

# REPORT ON INFLATION

11 November 2019

## *Food prices pushed CPI above expectations; disinflation seems to have stalled; CPI can rollercoaster around the target*

- According to the KSH statistical office, inflation in Hungary accelerated to 2.9% YoY in October, up from 2.8% in the previous month. We forecasted 2.8% inflation for October, and the market consensus was the same. So the incoming data exceeded both our forecast and the market expectations a bit.
- Underlying indicators also rose somewhat, and the rapid deceleration of the underlying inflation indicators, seen during the summer, has definitely ended:
  1. The closely watched constant tax core inflation increased further, to 3.7% from 3.4%. Our filtered inflation figure (inflation without volatile items and all government measures) also accelerated, to 3.3% YoY from 3.1% in the previous month. Our trend inflation indicator, which is similar to the MNB's demand-sensitive and sticky price inflation, stagnated at 3.2% YoY, while its 3M/3M annualized change increased somewhat to 2.7%, from 2.5% in the previous month (it oscillated in the 3.3%-3.5% range between October 2018 and March 2019).
  2. The inflation of core services (the most demand and labour cost sensitive items) increased to 5.4% YoY in October (from 5.3% in September). Its annualized 3M/3M change has been essentially unchanged since August: it stagnates at 5% (the annualized 3M/3M change peaked at 5.8-5.9% between March and June).
  3. To sum it up: the rapid decline in underlying inflation indicators seems to have ended, but this did not surprise us. Both trend inflation and core services inflation have stabilized. Retail sales accelerated again in the past few months and the HUF also weakened. These developments seem to have halted further disinflation. As real income growth accelerated in recent months and households' borrowing has been very strong since the 'baby loan' subsidized loan scheme was launched in July, we think that households' consumption may gain new momentum. Therefore we think that underlying inflation indicators may stabilize around their current level despite the deteriorating external environment and weakening inflation pressure in the eurozone.
- The higher-than-expected inflation was definitely the consequence of food prices. Inflation in each of the three main subgroups (seasonal foods, non-seasonal unprocessed foods, and processed foods) was 0.4 ppts higher than our forecast. In the case of non-seasonal unprocessed foods, the African swine fever still has a certain effect on raw meat prices. Raw meat price level has increased by roughly 5% since April, within which pork prices grew by 13%. In addition, flour prices essentially did not change in recent months, even though wheat price level declined by around 20%. Possibly, mills try to counterbalance other cost-side pressures or made some 'profit-restoration'. Nevertheless, the current 0% pass-through of wheat prices into flour prices does not seem sustainable in the longer run, so we expect inflation to decelerate in this segment. Milk processing also picked up in the past two months.
- Turning to the processed-foods: the higher-than-expected inflation in this segment was the consequence of items that are the 'processed pair' of the abovementioned non-processed foods. So, the processed meat and dairy products' inflation has accelerated. Furthermore, cereals prices did not decline, because neither did flour prices. In the case of processed meat products, the pass-through effect (from raw meat prices) is very fast and strong, with processed food prices growing by 5% (since April), similarly to raw meat prices. The pass-through effect from milk prices into dairy products was also very strong: the 60% increase in milk price level (since April) has already appeared in dairy products. Usually, the pass-through is much slower and milder. So the robust domestic demand and other cost-side pressures seem to have resulted in strong re-pricing also in the processed food segment. We also note that processed foods are parts of constant tax core inflation, and this segment was the main reason for the 0.3ppt increase in core inflation.

### Trading Desks

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### Fixed Income Desk

**András Sovány**  
+36 1 288 7561  
SoványA@otpbank.hu

**Benedek Károly Szűts**  
+36 1 288 7560  
SzutsB@otpbank.hu

**Barnabás Lugosi**  
+36 1 288 7557  
Barnabas.Lugosi@otpbank.hu

### FX Desk

**András Marton**  
+36 1 288 7523  
MartonA@otpbank.hu

**József Horváth**  
+36 1 288 7514  
Horvath.Jozsef@otpbank.hu

**András Sztopa**  
+36 1 288 7531  
Andras.Sztopa@otpbank.hu

### Money Market Desk

**Krisztián Tóth**  
+36 1 288 7531  
Krisztián.Toth.1@otpbank.hu

**Gábor Heidrich**  
+36 1 288 7534  
HeidrichG@otpbank.hu

**Judit Szobath**  
+36 1 288 7533  
SzobathJ@otpbank.hu

### FX Option Desk

**Gábor Réthy**  
+36 1 288 7524  
RethyG@otpbank.hu

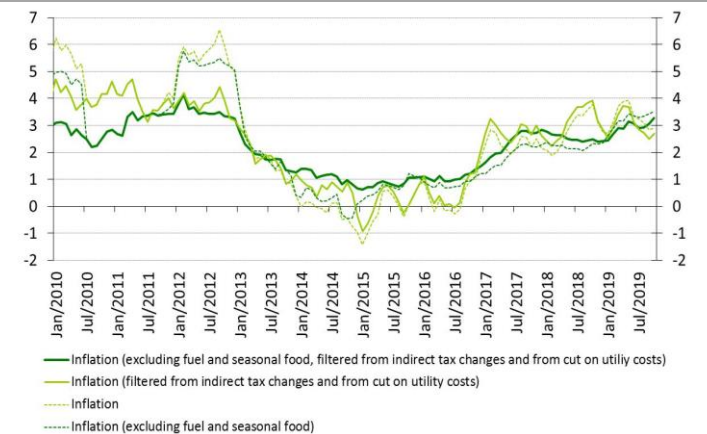
**Máté Kelemen**  
+36 1 288 7525  
KelemenMat@otpbank.hu

### Analyst

**Győző Eppich**  
+36 1 374 7274  
EppichGyo@otpbank.hu

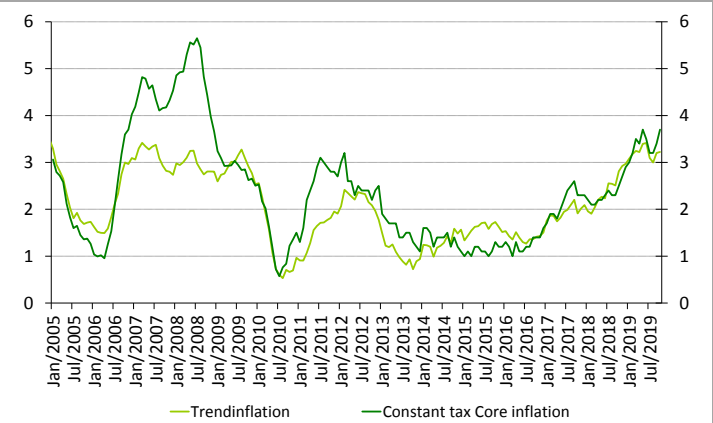
- Our short-term projection converged back to our medium-term projection plan (it was below the medium-term path in the past few months). But we note that there are significant differences in the structure of inflation. Our short-term trend inflation forecast is still considerably below our medium-term forecast' path, but higher food inflation, especially the higher processed food inflation, counterbalanced it. We also emphasize that headline CPI may accelerate further in the coming months, approaching again the 4% level in December-January, due to base effects. However, it can decline rapidly afterwards.
- The incoming data may make the MNB more precautionary, as disinflationary processes seem to have stalled. The incoming retail sales, real income, and borrowing data suggest that consumption may gain new momentum – this, coupled with the recent development in food prices, has made the risks surrounding the baseline balanced (after the downside risks in recent months).

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



Sources: KSH, OTP Research

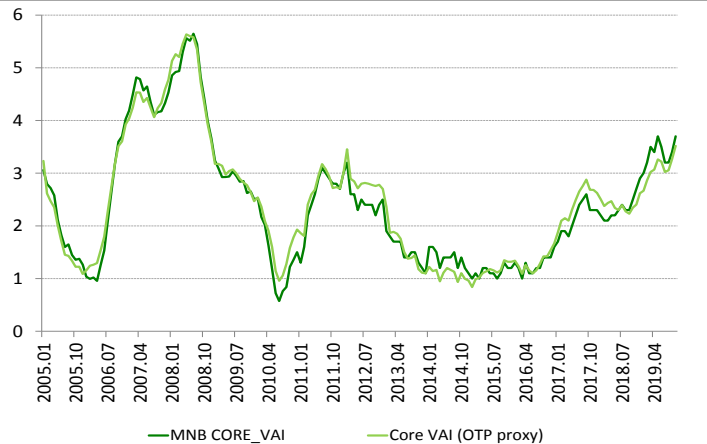
**Chart 2: Core and trend inflation\***  
(annual changes, %)



Sources: KSH, OTP Research

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

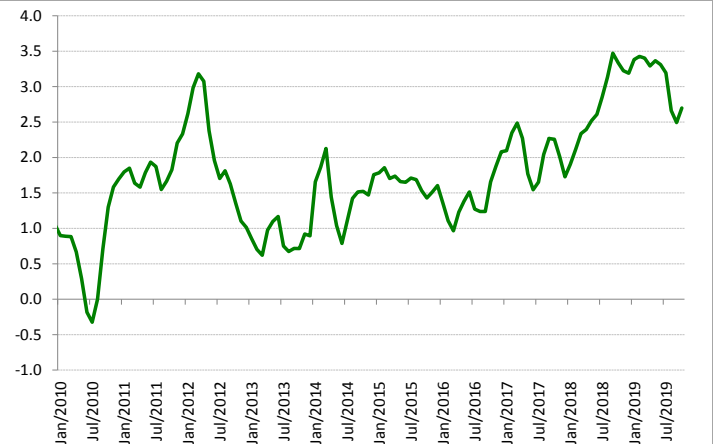
**Chart 3: Constant tax core inflation and our proxy\***  
(annual changes, %)



Sources: KSH, OTP Research

\*: we cannot reproduce exactly the tax-filtered core inflation because (1) the MNB has its own methodology for the calculation of tax changes, which is not known to us. (2) In addition, core inflation cannot be calculated exactly from the KSH's 160 CPI items. So, our calculation tries to proxy the MNB's core vai indicator.

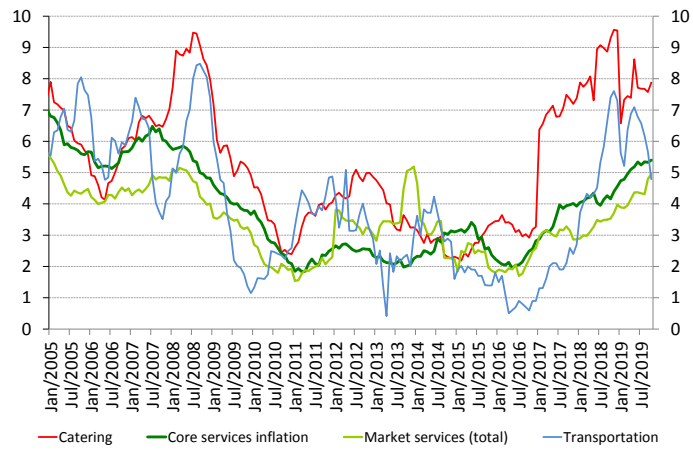
**Chart 4: Trend inflation\***  
(3M/3M annualized change, %)



Sources: KSH, OTP Research

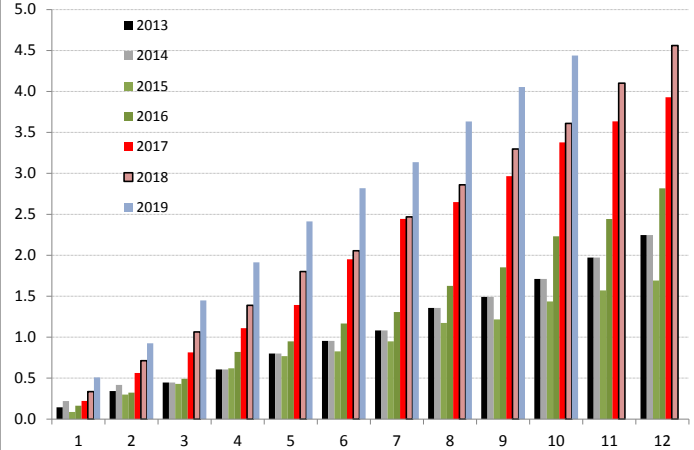
\*: Filtered from indirect tax (including the financial transaction tax) and visit fee changes

**Chart 5: Services inflation\***  
(annual changes, %)



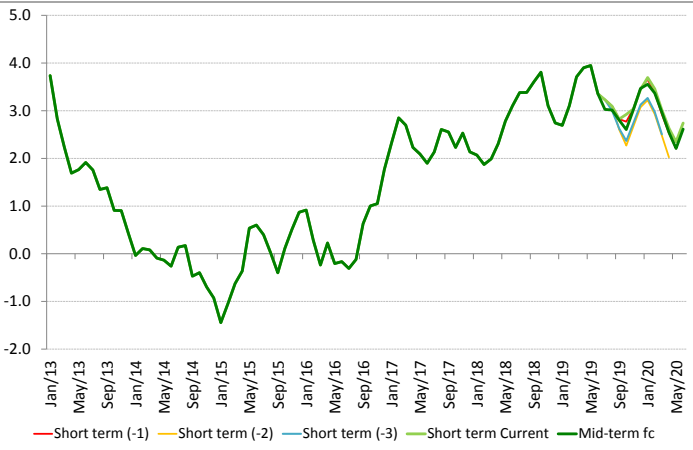
Sources: KSH, OTP Research  
\*: Filtered from indirect tax (including the financial transaction tax) and visit fee changes

**Chart 6: Intra-year price setting in core services\***  
(cumulated, over previous Dec, %, SA)



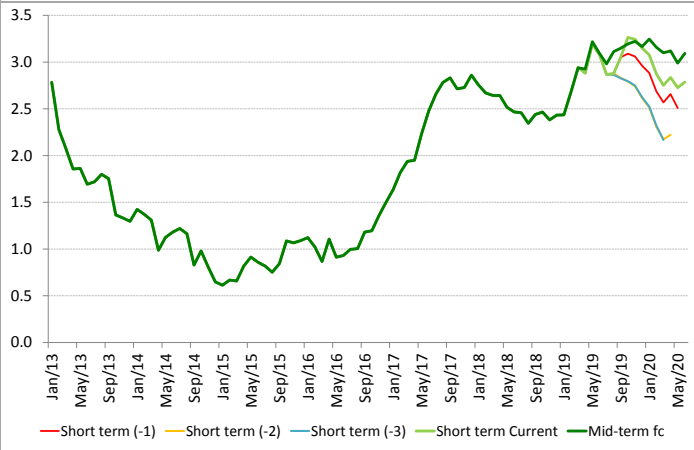
Sources: KSH, OTP Research  
\*: Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

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



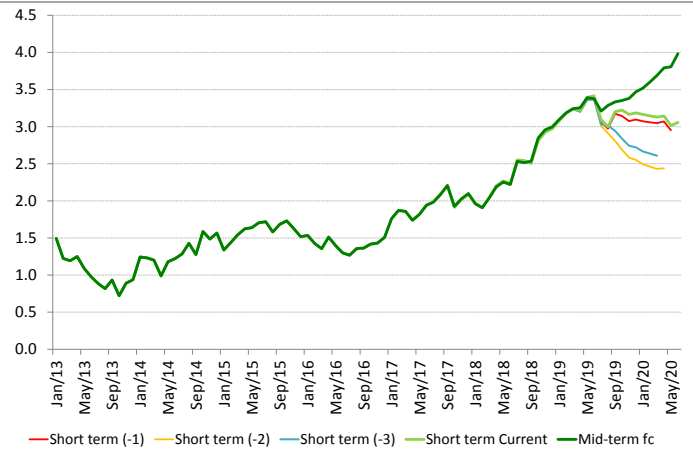
Sources: KSH, OTP Research

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



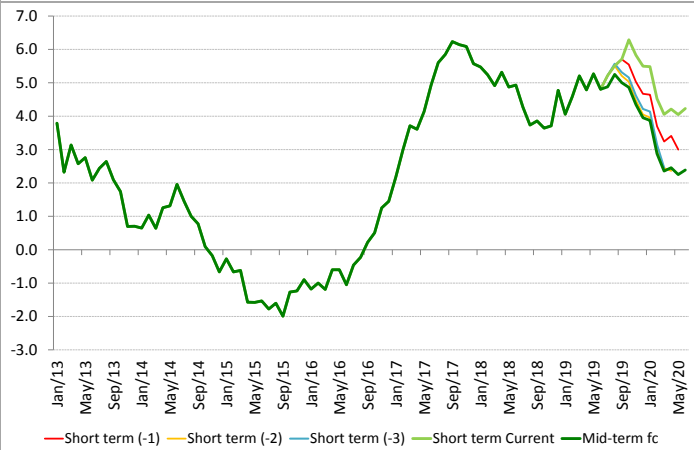
Sources: KSH, OTP Research

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



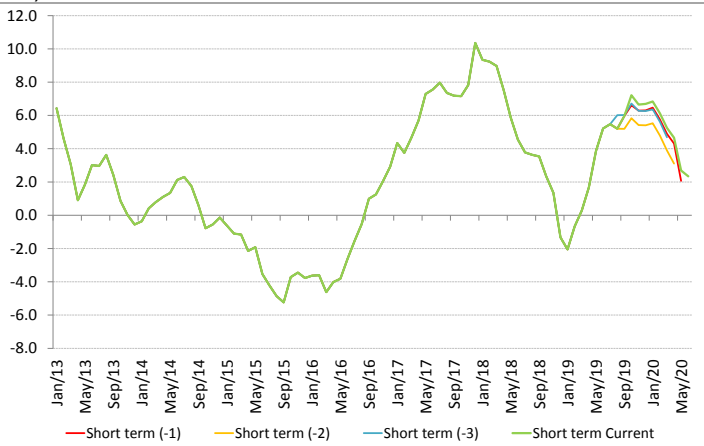
Sources: KSH, OTP Research

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



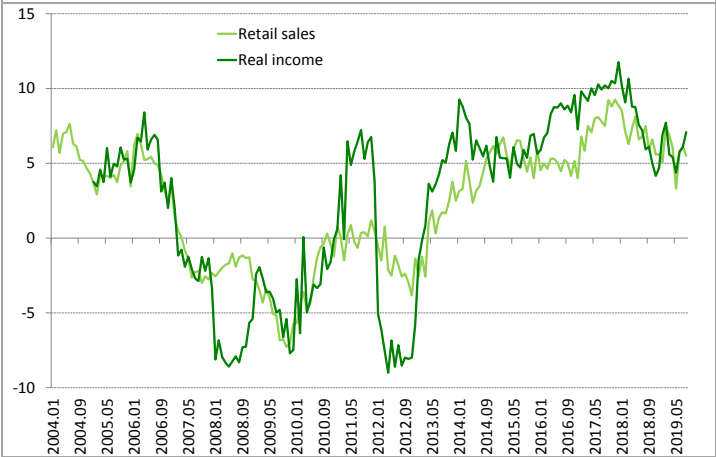
Sources: KSH, OTP Research

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



Sources: KSH, OTP Research

**Chart 12: Real income\* and retail sales (annual changes, %)**



Sources: KSH, MoF, OTP Research  
\*: net wages+transfers in cash

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