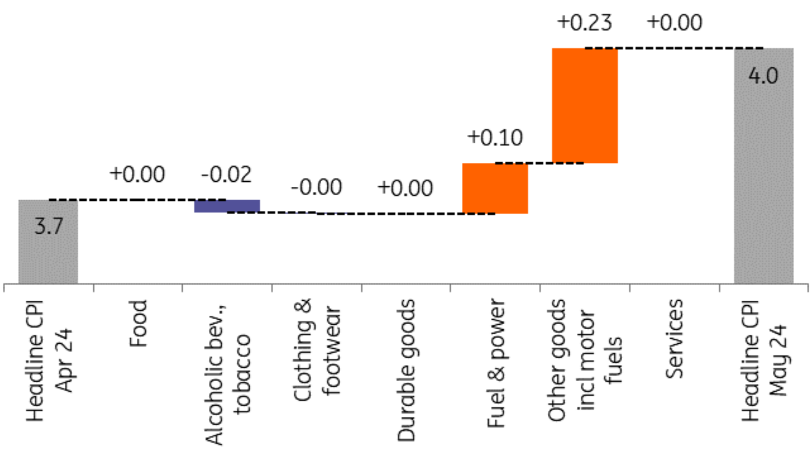
Lower than expected

To some extent, non-core elements have tamed reflation

The year-on-year Hungarian inflation figure rose slightly in May, delivering a downside surprise versus our expectations. Compared to April, headline inflation rose by 0.3ppt to 4.0% YoY, while the monthly repricing was -0.1%, meaning that this time base effects were the main culprit. It's fair to say that a few months ago we were expecting a bigger monthly bump in May, signalling the first phase of the reflation wave. In the end, however, this bump was significantly smaller, as non-core elements tamed headline inflation to some extent. This downside surprise is also underscored by the fact that the National Bank of Hungary (NBH) was expecting a 4.9% YoY reading for May back in March, when the Inflation report was released. Though in all fairness a lot has changed since March, especially in food and fuel items.

Nevertheless, it is important to emphasise that even though headline inflation is looking better than expected, the trajectory is still upward, with the general price pressure likely to remain above the central bank's tolerance band for the remainder of the year. Not to mention that core inflation surprised to the upside, suggesting that underlying price pressures remain intact.

Main drivers of the change in headline CPI (%)

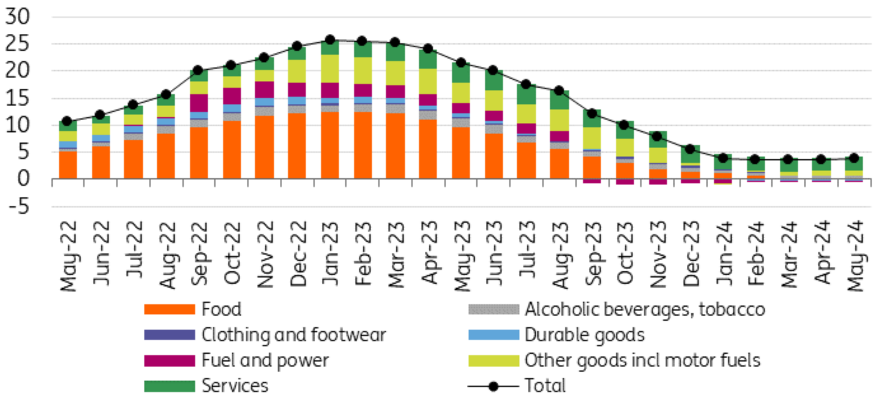


Source: HCSO, ING

The details

- Food prices rose only by 0.1% MoM, which brings the annual food inflation rate to 1%. On a monthly basis, prices of unprocessed foods decreased, while prices of processed foods increased, displaying a divergence within the food component.
- Fuel prices decreased by 4.4% MoM, which was one of the most important drivers behind the monthly repricing. At the same time, household energy prices also decreased on a monthly basis, which was in line with warmer weather conditions.
- Prices of durable goods fell by only 0.2% on a monthly basis, which can be explained by the still rather subdued demand for durable goods. Speaking of which, clothing prices posted a monthly decline, which could also reflect subdued demand for this category and this caught us a bit off guard.
- Services prices rose by 0.9% MoM, which kept the annual services inflation rate flat at 9.5%. This time, domestic holiday packages were one of the biggest contributors, while the retrospective repricing of financial and telecommunications services was still evident. In terms of annual headline inflation, the services component explains 63% of total inflation.

The composition of headline inflation (ppt)



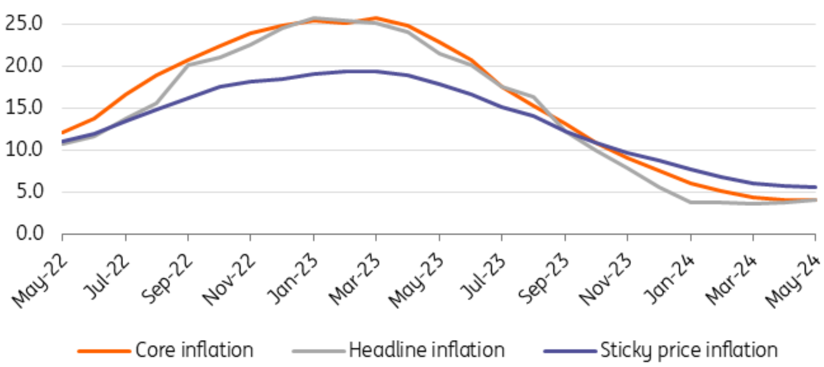
Source: HCSO, ING

Core inflation proves to be sticky

Core inflation decelerated by only 0.1ppt to 4.0% YoY in May, as a result of a 0.5% MoM increase in prices of core items. This deviation from the headline inflation underlines the importance of non-core basket goods in the evolution of the general price pressure. The National Bank of Hungary's measure of inflation for sticky prices also decreased somewhat, displaying a reading of 5.6% YoY. In all, underlying inflation indicators are signalling that Hungary still has an inflation problem under the surface. If we annualise the three-month average of seasonally adjusted monthly core inflation, we get a price pressure rate of 7% which is the highest reading since the March-June annualised average in 2023.

Altogether, despite the downside surprise in headline inflation, we don't think the overall inflation landscape has changed much. Again, the lower-than-expected decline in core inflation highlights the fact that the downside surprise in headline inflation was driven by non-core factors. In contrast, those items with more persistent price pressures, such as services inflation, remain relatively hot at an annualised rate of more than 11%.

Headline and underlying inflation measures (% YoY)



Source: NBH, ING

The first round of reflation will start in May

The recent weakness of the Hungarian forint (roughly 2.8% weakening from end-May low-point) and the approximately 5% price increase in crude oil since early June doesn't bode well for fuel prices. Though the weather might help reduce further the average energy bill of households and lack of demand might tame price pressures in semi-durable and durable goods, the two former categories could suffer from weaker FX as well. Taking into consideration seasonal patterns, June and July might bring positive monthly repricing again and the year-on-year print will hover around the recent figure.

The next major jump in headline inflation is expected from October onwards, when inflation could exceed 5%. Considering the current underlying processes, – and given that those elements delivered a downside surprise which aren't part of the core basket, and are more volatile in general – we maintain our forecast that inflation could range between 5.5-6.0% in December 2024, likely closer to the bottom end of the range. Despite the downside surprise in May, we stick to our call as we believe that the second round of reflation will be driven by price pressures within the core basket, along with base effects.

Sticky core inflation, coupled with market instability justifies the patient approach

From a monetary policy perspective, the recent headline inflation data could even argue for an unchanged pace of rate cut compared to the last meeting (50bp). However, it's important to note that the downside surprise was not driven by core elements that monetary policy can influence, but rather by volatile and autonomous elements that the central bank cannot influence. Not to mention the fact that corporate wage growth is still running hot at 12.7%, which limits the room for services inflation to cool down.

Based on the macro fundamentals, we argue for a slowdown in the pace of rate cuts to 25bp in June, but given the recent market instability regarding EUR/HUF, we strongly believe that the room for a larger rate cut than 25bp is extremely limited. Not to mention the fact, that the divergence between the Fed and ECB's rate path has started to materialise, and emerging market currencies will feel the heat of USD strength.

Therefore, considering a no-cut scenario may seem like an extreme outcome, but it could also be justified in our view. However, given that the central bank has already communicated that the policy rate could be lowered in the range of 6.75%-7.00% at the June meeting, this puts the probability of a no-cut scenario practically close to zero.

Overall, we maintain our view that the NBH will only cut by 25bp at the June meeting, bringing the policy rate down to 7.00%, which we believe will be the terminal rate for this year. Following this, a period of sustained inaction may ensue, as a relatively tighter monetary policy could ensure financial market and inflation stability over the longer term in an environment of rising inflation.

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