No brake on the Hungarian inflation train

Despite heightened expectations, October inflation was a significant upside surprise. Second-round effects are here as core inflation also jumped, heralding the need for stronger tightening

6.5%

Headline inflation

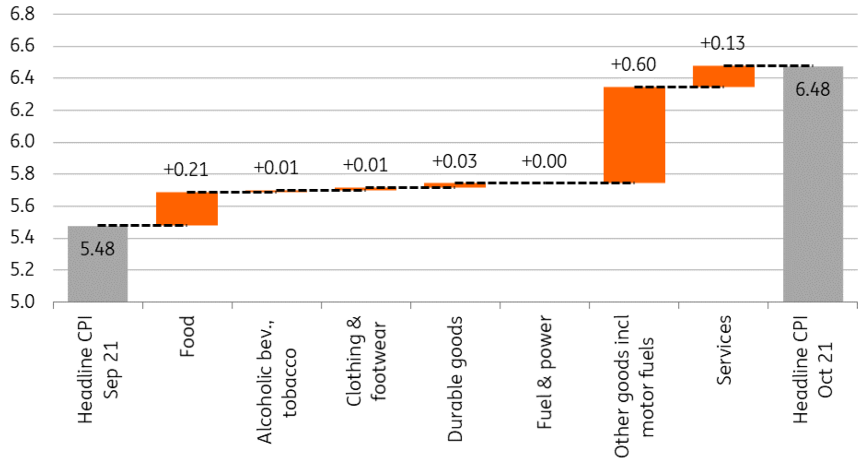
ING forecast 6% / Previous 5.5%

Higher than expected

Inflation moves well above expectations

Inflation is increasingly looking like a runaway freight train without working brakes. The market adjusted its inflation expectations after the 5.5% reading in September, only to be surprised yet again. After a 1ppt acceleration, headline inflation came in at 6.5% YoY, higher than any of the individual economist forecasts. This time, we can't lay the blame on the base effect, as month-on-month inflation was at 1.1%. Although there are some surprises, the majority of the acceleration stems from fuel.

Main drivers of the change in headline CPI (%)

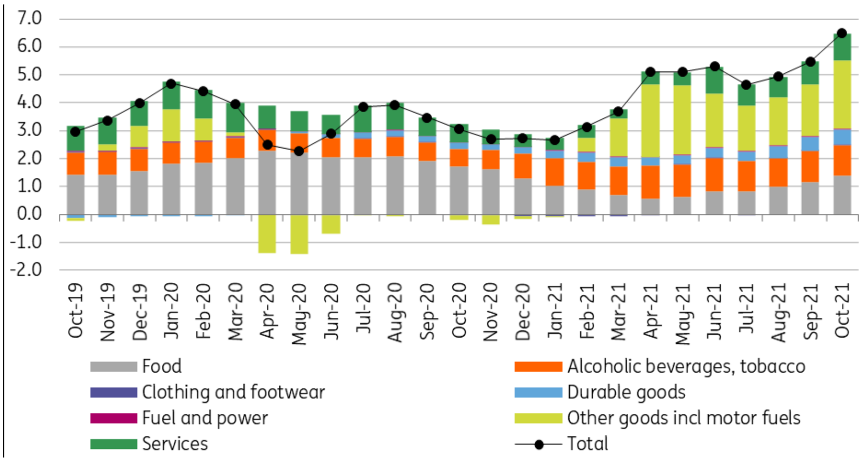


Source: HCSO, ING

The details

- Hungarian fuel prices in nominal terms reached record high levels in October. Monthly inflation in fuel was at 7.3%, translating into a 30.7% year-on-year price increase. This impact was responsible for 60% of the acceleration in headline inflation.
- Inflation in food came in 0.8ppt higher at 5.2% YoY in October. Import products like coffee and tea are showing significant price increases as are fresh fruit and vegetables. However, the elevated producer prices are spilling over into processed food prices too. Thus, second round effects have already arrived, impacting core inflation.
- Having talked about imported inflation, we need to mention price changes in durable consumer goods. On a monthly basis, the 0.7% rise translated into a 5.4% YoY reading, the highest since 2009. The rise in industrial producer prices caused by elevated transport costs, global spare parts shortages, and labour shortages have been showing up in consumer prices.
- Inflation in services used to decrease in October on seasonal factors, but not in 2021. The monthly price change was at 0.4%, thus the year-on-year change moved up to 3.7%. Transport, cultural and leisure activities mainly contributed to the rise in inflation, but the monthly decline in prices of holiday packages was also much smaller than usual.

The composition of headline inflation (ppt)

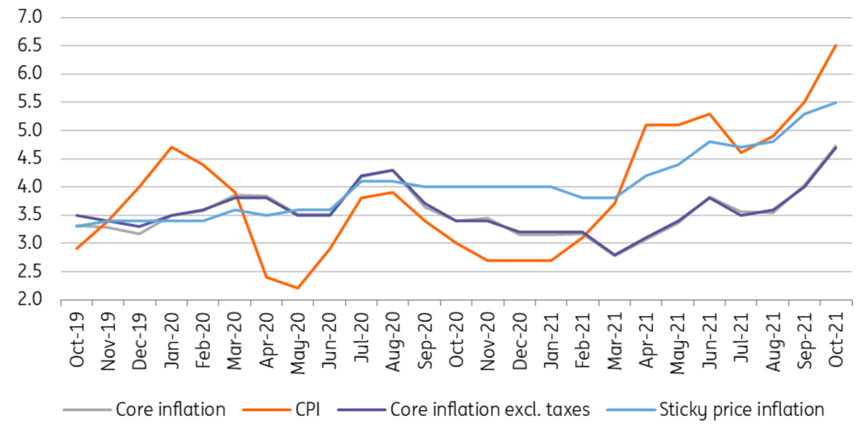


Source: HCSO, ING

Underlying price pressures increase further

In all, there is widespread inflation pressure, with non-core elements, shortages related to core goods and services, and second-round effects all in play. As a result, it hardly comes as a surprise that core inflation rose by 0.7ppt to 4.7% YoY in October. The further rise in underlying price pressures is also seen in the National Bank of Hungary's underlying indicators. Core inflation, excluding indirect tax sits at 4.7% YoY, while so-called sticky price inflation moved up to 5.5% YoY, matching the level last seen in July 2004.

Headline and core inflation measures (% YoY)



Source: HCSO, NBH, ING

We revise our inflation outlook upwards

Today's data significantly exceeded the short-term forecast published in the NBH's September Inflation Report. It is almost assured that inflation this year and next will be higher than outlined in September, which may mean a delay in reaching the inflation target if the NBH does not deviate from the interest rate path behind the forecast. In the wake of the October inflation reading, we need to update our inflation forecast to the upside. We see the 2021 average inflation rate at 5% and we expect an average yearly price increase in the 4.5-4.7% range over the next year.

The chances for stronger rate hikes increase

When it comes to monetary policy, we see an increased chance that the NBH will deviate from the 15bp step sizes seen in the past two months and will set itself up to raise interest rates at a stronger pace in light of today's data. Moreover, moves at other regional central banks are also putting pressure on the Hungarian central bank. The fact that core inflation has now approached 5% suggests that temporary effects are transforming quickly into second-round effects. Based on all this, it is more and more likely that a stronger pace of interest rate increases may be necessary to tackle inflation issues over the monetary policy horizon - a possibility which has already been mentioned by the central bank's vice governor.

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