otp Research

REPORT ON INFLATION

15 January 2020

Base effect in petrol prices and African swine fever's effect pushed CPI to 4% in December. After the peak in January, gradual disinflation is expected

- According to the KSH statistical office, Hungary's inflation rate was 4.0% YoY in December, up from 3.4% in the previous month. We forecasted 3.9% inflation for December, while the market consensus was 0.1 ppt lower than our expectation. So the incoming data was slightly higher than our forecast and the market consensus. The inflation rate was 3.4% in 2019 as a whole, above the MNB's target.
- All underlying indicators are around, but somewhat above, the MNB's 3% target. However, volatile items generate strong volatility in the headline CPI:
    1. The closely watched constant tax core inflation declined to 3.5%, from 3.6%. Our filtered inflation (inflation without volatile items and all government measures) stagnated at 3.1% YoY for the third consecutive month. Our trend inflation indicator, which is similar to the MNB's demand-sensitive and sticky price inflation, declined to 3.0% YoY from 3.2%, but its 3M/3M annualized change stagnated at 3.4%. The MNB's sticky price and demand sensitive inflation stagnated at 3.4% and 3.2% YoY, respectively. The MNB's sticky price and our trend inflation indicators have essentially stagnated at 3.4% and 3.1%, respectively since July.
    2. The inflation of core services (the most demand and labour cost sensitive items) stagnated at 5.6% YoY in December, as its annualized 3M/3M change also remained at 5.4%. The 3M/3M change has definitely passed its peak, as it stood around 6% between April and June, but it seems to have stuck at a high level.
- In December, it was unprocessed food prices that pushed the CPI above our forecast. Both 'core' unprocessed and the seasonal foods segment's inflation rates were higher than we had expected. In the first case, the African swine fever took its toll on pork prices, which have increased by 7.5% MoM. In the second case, fruit prices grew faster than we had expected.
- Our trend inflation indicator was somewhat lower than we had expected, while our filtered inflation indicator matched our forecast. We can see 1.3% MoM increase in tobacco prices but due to the price collection of NAV (National Tax and Customs Administration), this did not surprise us. In January higher excise duty was introduced on tobacco products, and supposedly a part of this measures appeared in the December data. We think this because, according to the NAV, there was just minor re-pricing activity in tobacco products in January. We still think that inflation may peak at 4.1%-4.2% in January.
- Main inflation stories in 2019, which can also affect the 2020 inflation:
    1. Seasonal foods and petrol prices generated high volatility: while our filtered inflation indicator oscillated between 2.7% and 3.1% in 2019, the headline CPI's range was between 2.7% and 4%. Potato and vegetables prices grew by 60% and 36%, respectively between July (June) 2018 and July 2019. But later these prices fell by 7.5% and 7%, respectively. In the case of fruit prices, the price boom started in summer 2019, and prices have grown by 7% until now. The African swine fever also left its mark on inflationary processes, as pork prices grew by 20% between April and December. And pork prices had certain spill-over effect on beef prices, too. These hardly predictable items can generate high volatility also in 2020, because if the agricultural season will be better and the pork prices normalize, they can generate significant (negative) base effect.
    2. During the summer, trend inflation seemed to come down. Nevertheless, as the fears about the economic slowdown faded, the HUF began to depreciate gradually (it counterbalanced the lower imported inflation, which came from the EU), and new consumption boosting measures were introduced (subsidized 'baby loan' and family car programmes), trend inflation converged back into the 3-3.5% range.

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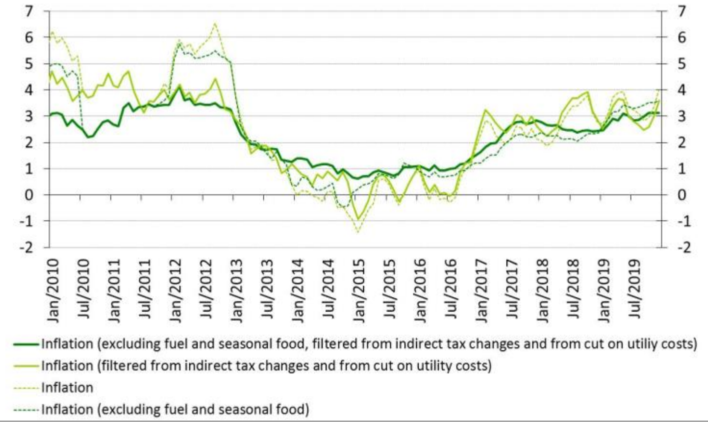
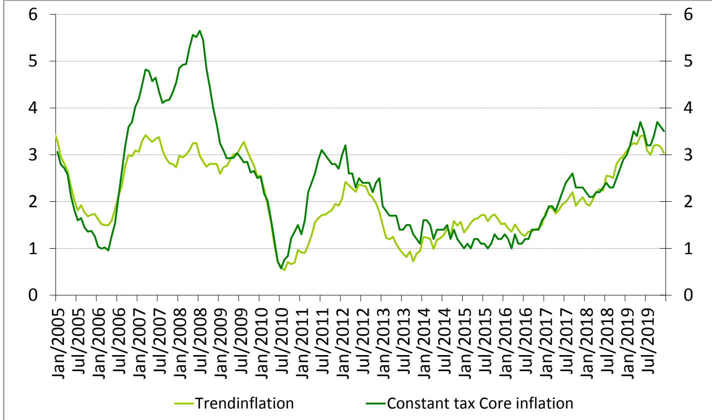
- In our baseline we assume decelerating wage growth in the private sector – ESI indicators suggest that labour shortage problems have eased somewhat – and more gradual HUF depreciation, which can be counterbalanced by the lower inflation in the eurozone to keep imported inflation stable. As a result, the CPI may return below the target. The main risk is that due to the robust, still double-digit wage growth in the private sector, coupled with a rapid HUF depreciation, inflationary processes may become unanchored, particularly if the MNB remains comfortable with the above-the-target underlying indicators. And under these circumstances, any unexpected inflation shock's (e.g. if food price shocks become persistent) effect can be stronger or longer lasting. But, on the other hand, if the MNB has luck with the abovementioned basis effects, we can see surprisingly low CPI figures in the second half of 2020.

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



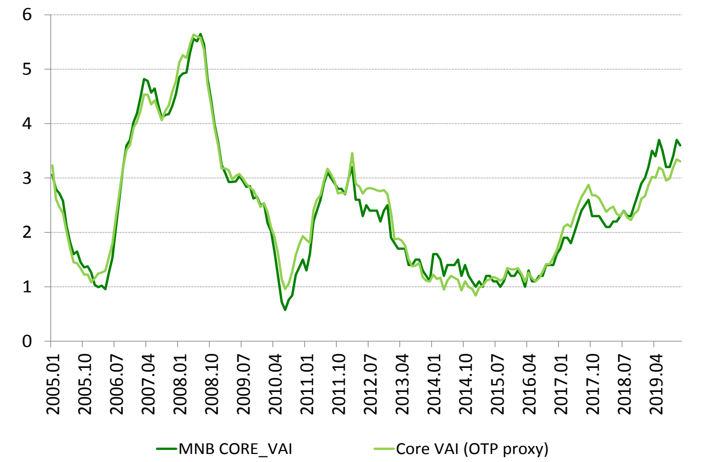
Sources: KSH, OTP Research

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



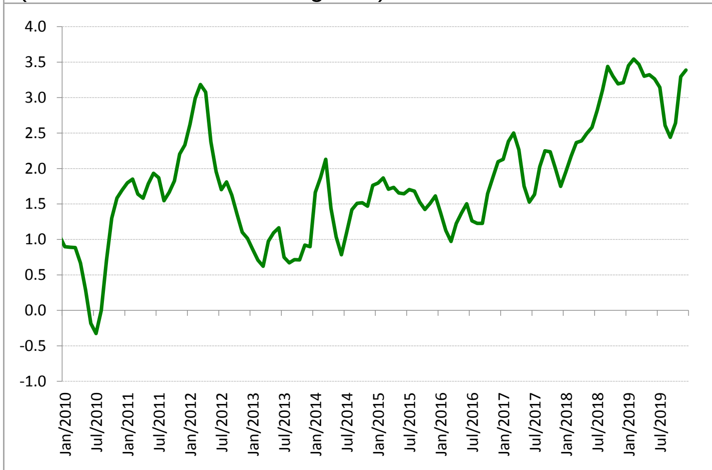
Sources: KSH, OTP Research
**: Filtered from indirect tax and visit fee changes, and one-off items and w/o second-hand car prices*

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



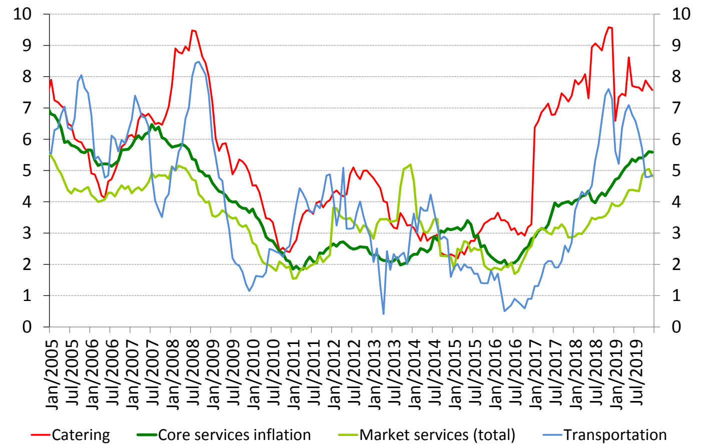
Sources: KSH, OTP Research
**: we cannot reproduce exactly the tax-filtered core inflation because (1) the MNB has its own methodology for the calculation of tax changes, which is not known to us. (2) In addition, core inflation cannot be calculated exactly from the KSH's 160 CPI items. So, our calculation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

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



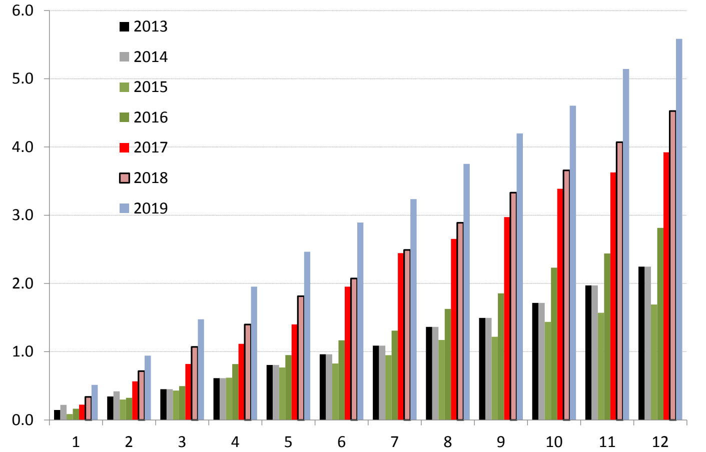
Sources: KSH, OTP Research
**: Filtered from indirect tax (including the financial transaction tax) and visit fee changes*

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



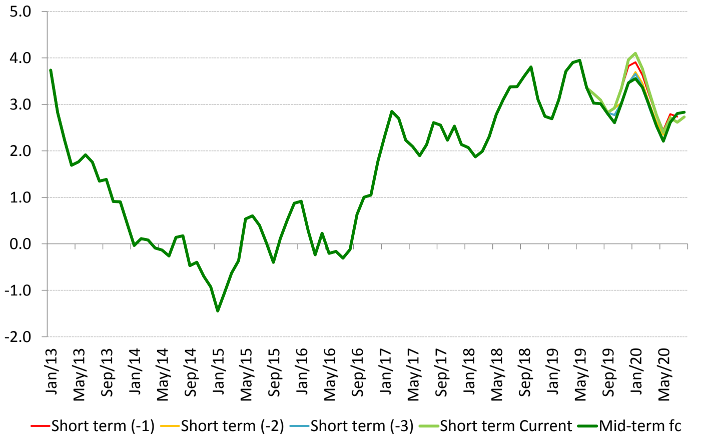
Sources: KSH, OTP Research
**: Filtered from indirect tax (including the financial transaction tax) and visit fee changes*

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



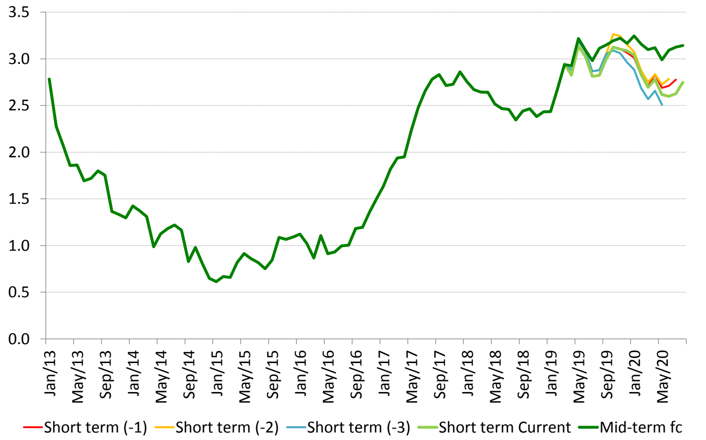
Sources: KSH, OTP Research
**: Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes*

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



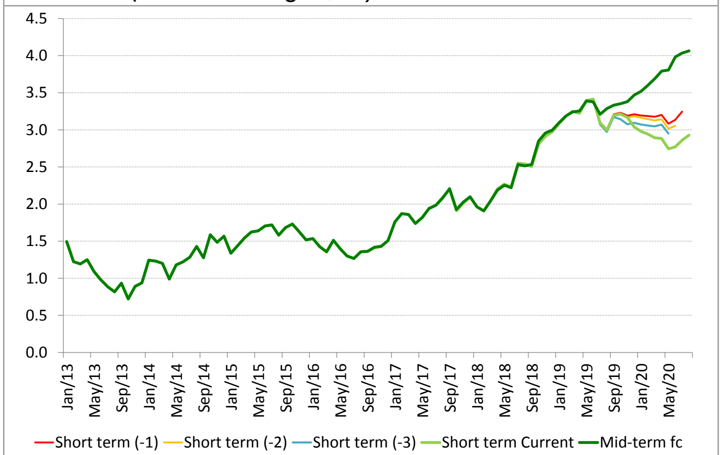
Sources: KSH, OTP Research

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



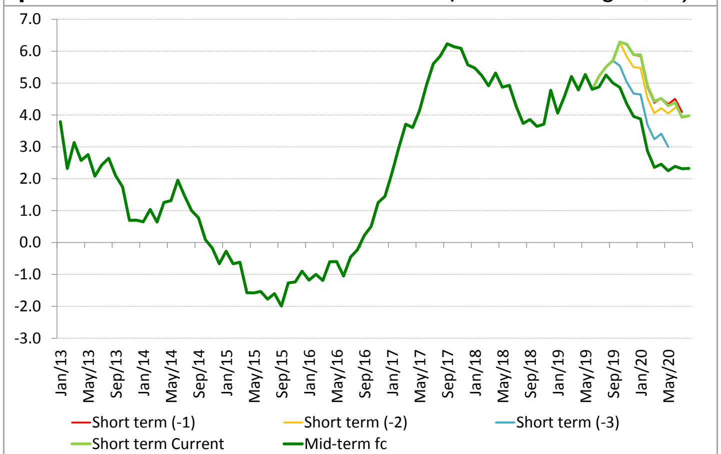
Sources: KSH, OTP Research

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



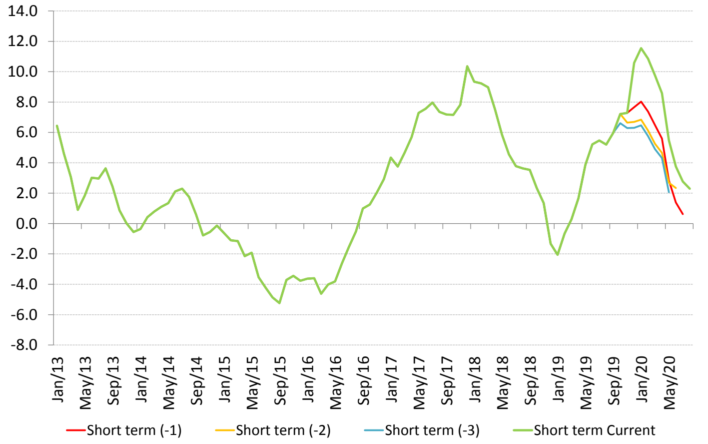
Sources: KSH, OTP Research

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



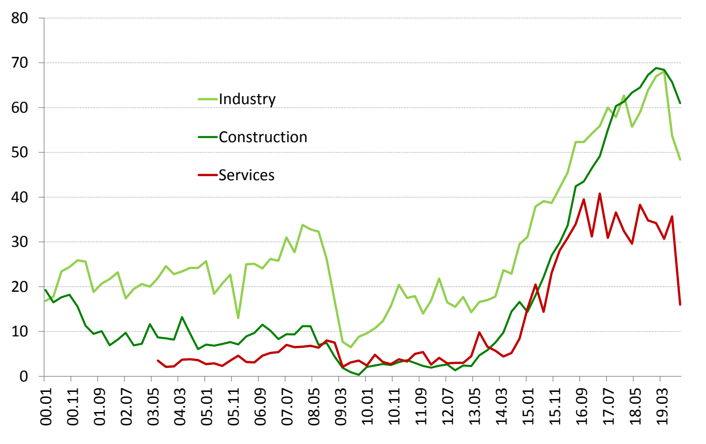
Sources: KSH, OTP Research

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



Sources: KSH, OTP Research

Chart 12: Labour shortage as production limiting factor (balance point)



Sources: European Commission, OTP Research

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