

# REPORT ON INFLATION

16 January 2019

## Upside surprises in December data may affect whole-year 2019 CPI

- According to the KSH statistical office's figures, Hungary inflation slowed to 2.7% YoY in December, from 3.1% in the previous month. We forecasted 2.6% inflation for December, while Portfolio.hu's consensus forecast was 0.1ppts higher than our expectation. So the incoming data was slightly higher than our forecast. Underlying indicators changed as follows:
  1. Filtered inflation (inflation without volatile items and all government measures) was 2.5% YoY, up from 2.4%, and it was 0.2ppts higher than our forecast. Its annualized 3M/3M change (rolling QoQ) was 2.5%. Filtered inflation has practically stagnated at 2.5% throughout the second half of 2018.
  2. Trend inflation (goods and market services without one-offs and government measures) stagnated at 2.9%, in line with our expectation. Trend inflation is clearly on a rising trend, as it was just 2.2% in April. Its 3M/3M growth rate (rolling QoQ) stagnated at 3.1%. The rolling QoQ figure has essentially stagnated around 0.8% (annualized: 3.2%) since July. Although trend inflation matched our forecast, its inner structure was different from our expectation. Market services inflation was higher, while goods inflation was lower than our forecast. In the case of market services, the upside surprise came from telecom prices, as well as insurance and banking fees. These items have long-lasting effect on market services inflation. Regarding the downside surprise in goods inflation, we think it is rather a 'noise' and will not last long. But as we expect further acceleration in trend inflation, the latter does not pose upside risk to our 2019 CPI forecast.
- The higher-than-expected inflation was the consequence of the following CPI items: seasonal foods, processed foods, and tobacco prices. In the case of seasonal foods, the rapid price growth became almost customary in the past few months, and it would be difficult to say how long this rapid price growth will last. Nevertheless, we should note the new harvest in mid-2019 can completely overwrite the recent price developments. As it is almost impossible to predict the price development of seasonal foods, we prefer our filtered inflation category when discussing inflationary processes. As the other two abovementioned CPI items are parts of the filtered inflation category, currently we see upside risks to our 2.5% filtered inflation forecast. Its degree can be around 0.1-0.2ppts.
- Raising the public health product tax on 1 January can add about 0.1ppts to 2019 inflation. This measure will not affect the filtered inflation category.
- In light of the recent developments on the financial markets, and the outpricing of the base rate hikes from the yield curve in the USA and the eurozone, the MNB's room for manoeuvre has changed. In its earlier communication the MNB linked the Hungarian monetary policy tightening to the ECB's cycle. We think this part of the communication will come to the fore again in the coming months. If all of the above-mentioned upside risks materialize, Hungary inflation can reach 3% (or even 3.1%) in 2019. But as long as constant tax core inflation remains below 3% –and our filtered inflation forecast suggests that it will–, the MNB will consider any factors that push CPI above 3% as temporary effects.

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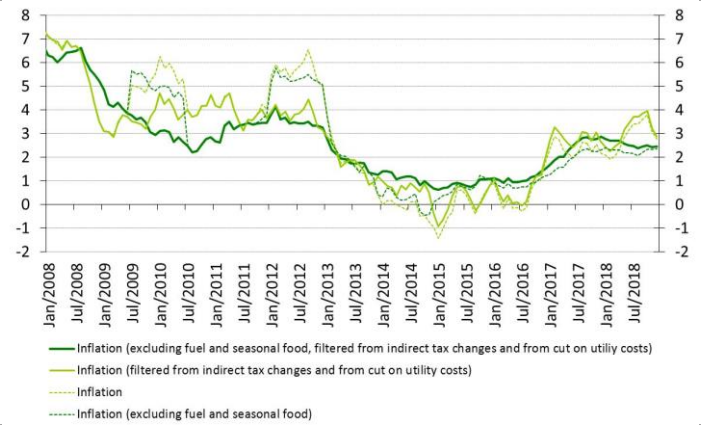
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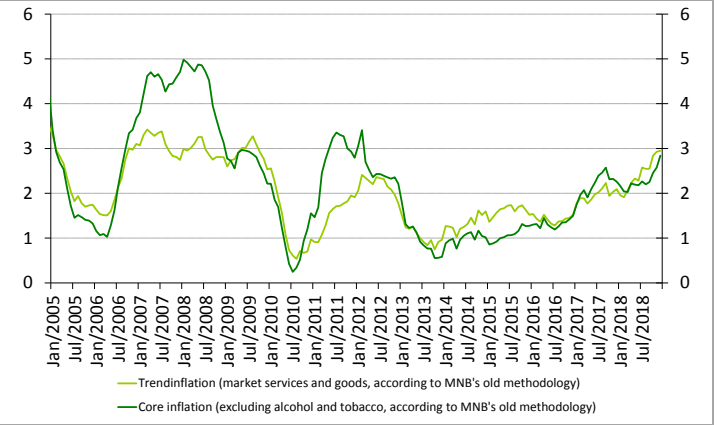
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**Chart 1: Summary chart of inflationary processes**  
(annual changes, %)



Sources: KSH, OTP Research

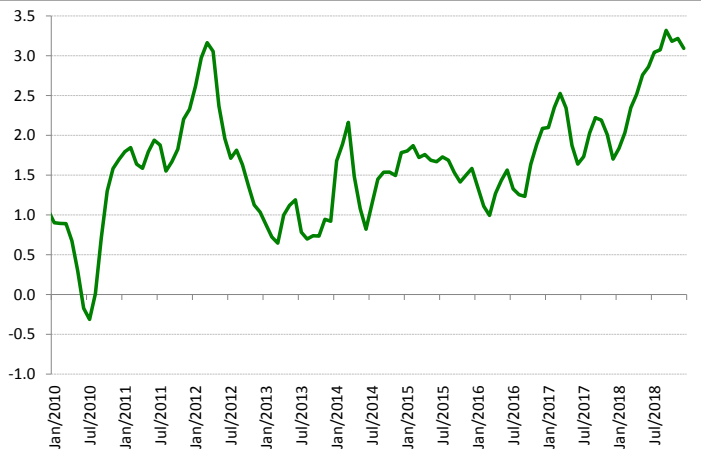
**Chart 2: Core\* and trend inflation\*\***  
(annual changes, %)



Sources: KSH, OTP Research

\*: Filtered from indirect tax and visit fee changes, and one-off items  
\*: w/o second-hand car prices

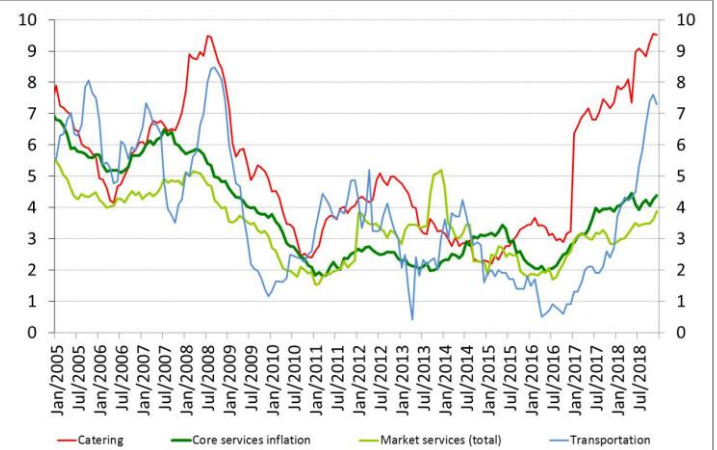
**Chart 3: Trend inflation\***  
(annualized 3M/3M changes, %)



Sources: KSH, OTP Research

\*: Filtered from indirect tax and visit fee changes, and one-off items, w/o second-hand car prices

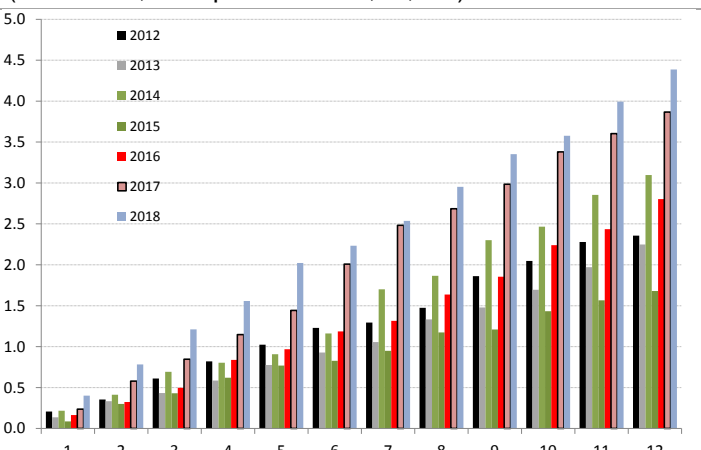
**Chart 4: Services inflation\***  
(annual changes, %)



Sources: KSH, OTP Research

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

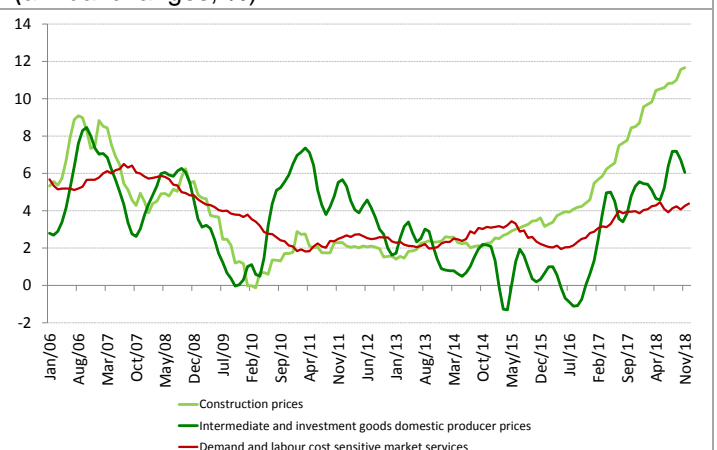
**Chart 5: Intra-year price setting in core services\***  
(cumulated, over previous Dec, %, SA)



Sources: KSH, OTP Research

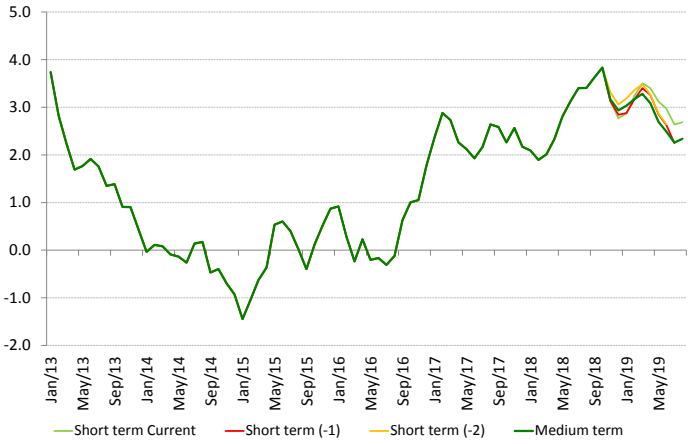
\*: Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

**Chart 6: Price evolution in some non-CPI items**  
(annual changes, %)



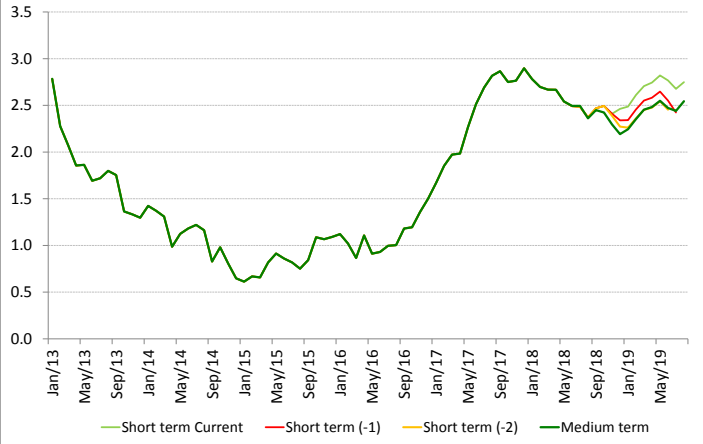
Sources: KSH, OTP Research

**Chart 7: Incoming data's effect on our CPI forecast (annual changes, %)**



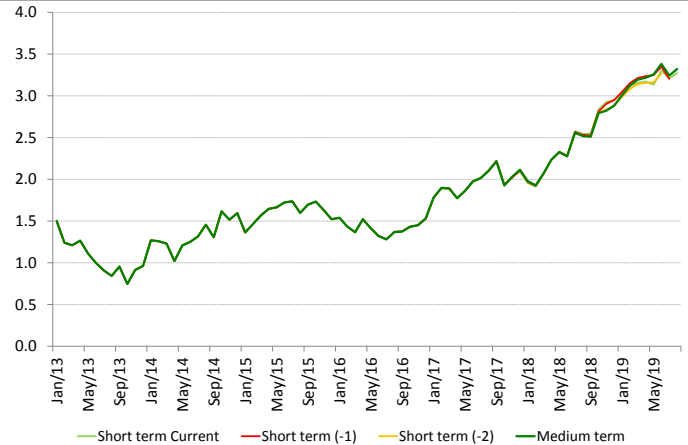
Sources: KSH, OTP Research

**Chart 8: Incoming data's effect on our filtered CPI forecast (annual changes, %)**



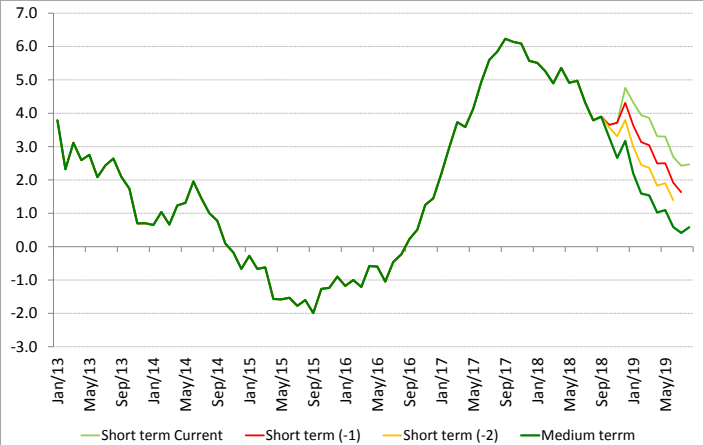
Sources: KSH, OTP Research

**Chart 9: Incoming data's effect on our trend inflation forecast (annual changes, %)**



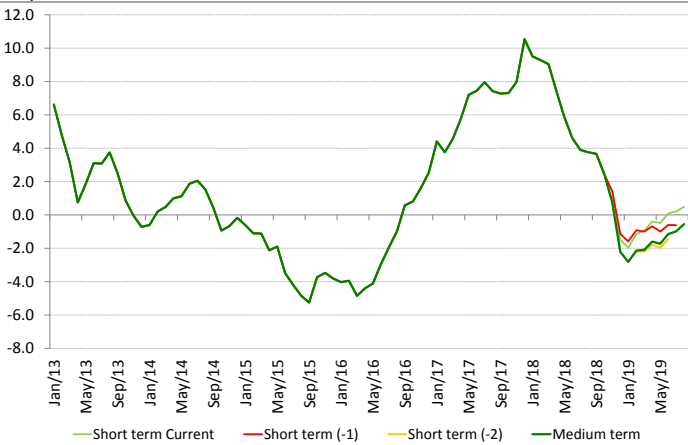
Sources: KSH, OTP Research

**Chart 10: Incoming data's effect on our core-processed food inflation forecast (annual changes, %)**



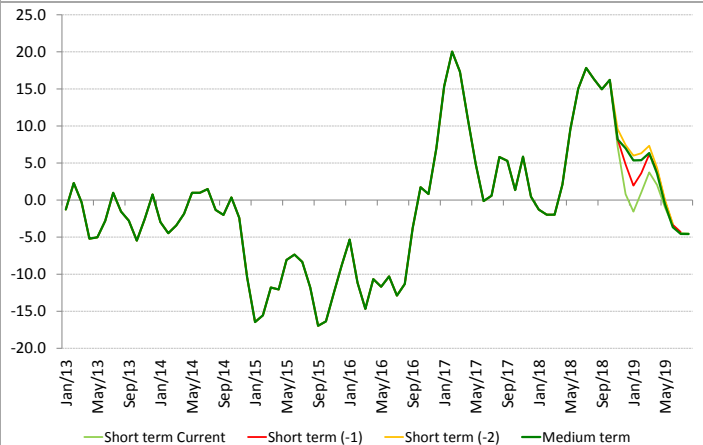
Sources: KSH, OTP Research

**Chart 11: Incoming data's effect on our core-unprocessed food inflation forecast (annual changes, %)**



Sources: KSH, OTP Research

**Chart 12: Incoming data's effect on our fuel price forecast (annual changes, %)**



Sources: KSH, OTP Research

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