

REPORT ON INFLATION

14 February 2018

CPI stagnated at 2.1% YoY in January, despite lower-than-expected pass-through of VAT cuts

- Inflation in Hungary was 2.1% YoY in January, the same as in the previous month, the KSH statistical office said. The incoming data was in line with our forecast and market consensus as well. Filtered inflation (inflation without volatile items and all government measures) held steady at 3% YoY. Its annualized 3M/3M change (rolling QoQ) was 2.7%.
- The main questions about the current data were the following: to which extent will the VAT cuts (from 18% to 5% on internet providing services and on catering, and from 27% to 5% on fish and animal offal) pass through, and will the re-pricing intentions of economic actors gain impetus due to the robust domestic demand? The answers are mixed. Just like a year earlier, internet service providers pass through the entire theoretical effect of the cut, but the price reaction in catering services was muted: in our estimate, just a modest 30% of the theoretical maximum effect was reflected in prices in January, while in the case of unprocessed foods it was about 60% – compared to the previous year's around-80% figure. Although these figures do not mean that the cumulative pass-through will not be higher later, the first month's effect is weaker than a year ago. This suggests that demand is strong enough to provide room for *not* giving the benefit to costumers.
- Yet the price-setting behaviour does not show many signs of aggressive price hikes: in core service items the January MoM index lags behind its 2017 January figure. However, it holds uncertainty and field experience suggests that re-pricing may accelerate in the coming months. In our view, with low overall inflation and stable regulated prices, price-setting across services has become less coordinated. Previously, the January regulated price hikes (which are an important cost item for several services and acted as a signal of overall inflation trends) encouraged firms to change their prices at the beginning of the year. In recent years, administrative price hikes practically vanished in Hungary, and re-pricing also appears to be more evenly distributed throughout the year. So far, 3M on 3M annualized core services' CPI has dropped to 2.1% from 4.1% a year ago, while a similar measure of trend CPI was 0.8% in January, a four-and-a-half-year low.
- Besides, in January there was a downward surprise in unprocessed foods and in non-durable goods prices. The first is related to core unprocessed foods (i.e. non-seasonal items such as flour, meat and egg) as well as potato, while the latter was quite broad-based. The [egg price rally](#) seems to be over and some normalization may come. On the other hand, processed food inflation has not dropped as fast as we had forecasted, because of processed fruit and vegetable prices, and sugar prices also show sign of some future increase.
- Regarding fuel prices, our [medium-term forecast](#) assumed peaking prices at the turn of 2017/18, and some modest decline going forward. Taking into account the most recent evolution of Brent crude's price, this assumption has been right so far.
- In all, the 2.1% YoY CPI in January is generally in line with our medium-term forecast, while our most recent subgroup trackers point to decelerating CPI in all the main fields of consumer prices. We maintain our below-market consensus expectation of around 2% CPI for the majority of 2018 (the February Focus Economics consensus forecast is 2.6%). CPI is not expected to increase before the second half of 2018 and is unlikely to match the MNB's 3% target in a sustainable manner before the second half of 2019.
- As a result, we maintain our expectation of a very loose monetary policy over the next several quarters; even though the central bank seems to be less committed to keeping down the long end of the curve (instead, it targeted stable spreads above international benchmarks). In any case, short rates are likely to stick to zero and any form of tightening is very unlikely to come before the second half of 2019.

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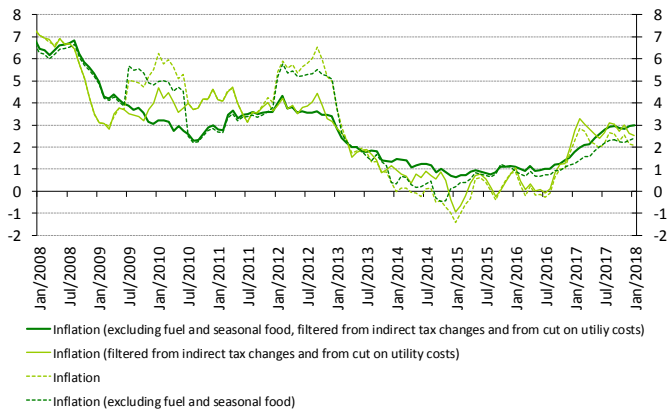
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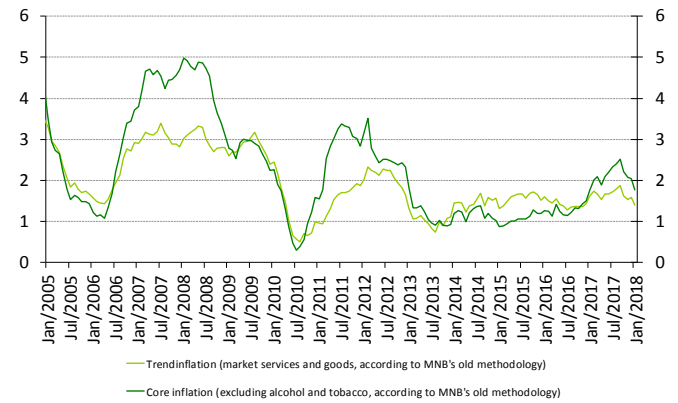
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Chart 1: Summary chart of inflationary processes
(annual changes, %)



Sources: HCSO, OTP Research

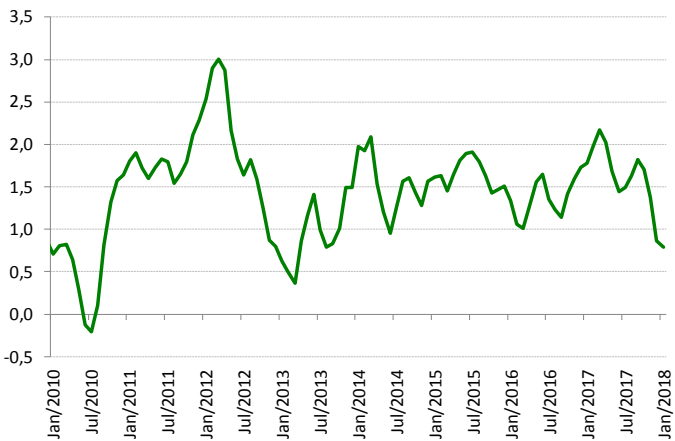
Chart 2: Core* and trend inflation*
(annual changes, %)



Sources: HCSO, OTP Research

*: Filtered from indirect tax and visit fee changes, and one-off items

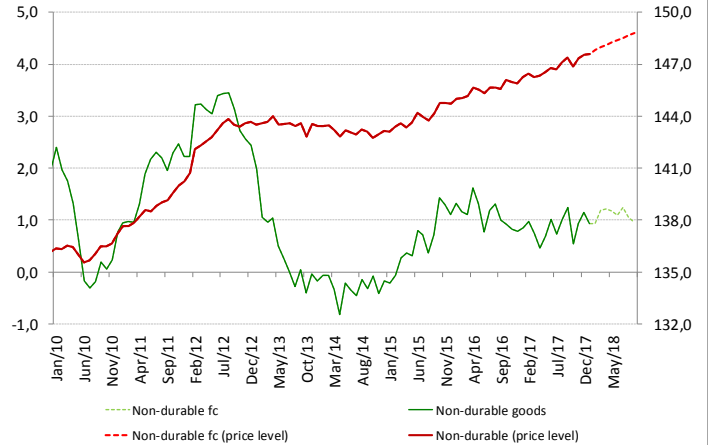
Chart 3: Trend inflation*
(annualized 3M/3M changes, %)



Sources: HCSO, OTP Research

*: Filtered from indirect tax and visit fee changes, and one-off items

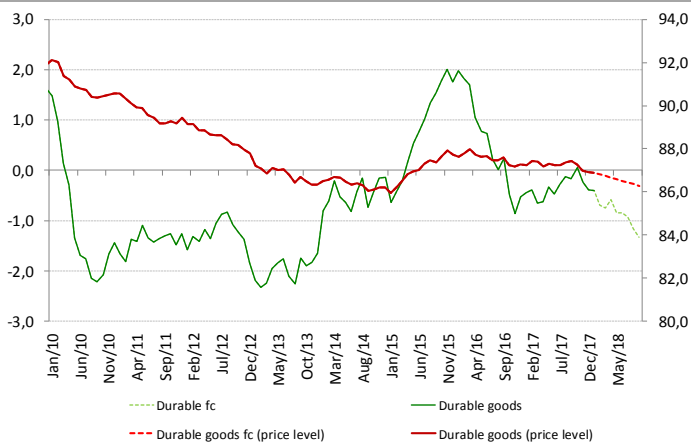
Chart 4: Non-durable goods inflation*
(annual changes % and 2000 Jan=100)



Sources: HCSO, OTP Research

*: Filtered from indirect tax changes

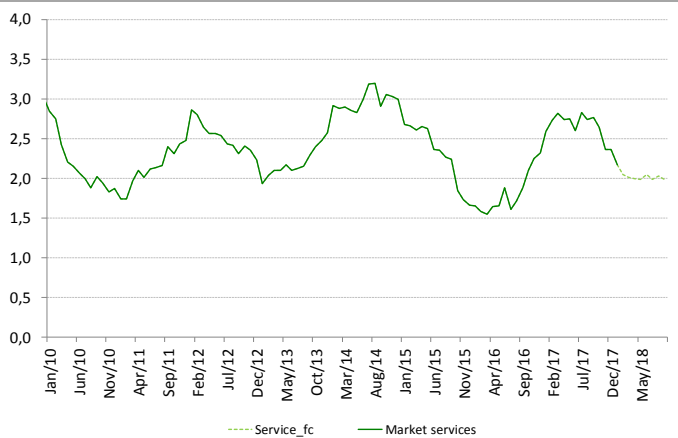
Chart 5: Durable goods inflation*
(annual changes % and 2000 Jan=100)



Sources: HCSO, OTP Research

*: Filtered from indirect tax changes

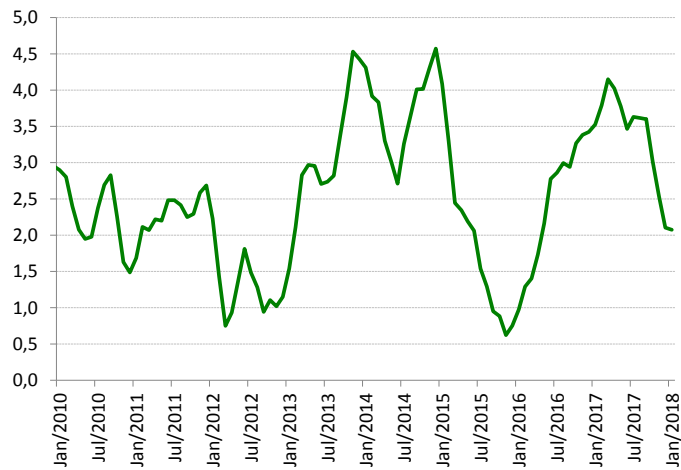
Chart 6: Market services inflation*
(annual changes, %)



Sources: HCSO, OTP Research

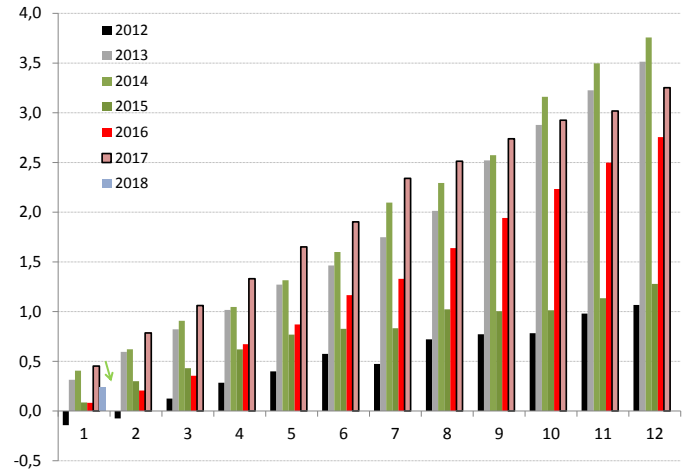
*: Filtered from indirect tax (including financial transaction tax) and visit fee changes

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



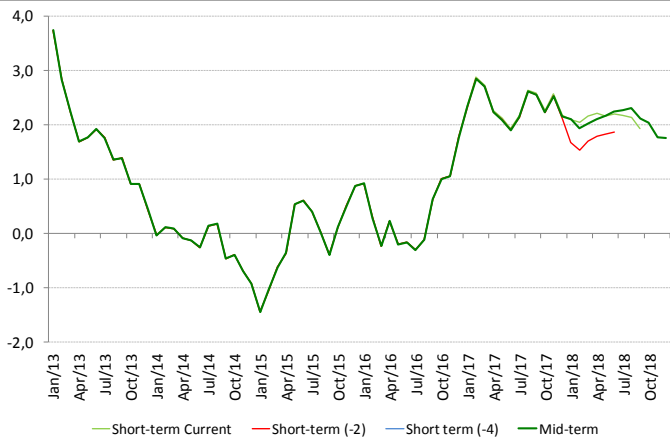
Sources: HCSO, OTP Research
*: Filtered from indirect tax (including financial transaction tax) and visit fee changes

Chart 8: Intra-year price setting in core services*
(cumulated, over previous Dec, %, SA)



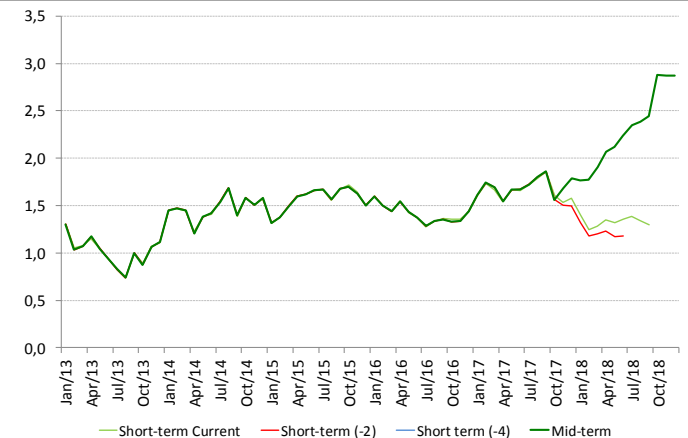
Sources: HCSO, OTP Research
*: Filtered from indirect tax (including financial transaction tax) and visit fee changes

Chart 9: Evolution of our CPI forecast*
(annual changes, %)



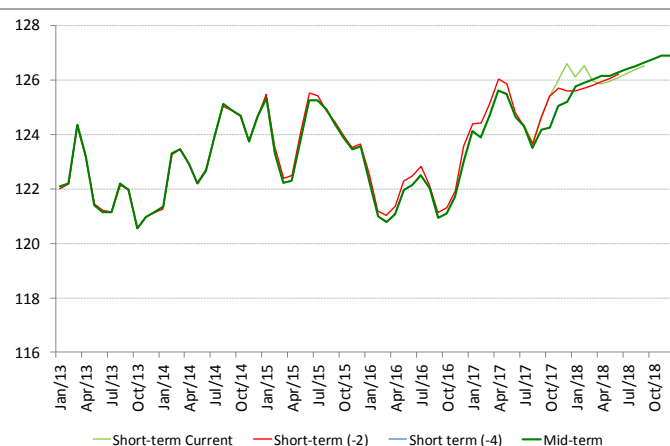
Sources: HCSO, OTP Research
*Short-term forecast: our model-based short range forecast, updated every month with the incoming data
Medium-term: our model-based forward looking forecast, updated twice a year

Chart 10: Evolution of our trendCPI forecast*
(annual changes, %)



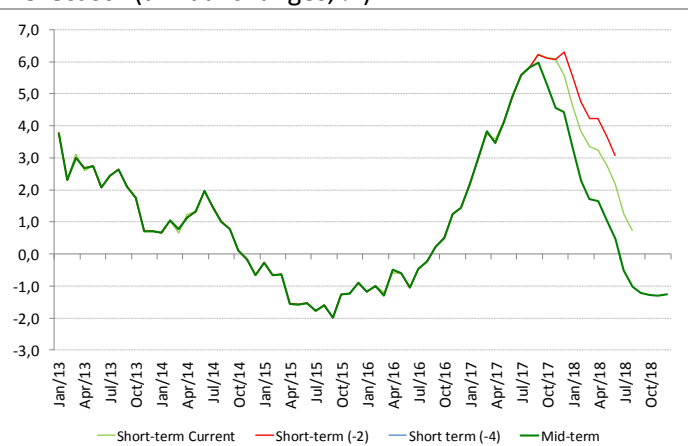
Sources: HCSO, OTP Research
*: Filtered from indirect tax (including financial transaction tax) and visit fee changes; Short-term forecast: our model-based short range forecast, updated every month with the incoming data
Medium-term: our model-based forward looking forecast, updated twice a year

Chart 11: Forecast of imported inflation*
(2005=100)



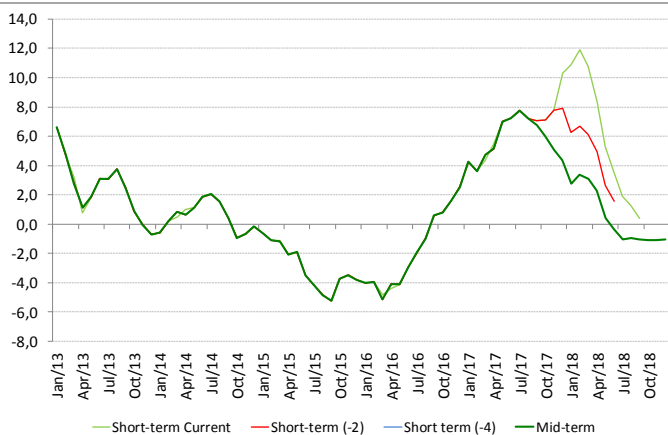
Sources: HCSO, OTP Research
*: import price of non-food intermediate goods+passenger cars;
Short-term forecast: our model-based short range forecast, updated every month with the incoming data
Medium-term: our model-based forward looking forecast, updated twice a year

Chart 12: Evolution of our core-processed food inflation forecast*
(annual changes, %)



Sources: HCSO, EC, OTP Research
*Short-term forecast: our model-based short range forecast, updated every month with the incoming data
Medium-term: our model-based forward looking forecast, updated twice a year

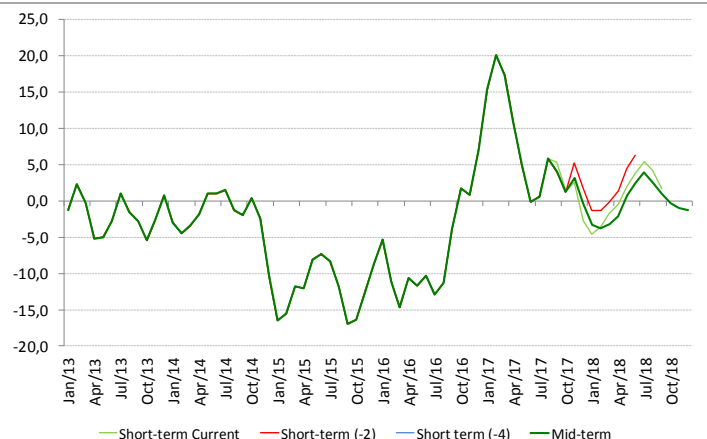
Chart 11: Evolution of our core-unprocessed food inflation forecast* (annual changes, %)



Sources: HCSO, OTP Research

*Short-term forecast: our model-based short range forecast, updated every month with the incoming data Medium-term: our model-based forward looking forecast, updated twice a year

Chart 12: Evolution of our fuel price forecast* (annual changes, %)



Sources: HCSO, OTP Research

*Short-term forecast: our model-based short range forecast, updated every month with the incoming data Medium-term: our model-based forward looking forecast, updated twice a year

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