Temporary slowdown in Hungarian disinflation

The expiry of food price caps and soaring fuel prices gave a temporary boost to Hungary's monthly inflation in August. Developments in core inflation look more encouraging, especially in services

People shopping in the Great Market Hall in Budapest

16.4%

Headline inflation (YoY)

ING estimate 16.3% / Previous 17.6%

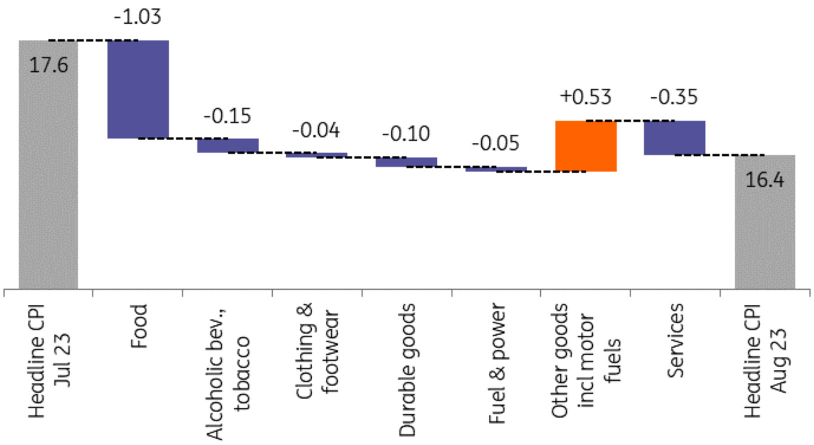
Higher than expected

Disinflation is getting more widespread with some exceptions

As expected, the disinflationary process in Hungary continued in August, albeit at a slightly slower pace. Headline inflation decreased to 16.4% year-on-year. Base effects helped to cover the pick-up in month-on-month inflation, which came in at an above-consensus 0.7%. The last time monthly price pressures were this high was in April earlier this year. It is also important to note that August typically shows a slightly negative monthly repricing based on the historical average. Against this backdrop, we can say that the monthly price momentum was strong in

August 2023 – but the vast majority of this momentum stems from one-off elements.

Main drivers of the change in headline CPI (%)

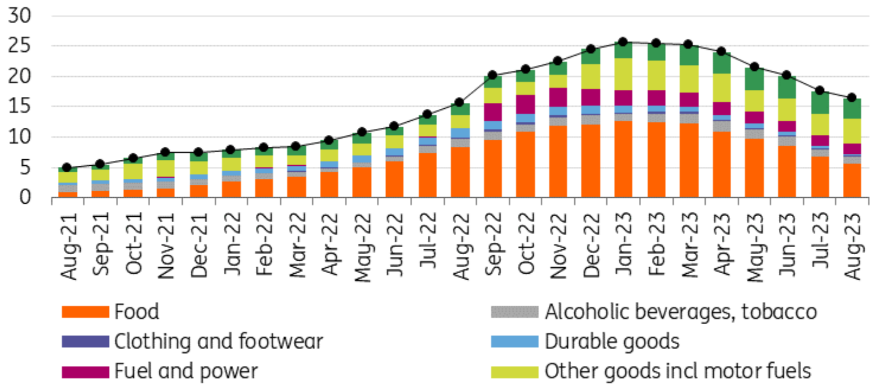


Source: HCSO, ING

The details

- In August 2023, the government abolished food price caps, which set the prices of some selected basic foodstuffs at the level of October 2021. It is therefore not surprising that food prices rose again on a monthly basis. However, given the general price pressure on food last year, the base effect still helped to reduce the YoY increase to below 20%.
- Another major factor behind the strong monthly repricing is fuel. The strengthening of the dollar resulted in a much higher USD/HUF level (roughly 7% versus mid-July), while oil prices edged up as well. As a result, fuel prices jumped by 8.2% MoM in August, putting the brakes on the general disinflation process in the yearly-based headline print.
- The global disinflationary trend helped with a minor retreat in the average prices of durable goods (-0.1% MoM), counterbalancing the volatile movements in the forint. Falling consumption and fierce competition are also key players here as the real disposable income of households continues to shrink.
- Last but not least, the real downside surprise was the yearly-based inflation in services, which slowed to 13.2% and broke a 13-month uptrend. It seems that the collapse in domestic demand has started to impact the repricing power of service providers. Even if we exclude the effects of the one-off price cut in telephone and internet services in August, the monthly repricing in services is lower than usual.

The composition of headline inflation (ppt)



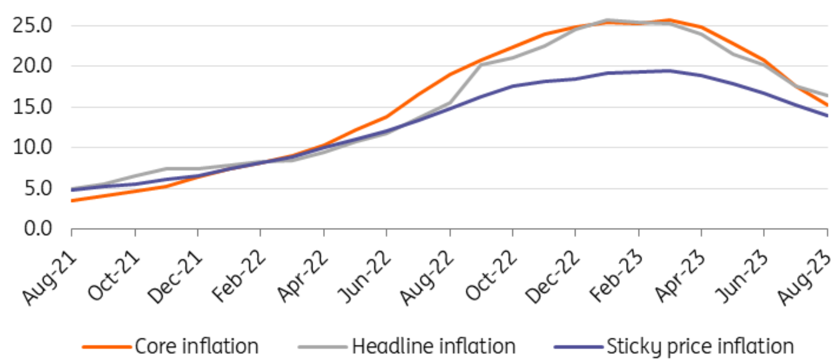
Source: HCSO, ING

Inflation structure takes a favourable turn

Upward pressure on inflation in August came mainly from fuel and other non-core items, and disinflation was more widespread than expected (including services). This explains why we're now seeing a stronger deceleration in core inflation than in the headline. The core reading fell 2.3ppt to 15.2% YoY. This is not just a base effect phenomenon, as the month-on-month print was 0.2%.

Moreover, over the last three months, core inflation has averaged 0.247% MoM, which is in line with the central bank's target of 3% annualised inflation. We are not saying the job is done, but the underlying inflation performance is encouraging. Other underlying indicators, such as the sticky price inflation calculated by the National Bank of Hungary, are also promising and suggest that price pressures are continuing to ease in the deeper layers of the economy. Hungary is slowly but surely coming out of the woods.

Headline and underlying inflation measures (% YoY)

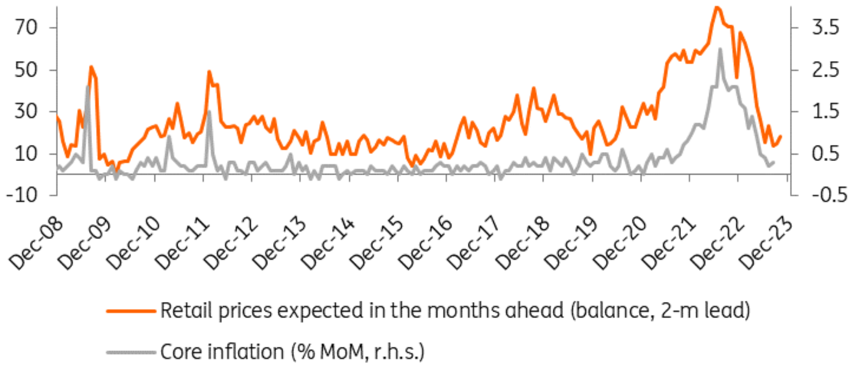


Source: HCSO, NBH, ING

Single-digit inflation achievable by November

In light of today's data, a single-digit inflation rate at the end of the year seems certain. If there are no further price shocks, we could even see a rate below 10% as early as November. If we see a continuation of the recent repricing trend, and based on retail price expectations, we can be hopeful that the core reading will reach the sub-10% range by December. When it comes to average headline inflation, we have not changed our view and are looking for an inflation rate of around 18% in 2023 on average.

The correlation between retail price expectations and core inflation



Source: Eurostat, HCSO, ING

Looking ahead to next year, we're expecting average inflation to be at around 5.0% – although we still see some upside risks. The expected dynamic wage outflows next year should translate into significant positive real wage growth. Households with savings in inflation-linked retail bonds should also see a large coupon payment in the first quarter of 2024. Should the reinvestment rate turn out to be lower than expected, the rising consumption propensity could bring back the strong repricing power of companies on the back of boosted domestic demand.

Upcoming tax changes – such as the increase in fuel excise duty and the hike in road tolls – could also lead to second-round effects. On the other hand, recessionary risks in the developed world and the renewal of corporate energy contracts expiring this year on much more favourable terms will help to partially offset these risks.

No room for complacency in monetary policy

In our view, monetary policy is unlikely to be significantly influenced by inflation developments in August. It is almost out of the question that the central bank will cut the effective rate to 13% in September, merging this with the base rate. The National Bank of Hungary will reduce the complexity of the monetary policy to some extent. However, given the risks to financial markets (mostly FX markets) and the evolution of global monetary policy with higher-for-longer narratives, the central bank may adopt a more hawkish stance than the market consensus after September, which could include leaving the effective interest rate unchanged for one or two months.

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