

REPORT ON INFLATION

9 July 2020

Inflation approached 3% in June; underlying indicators are still above 3%

- Hungary's inflation rate was 2.9% YoY in June, up from 2.2% in the previous month, the KSH statistical office said. Both the market consensus and our forecast were 3.0%. The acceleration of the inflation was mainly the consequence of base effect from higher fuel prices. KSH published a note about data collection issues during the pandemic crisis, offering a glimpse into the way it handles them. Based on this knowledge, we cannot exclude future surprises in inflation data when data collection methodology returns to normal.
- Underlying indicators remained practically unchanged compared to the previous month, but they are still above the MNB's 3% target. The closely watched constant tax core inflation stagnated at 3.5%. Our filtered inflation figure (inflation without volatile items and all government measures) declined from 3.3% YoY to 3.2%. Our trend inflation indicator¹, which is similar the MNB's demand-sensitive and sticky price inflation, remained stable at 3.3% YoY, while its 3M/3M (annualized) change decelerated from 3.8% to 3.3%. The MNB's sticky price inflation stagnated at 3.6%.
- Although trend inflation was in line with our expectation, there were differences in its structure. In the most exchange-rate-sensitive durable goods category, inflation was higher, while non-durable goods' inflation was lower than we had thought. In the case of durable goods, the acceleration of inflation was widespread among sub-items, while in the case of non-durable goods the lower-than-expected inflation was largely a consequence of the prices of clothes and textiles, which remained subdued. Core services' inflation decelerated to 4.9% from 5.2% YoY, while the 3M/3M (annualized) change declined to 3.2% from 5%. For now, the pandemic's effect on services prices is visible, but it is still subdued. The within-year price change in the core services segment was higher in 2020 than in 2019 until April (Chart 6). Since then, the relationship between the two indicators has reversed. Nevertheless, mainly two items are responsible for this change: domestic holidays and the 'museums, libraries and sports services' segment. Indeed, these items were strongly affected by the pandemic (and consequently, by the methodological issues), so disinflation in these items is not a big surprise. Nevertheless, in the case of domestic holidays, it seems that domestic tourism demand has almost recovered by now, and July and August are strong re-pricing periods (due to the tourism season) in this segment. A rebound in new infections in neighbouring countries (which are frequent destinations of Hungarian travellers) can also redirect tourism demand to domestic destinations. So, we cannot exclude that disinflation in domestic holidays will not be long-lasting.
- The sky-rocketing seasonal food prices in June delivered positive surprise for us. Potato and vegetables prices dropped significantly (-3% and -5% MoM, respectively; both seasonally adjusted), but fruit prices are still on the rise. Inflation of core-unprocessed foods also delivered a minor positive surprise, largely due to raw meat prices. To recap: raw meat and live animal prices have significantly risen since April 2019 due to the African Swine Fever. Live animal prices fell substantially, by 6.5% MoM, in April. The pass-through of this decline probably appeared in consumer prices in June. Nevertheless, this drop is probably more the consequence of the market anomaly caused by covid-19, than of the African Swine Fever's fading effect. Due to the falling retail sales and demand for catering services, the market becomes 'oversupplied'. There are media reports about slaughterhouses that do not accept live animals, because they have no more storage capacities. We do not know how long this market anomaly will last, but we think the gradual normalization will start in the coming months and the current decline in meat prices will not last long.

¹ Trend inflation and core services inflation include catering services. In the catering sector, VAT was cut from 18% to 5% but almost nothing appeared in CPI. So we added the whole technical effect to our underlying indicators. We think this is the appropriate solution because in the case of VAT cuts, the immediate and short-term effects are very limited, but re-pricing in the following months is usually lower than it would be without the VAT cut. So, in the short run, our underlying indicators may somewhat over-estimate the 'actual' underlying trend, but in the second half of the year our figure will converge with the 'actual' figure.

Analyst

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

Institutional Sales Desk

Attila Preisz
Head of Department
+36 1 288 7526
Attila.Preiszi@otpbank.hu

János Mladoniczki
+36 1 288 7551
MladoniczkiJ@otpbank.hu

Zoltán Ballai
+36 1 288 7545
Zoltan.Ballai@otpbank.hu

Kitti Palásthy
+36 1 288 7574
Kitti.Palasthy@otpbank.hu

Corporate Sales Desk

János Imrei
Head of Department
+36 1 288 7544
Janos.Imrei@otpbank.hu

Nóra Ilona Gordos
+36 1 288 7549
Nora.Ilona.Gordos@otpbank.hu

Roxána Kosztelnik
+36 1 288 7541
roxana.kosztelnik@otpbank.hu

Edít Kovács Gyimóti
+36 1 288 7542
KovacsGyE@otpbank.hu

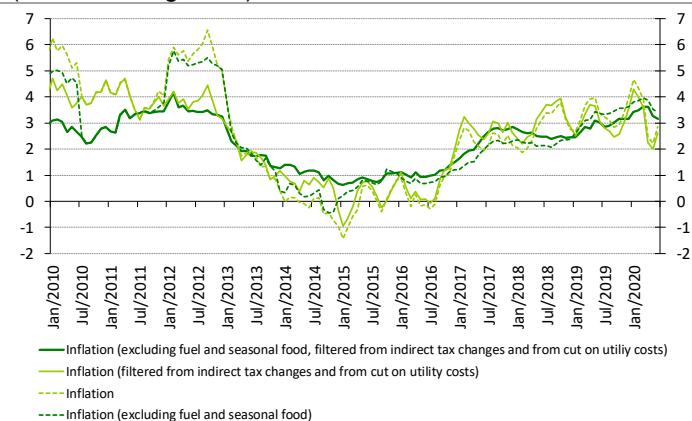
Anna Almási
OTP Trader
+36 1 298 3169
AlmasiaA@otpbank.hu

Fodor István
+36 1 288 7555
Istvan.Fodor.1@otpbank.hu

Andorka Rudolf Flórián
+36 1 288 7558
Rudolf.Florian.Andorka.1@otpbank.hu

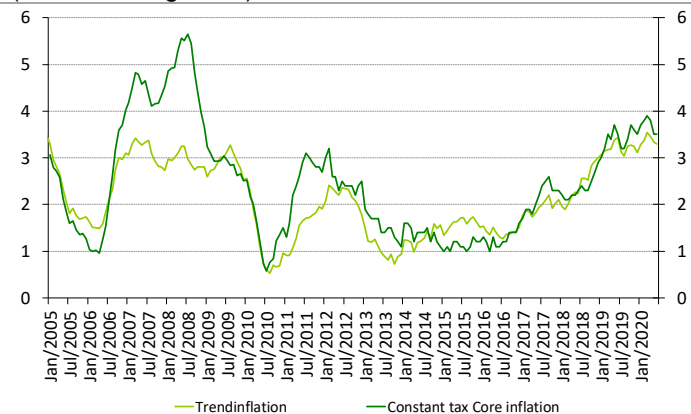
- As the incoming CPI data was in line with the MNB's short-term forecast, we think the messages of the latest MC meeting are still in force. Our short-term forecast shows that CPI may remain around its current level in the next few months and it can sink below 3% in the last third of 2020 (mainly due to base effects). So, we maintain [our view](#) that further (at least one) 15bps base rate cut is expected this year. Nevertheless, the strong exchange rate pass-through may cause a concern, particularly as the recent economic data in the euro area increase the chances of a V-shaped recovery, which could result in weaker-than-previously-thought disinflation in the euro area.

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

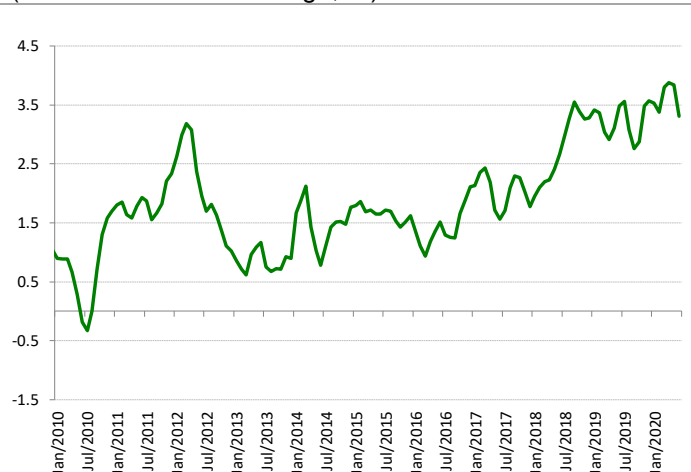
Chart 3: Constant tax core inflation and our proxy*
(annual changes, %)



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.

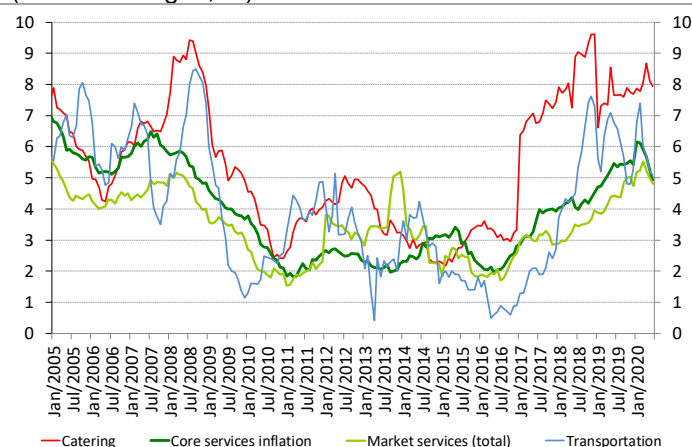
Chart 4: Trend inflation*
(3M/3M annualized change, %)



Sources: KSH, OTP Research

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

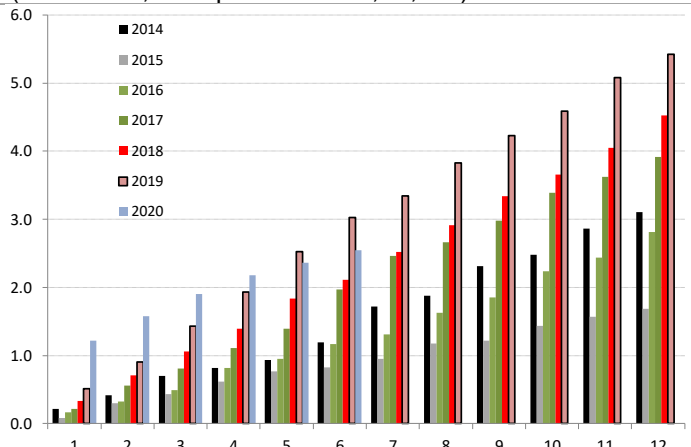
Chart 5: Services inflation*
(annual changes, %)



Sources: KSH, OTP Research

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

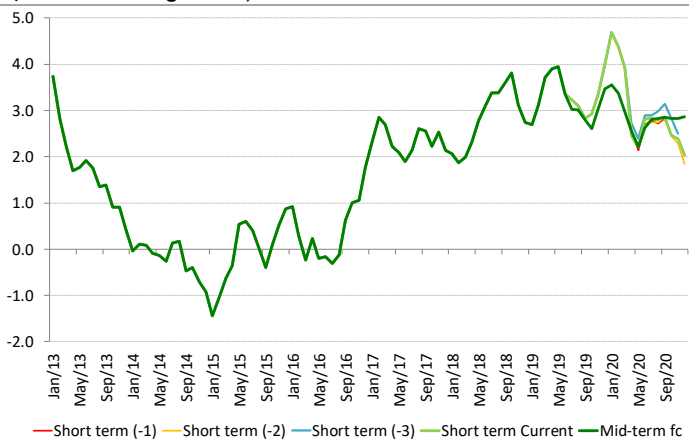
Chart 6: Intra-year price setting in core services*
(cumulated, over previous Dec, %, SA)



Sources: KSH, OTP Research

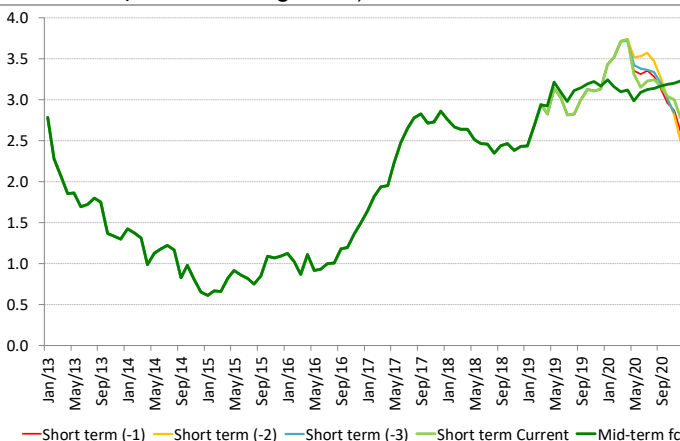
*: Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

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



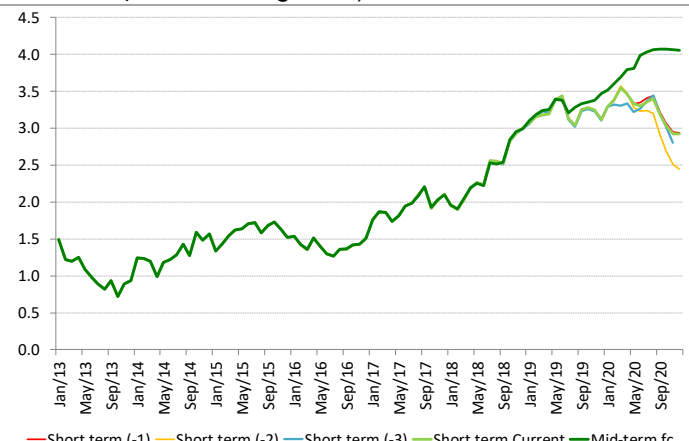
Sources: KSH, OTP Research

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



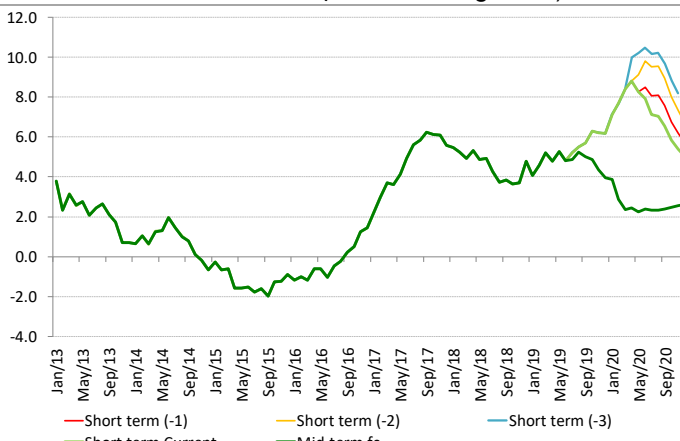
Sources: KSH, OTP Research

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



Sources: KSH, OTP Research

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



Sources: Eurostat Consumer Confidence Survey, OTP Research

Disclaimer

1. **The statements in this document shall not be considered as an objective or independent explanation of the matters. Please note that this document (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and (b) is not subject to any prohibition on dealing ahead of the dissemination or publication of investment research.**
2. This communication does not contain a comprehensive analysis of the described issues. No part, chapter, or the entirety of this information shall be considered as investment recommendation, an offer or solicitation for the purchase or sale of any financial instrument, inducement to invest, financial or investment analysis, investment research or marketing communication, not even if any part of this document contains a description of a certain financial instrument in terms of its possible price or yield development, and the related investment options; the data herein are for informational purposes only. This document shall not be considered as investment recommendation falling under Directive 596/2014/EU of the European Parliament and of the Council. This document does not take into account investors' individual interests, circumstances, or objectives; therefore, in the absence of personal recommendation, it shall not be considered as investment advice. OTP Bank intends to make this document available to its clients or to the public, or to make it accessible to other persons in such a way that allows this document to be disseminated to the public.
3. Information herein reflects the market situation at the time of writing. However, it provides only momentary information and may change as market conditions and circumstances develop. You may request more information from OTP Bank. Although the information in this document has been prepared in good faith from sources that OTP Bank believes to be reliable, we do not represent or warrant its accuracy or completeness. This document was prepared using data, facts and information from the following essential sources: Bloomberg, Reuters, KSH (Hungarian Central Statistical Office), Eurostat, Magyar Nemzeti Bank (Hungary's central bank) ÁKK (Hungary's Government Debt Management Agency), and European Central Bank (ECB). The opinions and estimates in this document are based on the opinion of OTP Research's analyst(s) at the time when the document was prepared, and they may be subject to change at any time in the future without further notice. You may receive different recommendation from the staff of OTP Bank, in particular if you are provided investment advice based on an investment advice agreement.
4. This publication contains generic presentation of information and knowledge, thus it does not take into account the individual clients' unique and special interests, financial condition, or their ability and willingness to take risks. Therefore please contact our staff or contact your banking consultant for advice before you make an investment decision. The assessment and the consideration of the individual circumstances is provided by the suitability and appropriateness tests that assess clients' financial knowledge, experience, risk-taking abilities, as well as the examination of the target market.
5. Before making an informed decision to invest and to use the services, please carefully read through all documents, including the documentation, prospectus, regulations, terms and conditions, announcements and key information documents for that product/service, and carefully consider the subject, the risk, the fees and costs of your investment, the possibility of any loss, and seek information about the tax regulations regarding the product and the investment. The prices of financial instruments and securities are changing, outright sales are realized at then current market prices, which may involve losses. The information and opinions in this document do not substitute or take the place of the issuance documentation for the given financial assets (e.g. prospectus, fund management rules), or their brochures or announcements.
6. You assume total responsibility and risk for any specific decision or investment; OTP Bank shall not be held responsible for the effectiveness of investment decisions or for reaching your purpose, nor for the individual investment decision made based on this document or any part thereof, or for their consequences.
Investments in financial instruments carry a certain degree of risk, which may affect the effectiveness of the investment decision, and investors may not receive the whole amount they expected the investment to yield in their investment targets; they may not preserve even the invested amount, therefore the invested capital might even decrease, be wholly lost, or even lead to additional payment obligation.
7. Trading with leveraged products (such as foreign exchange contracts) or with shares and indices that have underlying products carries a considerable amount of risk, and these products are not suitable for all investors. Trading with leveraged products carries the risk of losing all capital, and it may incur losses that exceed the amount invested.
8. **The figures and information described herein refer to yields or changes in the past. Past performance is not a reliable indicator of future yields, changes, or performance.** The changes on money and capital markets, the fluctuation of prices, the development of investments and their yields are influenced by the combined effect of multiple factors; one important factor of them is the change in investors' expectations. **The development of prices, the future yield of financial assets, indices or indicators, the examination of their changes, trends, and future performance is based on estimations and forecasts, which forecasts do not allow reliable conclusions to be drawn about the future moves of prices, real future yields, changes, or performance.** For each product and service, please assess their tax accounting implications, and other tax consequences, taking into account that they cannot be precisely assessed without knowing the effective tax regulations or the client's individual circumstances; and these legislative provisions as well as the circumstances may change over time.
9. This document shall not be a basis for any further analysis in relation to the financial instruments contained therein. Any reference in this document to the future distribution of a financial instrument shall be construed as indicative, preliminary and informative, and any analysis of such financial instrument is exclusively based on publicly available information listed in the respective prospectus or announcement. The content of this document shall not imply that OTP Bank acts as an agent, a fiduciary, or an advisor to, or on behalf of, any prospective purchaser of the financial instruments discussed herein.
10. For certain persons, access to the products and/or services discussed in this document may not be granted, or it may be limited. The act of preparing this document by OTP Bank, its uploading to the website, its publication may under no circumstances be considered as OTP Bank's intention to make available the product and/or service information in the prospectus to persons whom any country or state prohibits from having or obtaining the given product and/or service, including the promotion and the advertisement thereof.
11. OTP Bank maintains a conflict of interest policy and it keeps such records, and it also has requirements that regulate the transmission of bank secrets and securities secrets, which requirements shall be considered as the effective internal organizational and management solutions as well as information barriers to prevent or manage conflicts of interest.
OTP Bank has developed appropriate internal procedures for (i) the personal transactions and trading of financial analysts and other relevant persons, (ii) the physical separation of the financial analysts involved in the production of investment research and other relevant persons; moreover, information barriers have been implemented, (iii) for accepting and managing incentives and remuneration.
Please be informed that OTP Bank is entitled to deal or trade as market maker, acting in good faith and in accordance with the usual way of market-making, with the financial instruments distributed by the issuer(s) specified in this document, as well as to provide other investment activities or ancillary (investment) services, and/or other financial or ancillary financial services to the issuer and other persons.
12. Previous documents on investing in this asset or product are available on the website of OTP Research: www.otpresearch.com
13. OTP Bank (company registration number: 01-10-041-585; registered seat: Nádor utca 16., Budapest H-1051, Hungary. Supervisory authority: Magyar Nemzeti Bank (National Bank of Hungary – H-1054 Budapest, Szabadság tér 9); financial customer services: H-1013 Budapest, Krisztina krt. 39. PSZÁF licence numbers: III/41.003-22/2002 and E-III/456/2008; further information: <https://www.otpbank.hu/portal/hu/Megtakaritas/Ertekpapir/MIFID>). All rights reserved. This document is solely owned by OTP Bank. No part of this material can be reproduced, re-used, disseminated, made available, re-published, referenced to, or inserted in other websites or services without the prior written consent of OTP Bank.
14. If you received this document from OTP Bank Plc, then it was sent to you with your previous consent. You may withdraw this permission by sending an e-mail to research@otpbank.hu or by writing a letter to 'Research Center', Hungary H-1051, Budapest, Nádor utca 21. Please refer to your name and e-mail address in both cases.
Data management registration number: NAIH-89457/2015
15. The personal data in this investment research are processed by OTP Bank. The legal basis for processing the data is the legitimate interest of OTP Bank. The detailed information about the processing of personal data and the related rights of data subjects is available [here](#).

This document was prepared on 09 July 2020.