

REPORT ON INFLATION

10 August 2022

Another upside surprise in inflation. Newer and newer inflationary shocks keep coming

- Hungary's headline inflation accelerated to 13.7% YoY in July, from 11.7% in June. The data caused upside surprise for both the market (13.0%-13.1%) and for us (13.0%). The acceleration was broad-based. We think part of the announced fiscal measures (rising the public health product tax, increasing the retail sector tax, higher excise duty on alcohol products) has already appeared in the CPI figure. Nevertheless, we cannot exclude that further price shocks will come due to the fiscal measures (higher sectoral tax on insurance companies, increasing the financial transaction tax, etc.). According to our calculations, raising the excise duty and the public health fee added around 0.3% point to the headline CPI. Corporations seem to pass on (almost) all of their cost-push shocks, as the around 15% wage growth and the all-time high YoY growth rate of domestic demand (in Q1) made this possible.
- All underlying inflation indicators accelerated significantly, and they went parabolic. The closely watched constant tax core inflation grew from 13.8% to 16.6% YoY. Our filtered inflation indicator (which excludes volatile items and government measures) accelerated from 11.8% to 14.0% YoY, while our trend inflation indicator rose from 9.9% to 11.2% YoY. The MNB's sticky price inflation climbed from 12% to 13.4%. June's massive price setting was followed by even stronger figure in July (see Chart 9).
- Despite the current high inflation, we can already see further inflation shocks: the partial abandonment of households' fixed energy prices (+3%points), the expected lift-off of the cap on automotive fuel prices (likely in October, +1.6%points), and the extremely high natural gas prices. And it would be very difficult to say how strong re-pricing will be triggered by the rising sectoral taxes (and significant tightening of eligibility criteria for the KATA flat-rate tax scheme for small taxpayers, which can strongly affect the inflation of personal services – e.g. hairdressers, repair and maintenance of household appliances, etc.). As a result, we raised our CPI forecasts for 2022 and 2023 to 13.6% and 13.3%, respectively. Inflation may peak around 20% at the end of this year.
- Nevertheless, we still think that the upcoming economic slowdown will sooner or later ease inflationary pressures. We can already see early signs that high inflation takes its toll on consumption. Retail sales contracted by 0.4% and 0.5% MoM (w/o automotive fuel) in May and June, respectively. Households' saving rate has also declined sharply. The announced fiscal measures (particularly partly abandoning fixed energy prices, and narrowing the KATA tax scheme) will significantly reduce households' real income in the last third of the year. The slowdown of households' consumption growth may hold back the very strong re-pricing activity. In addition, many industrial metal prices, as well as crude oil prices, started to decline in recent weeks. Finally, if the forint can stabilize around its current level, that can also help the disinflation in the second half of next year. Wage developments in the coming months will be crucial to assess whether the wage-price spiral has already begun, or not. In our baseline forecast, we have assumed anchored inflation expectations. This means the currently very high extra re-pricing compared to the historical average – see on Chart 9 – will be close to zero by the end of 2023.
- The partial scrapping of fixed energy prices made us raise our base rate expectations, with the peak at 13.25%. The published data strengthened this view. We think the MNB will hike the base rate by 100 bps in August, and it will be followed by additional three 50 bps steps.

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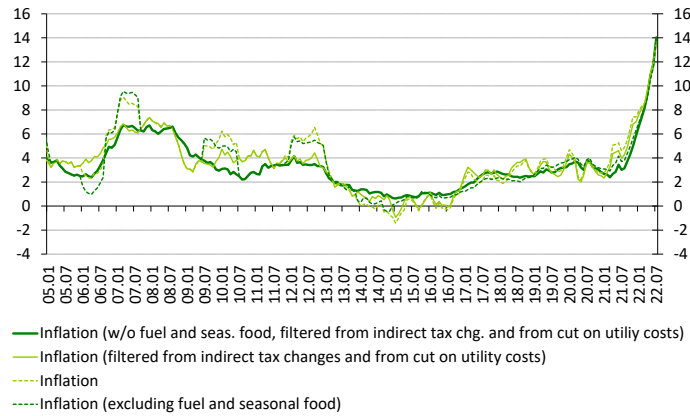
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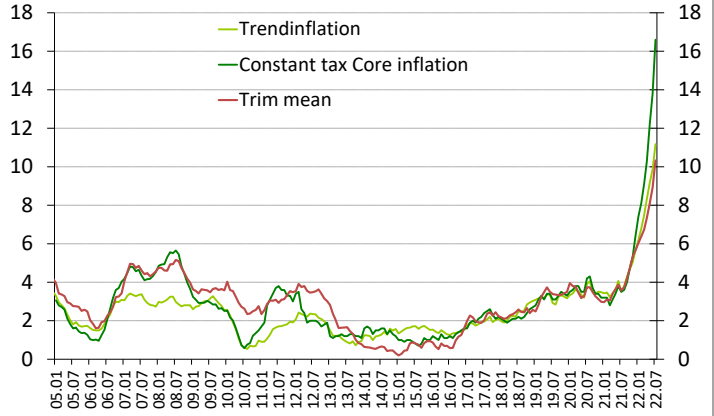
Chart 1: Summary chart of inflationary processes*
(annual changes, %)



Sources: KSH, OTP Research

* our filtered inflation indicator corrected with the price-cap effects on certain food items

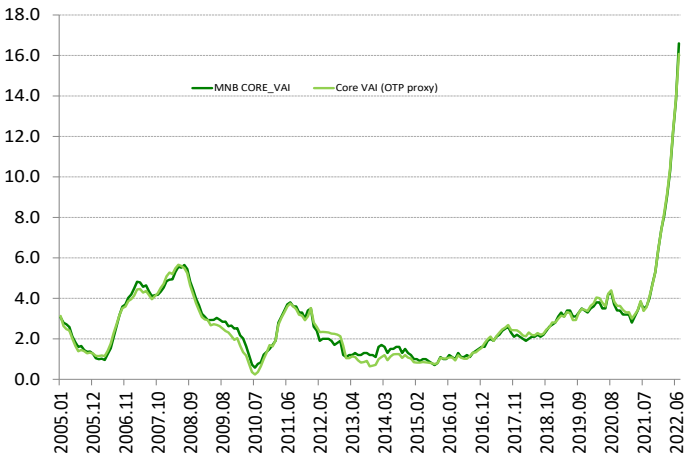
Chart 2: Core, trend* and trimmed mean inflation
(annual changes, %)



Sources: KSH, OTP Research

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

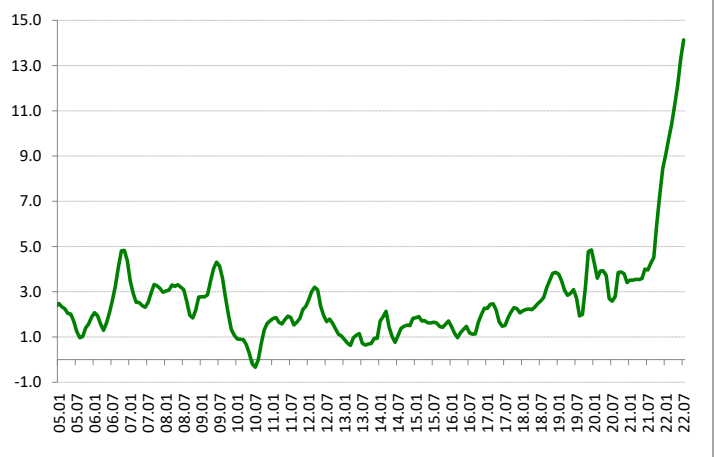
Chart 3: Constant tax core inflation and our proxy*
(annual changes, %)



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.

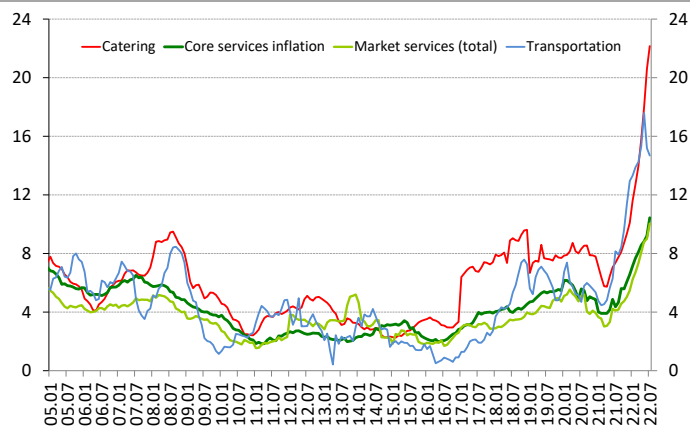
Chart 4: Trend inflation*
(3M/3M annualized change, %)



Sources: KSH, OTP Research

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

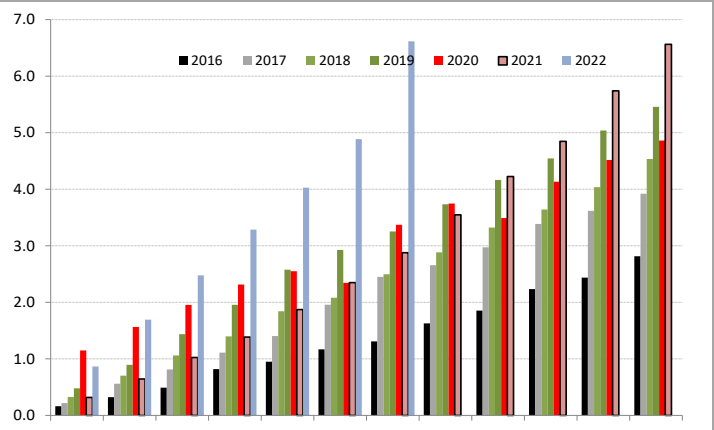
Chart 5: Services inflation*
(annual changes, %)



Sources: KSH, OTP Research

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

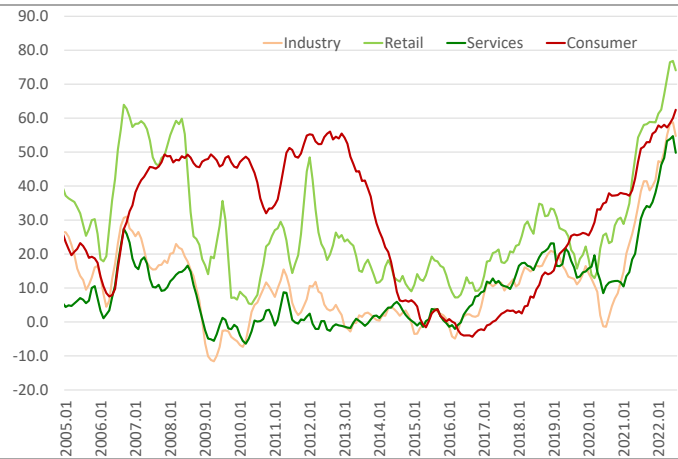
Chart 6: Intra-year price setting in core services*
(cumulated, over previous Dec, %, SA)



Sources: KSH, OTP Research

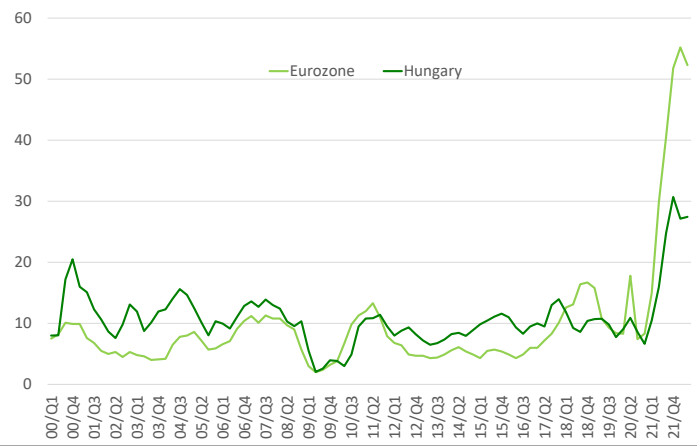
* Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

Chart 7: Inflation expectations* (balance points)



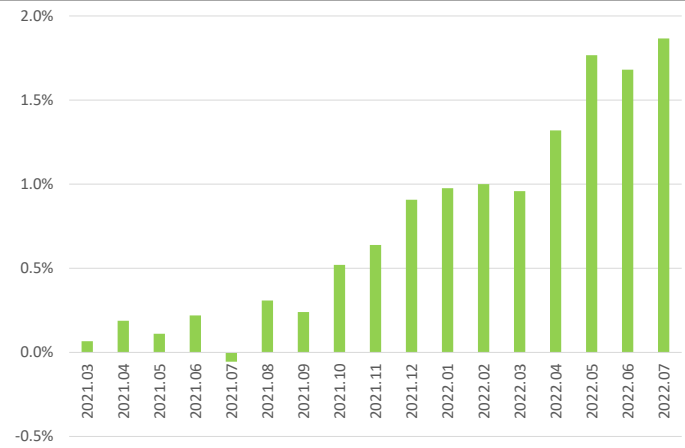
Sources: European Commission, OTP Research

Chart 8: Materials as production limiting factor in the EZ (balance point)



Sources: European Commission, OTP Research

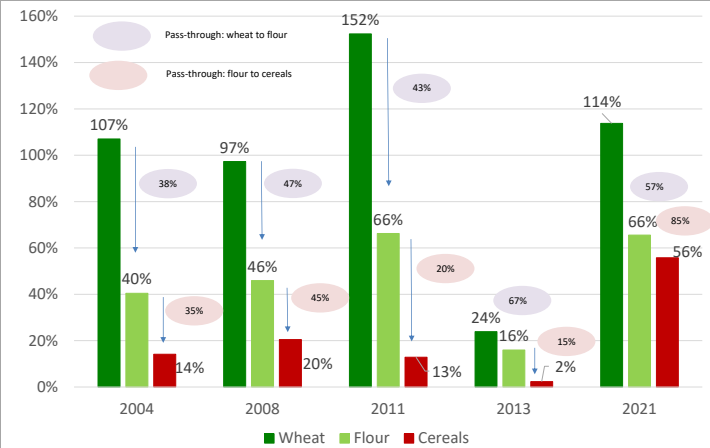
Chart 9: Extra re-pricing* in the constant tax core inflation (%point)



Sources: KSH, OTP Research

*: %point difference of MoM changes compared to the average MoM rate of given month in the 2017-2019 period; from February, data are adjusted by the effect of the price caps on vegetable oils, sugar, and milk

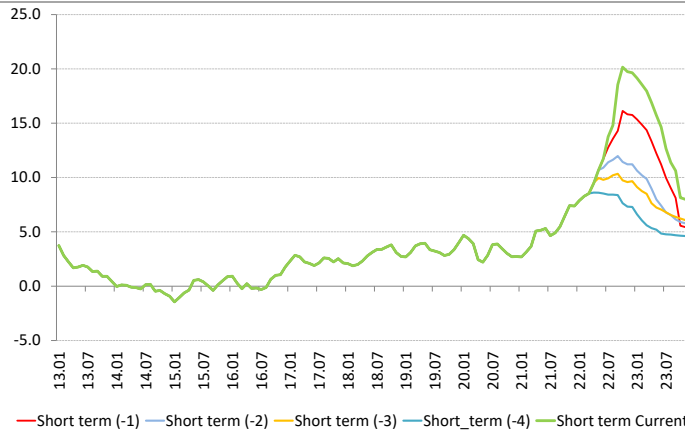
Chart 10: Agro-commodities' pass-through into consumer prices* (annual changes, %)



Sources: KSH, OTP Research

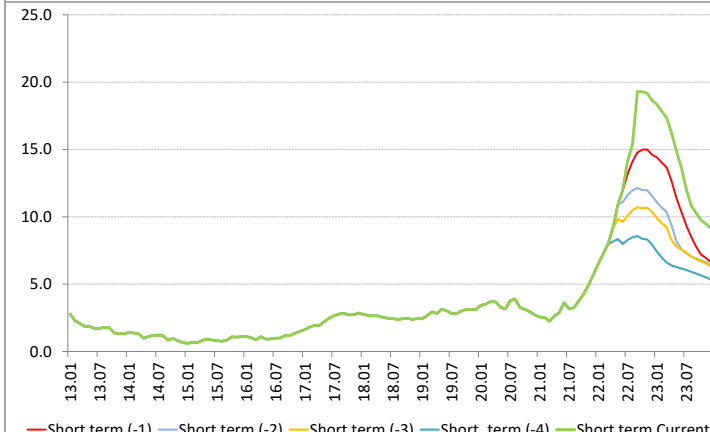
*: in the case of flour we used "shadow prices" (since February) calculated from the fine flour prices as in February price cap was introduced on strudel flour

Chart 11: Effect of the incoming data on our inflation forecast (annual changes, %)



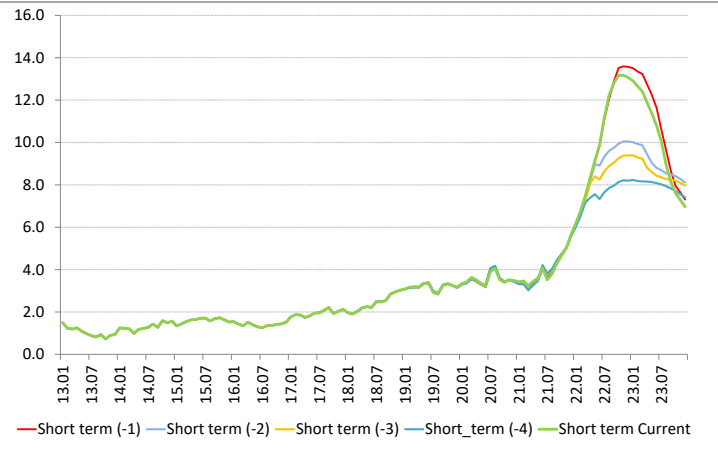
Sources: KSH, OTP Research

Chart 12: Effect of the incoming data on our filtered inflation forecast (annual changes, %)



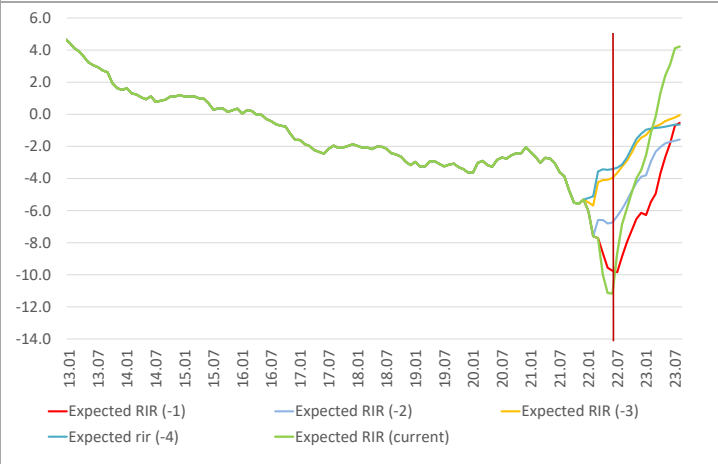
Sources: KSH, OTP Research

Chart 13: Effect of the incoming data on our trend inflation forecast (annual changes, %)



Sources: KSH, OTP Research

Chart 14: Expected ex ante real interest rate* (%)



Sources: KSH, OTP Research

*: calculated from 3M BUBOR and the 3 months ahead constant tax core inflation

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