REPORT ON INFLATION

11 December 2017

CPI rebounds on fuel prices, while all underlying figures suggest decelerating inflation

- After falling short of expectations in October at 2.2% YoY, the November headline figure of Hungary CPI, at 2.5% was in line with median polls of Reuters and portfolio.hu, with the MNB's latest forecast for November (updated in September 2017) and also with our in-house forecast. In a Bloomberg poll, analysts' median forecast was 2.6% YoY.
- Fuel prices had a significant role in the acceleration, as their YoY inflation jumped to 5.9% from 1.3% in the previous month. Taking into account fuel's weight in the CPI basket, it added 0.3ppts to the headline CPI. Hence, the inflation without volatile items and all government measures (our figure for underlying inflation) declined to 2.2% from 2.3% a month earlier and from 2.4% (its most recent peak) in September. We think this indicator is better at capturing underlying inflationary processes than core inflation (which dropped from 2.7% to 2.6% YoY), because the latter is not filtered from the effect of indirect tax changes and was recently pushed up by excise duty hikes on tobacco products. Trend inflation (the aggregate of goods and market services) declined from 1.3% to 1.1%. Its annualized 3M/3M change (rolling QoQ) decelerated from 1.5% to 1.1%.
- There are two main factors behind the sharp decline in trend inflation. First, the price of telecommunication services fell by a stunning 1.4% MoM, dragging down the YoY index to -5.1%. Although this could be the consequence of some forward-brought price adjustment to the 2018 January cut of VAT on internet access services (from 18% to 5%), it seems more plausible that this is an additional price cut, which will remain in the prices. We note that the weight of this item in the overall CPI is 4.2% and it gives nearly 20% of market services. In other words, from the very significant 0.6 pp decline of market services' yearly index from 2.2% in October to 1.6% in November, 0.4 pp is explained by the drop of telecom services prices. However, other market services items as newspaper and book retail trade or transportation services also posted slightly decelerating inflation. Second, the recent downward trend in durable goods got further impetus due to the 2.1% MoM price drop of used passenger vehicles (this item weighs 1.3% in the overall CPI). As a result, the durable goods inflation swung back below zero, to -0.2% YoY.
- On the other hand, tobacco prices, market priced energy and non-durable goods inflation surprised slightly on the upside. However, tobacco prices' effect on the headline CPI is not significant (though we assess it as a permanent factor), and accelerating market priced energy (i.e. firewood) inflation refers to fears of as cold winter as a year ago and thus elevated demand (according to local media sources), while the upswing in non-durable goods inflation is due to the changed seasonality of sports equipment pricing. The upshot is that we do not foresee these factors to have sizeable effect on future CPI.
- To sum it up, the November data underpin our view that inflation has surpassed its peak and is on a downward trend now, despite the November rebound in the YoY index. This may seem surprising, given the very robust economic performance. However, this vigorous performance drives underlying inflation while the headline inflation is strongly affected by the modest food and energy prices, still very low and recently decelerating imported inflation and a load of government measures (VAT cuts, employers' social security contribution cuts, abolishment of roaming fees, lack of raise in administered prices). All these effects result in lower inflation perception, which slows down the rise of underlying inflation.
- Looking forward, we expect inflation to fall close to 2% in December, due to base effect, and to decline further at the beginning of next year. In its updated Inflation Report, due out on 21 December, Hungary's central bank will almost certainly revise down its current 2.5% forecast for 2018 CPI (cf. our current forecast is 1.7% YoY), which will support decision-makers' commitment to loose monetary conditions.
- As a result, the MNB will not be in hurry to tighten monetary policy conditions. Our baseline scenario is that the 3M deposit rate will remain 0.9% well into 2019 and the 3M BUBOR (which can be considered as an effective monetary policy rate now) will be close to zero until 2019.

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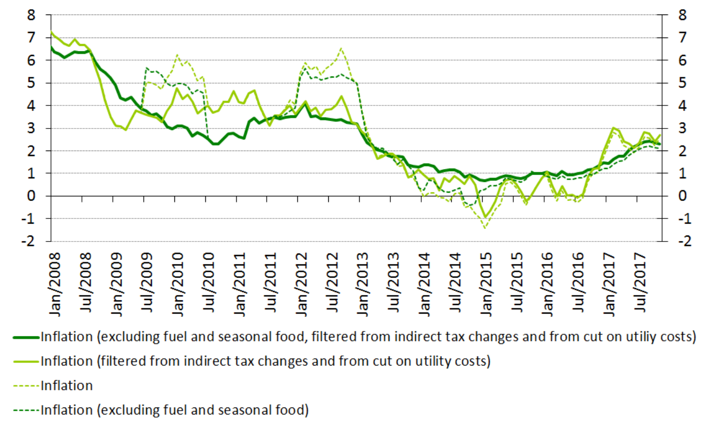
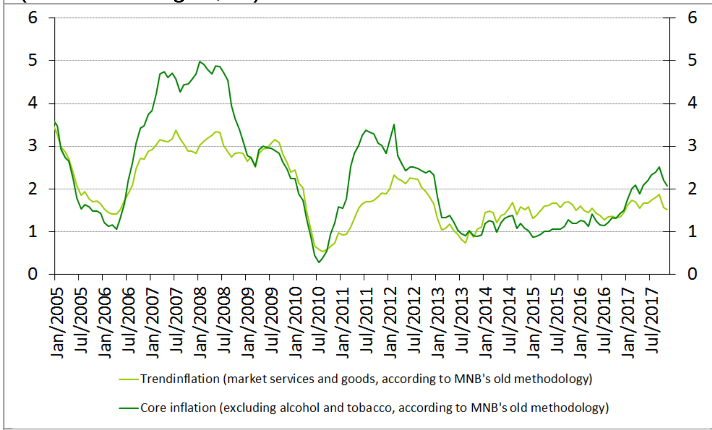
Chart 1: Summary chart of inflationary processes
(annual changes, %)



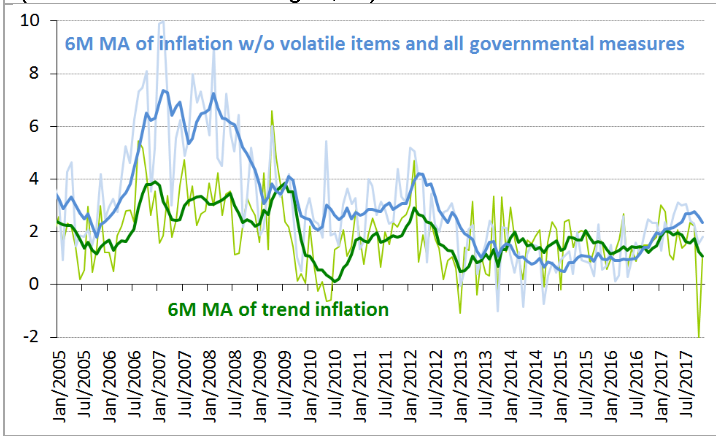
Sources: HCSO, OTP Research

Chart 2: Core* and trend inflation*
(annual changes, %)



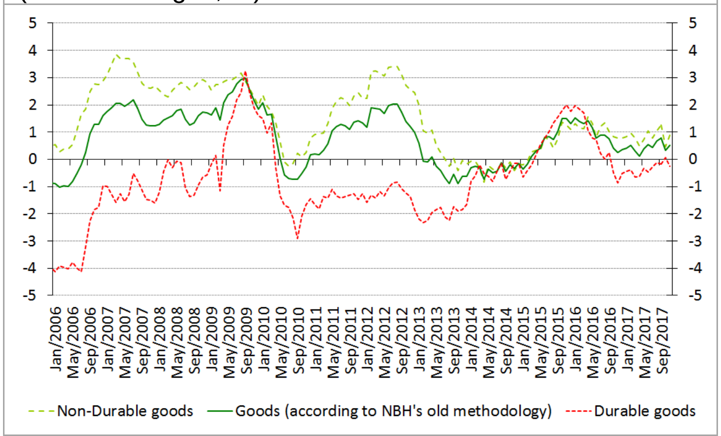
Sources: HCSO, OTP Research
**: Filtered from indirect tax and visit fee changes, and one-off items*

Chart 3: Underlying inflation indicators*
(annualized MoM changes, %)



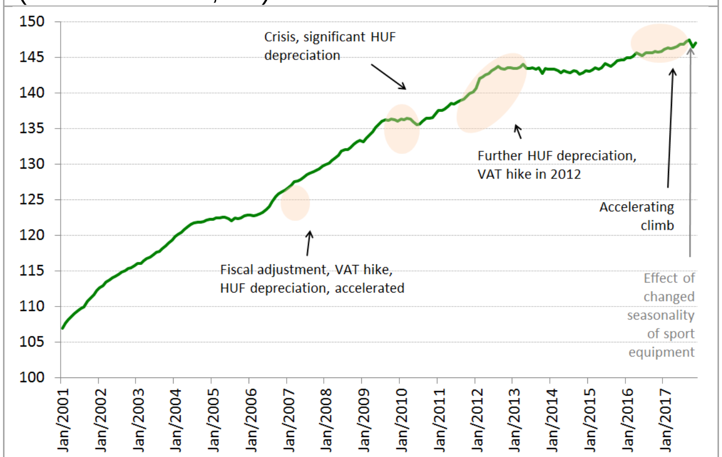
Sources: HCSO, OTP Research
**: Filtered from indirect tax and visit fee changes, and one-off items*

Chart 4: Goods inflation*
(annual changes, %)



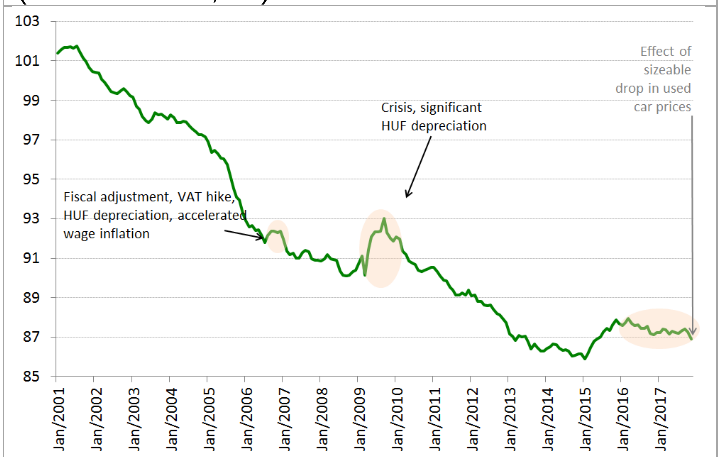
Sources: HCSO, OTP Research
**: Filtered from indirect tax changes*

Chart 5: Price level of non-durable goods
(2000 Jan = 100, SA)



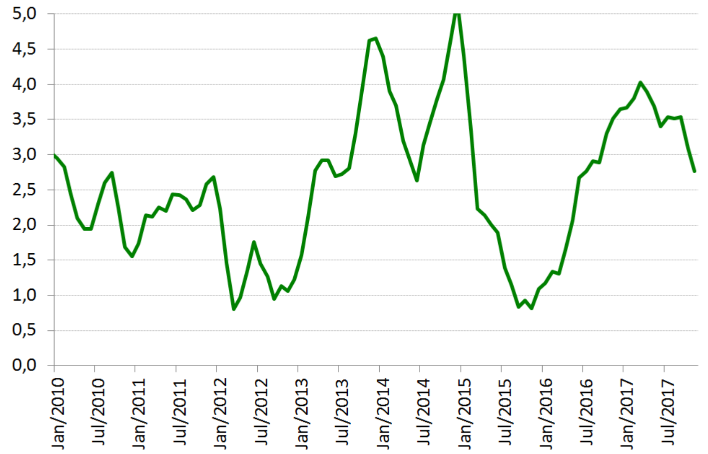
Sources: HCSO, OTP Research

Chart 6: Price level of durable goods
(2000 Jan = 100, SA)



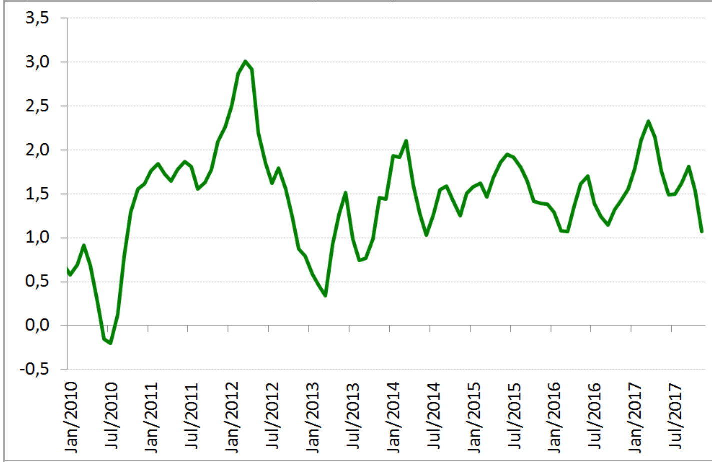
Sources: HCSO, OTP Research

Chart 7: Core services inflation*
(annualized 3M/3M changes, %)



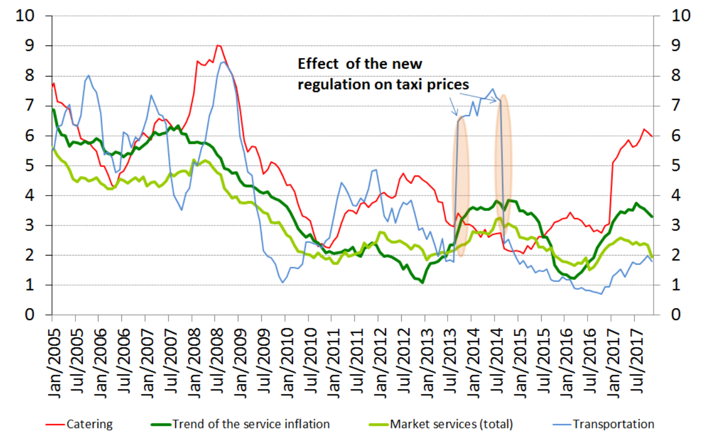
Sources: HCSO, OTP Research
**: Filtered from indirect tax (including financial transaction tax) and visit fee changes*

Chart 8: Trend inflation*
(annualized 3M/3M changes, %)



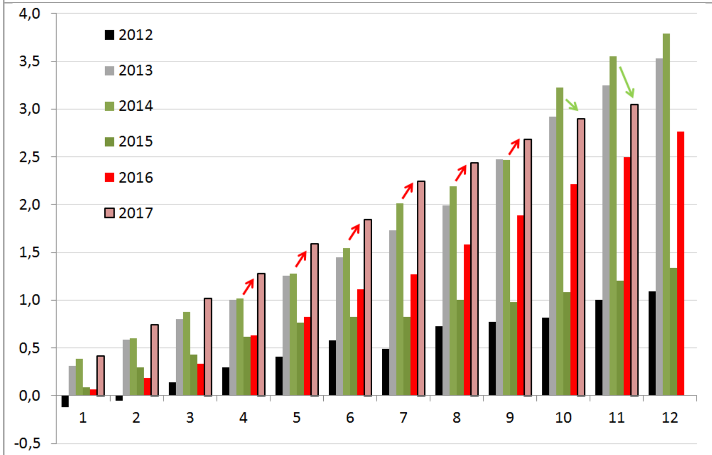
Sources: HCSO, OTP Research
**: Filtered from indirect tax (including financial transaction tax) and visit fee changes*

Chart 9: : Market services inflation*
(annual changes, %)



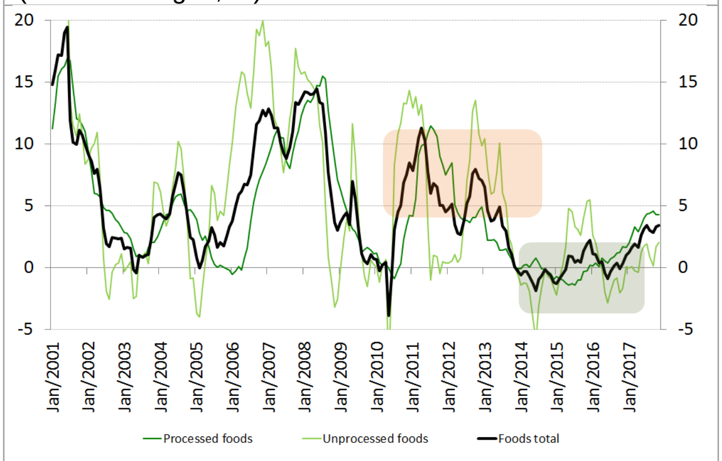
Sources: HCSO, OTP Research
**: Filtered from indirect tax (including financial transaction tax) and visit fee changes*

Chart 10: Intra-year price setting in core services*
(cumulated, over previous Dec, %, SA)



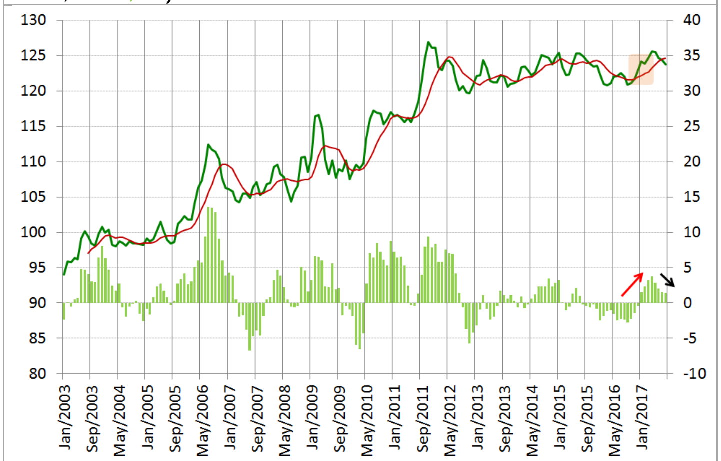
Sources: HCSO, OTP Research
**: Filtered from indirect tax (including financial transaction tax) and visit fee changes*

Chart 11: Inflation of food products
(annual changes, %)



Sources: HCSO, OTP Research

Chart 12: Imported inflation* (monthly data, 2005 avg = 100, YoY, %)



Sources: HCSO, EC, OTP Research
**: import price of non-food intermediate goods+passenger cars*

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