

REPORT ON INFLATION

9 June 2023

Better-than-expected inflation data in May allows the MNB to cut rates by another 100 bps in June

- Hungary's headline inflation decelerated to 21.5% YoY in May, from 24% in April. The data caused downside surprise for us (nowcast: 22%) and an even larger for the market (consensus: 22.3%). About 0.25ppts downside surprise came from two administered CPI items: natural gas prices¹ fell by 6.5% MoM, while public transport fees declined by 22% MoM due to the introduction of a flat-fee monthly combined public transportation ticket.
- The improvement of underlying indicators continued in May. The closely watched constant tax core inflation decreased from 24.7% to 22.7% YoY. Our trend inflation indicators also slowed from 19.2% to 18.4% YoY, while its annualized 3M/3M change decelerated from 19% to 18.6%. The MNB's sticky price inflation gauge sank from 18.9% to 17.9% YoY. The extra MoM repricing in constant tax core inflation returned to its declining trend and stood at 0.2%.
- As we noted also in our previous Inflation Reports, it seems that the stronger exchange rate has started to work, as we can see a clear deceleration in durable goods' MoM inflation figures. In May, not only durable goods' MoM inflation was muted, but the non-durable goods' annualized MoM inflation also declined below 5% which is similar to mid-2021 values.
- On the negative side, the inflation of market services should be primarily highlighted. Our 'core-service' annualized MoM inflation – which contains the most labour-cost-and-demand-sensitive items – has stuck around 16% since July 2022, except January 2023 (the main re-pricing period), when the annualized MoM rate was above 30%. As a result, the within-a-year price setting stood at very high level in May. Fortunately, the disinflation of the catering services gained momentum in May, which counterbalanced the rising banking and insurance fees' effect on service inflation.
- In our view, the falling consumption (indicated by the subdued retail sales data and the weak tax revenues, as well as significant decline of real income), the appreciation of the HUF, and lower agricultural crop prices all suggest that disinflation will continue, and the single-digit inflation level by the end of the year is achievable. As a consequence of the stronger-than-expected adjustment in food prices and higher-than-expected decline in households' consumption in Q1, and the general decline of international commodity prices, we reduced our 2023 inflation forecast from 18.5% to 18.0%. The government announced excise duty hike on automotive fuels in 2024, which has around 0.6ppts effect on the next year's inflation. Nevertheless, due to the general improvement in the disinflation process, we maintain our 5% inflation forecast for 2024.
- All in all, we think the data will allow the MNB to go on with rate cuts; we think that another round of 100 bps is in the pipeline for June. Even if we cannot rule out a more aggressive cut in June, we find it unlikely, as the monthly repricing of services was still well above the comfortable level in May.

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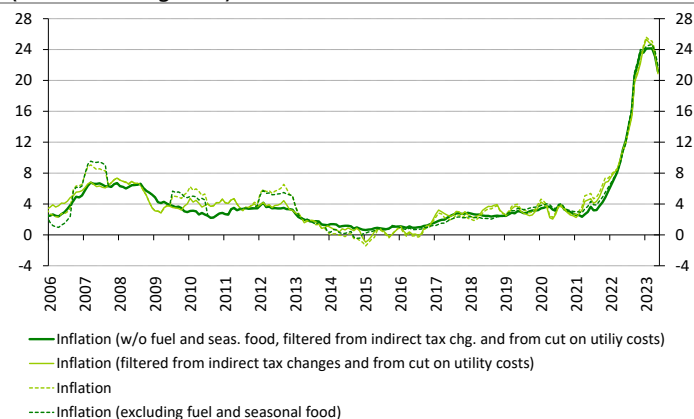
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¹ Regulated natural gas prices did not change, but due to the lower consumption a lot of households remained in below-average consumption category (less than 1,730m³ a year), thus their entire gas bill was subject to preferential price.

Chart 1: Summary chart of inflationary processes*

(annual changes, %)

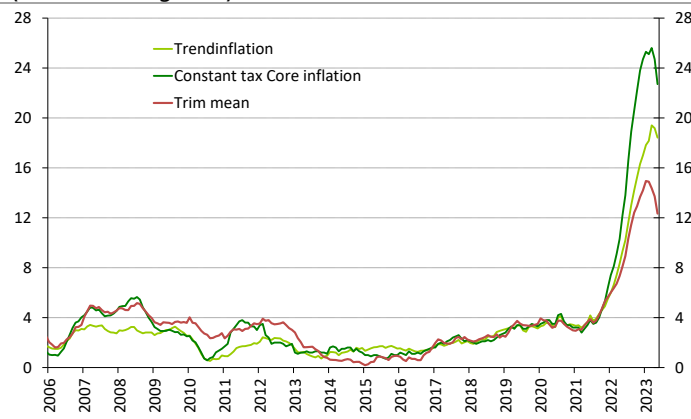


Sources: KSH, OTP Research

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

Chart 2: Core, trend* and trimmed mean inflation

(annual changes, %)

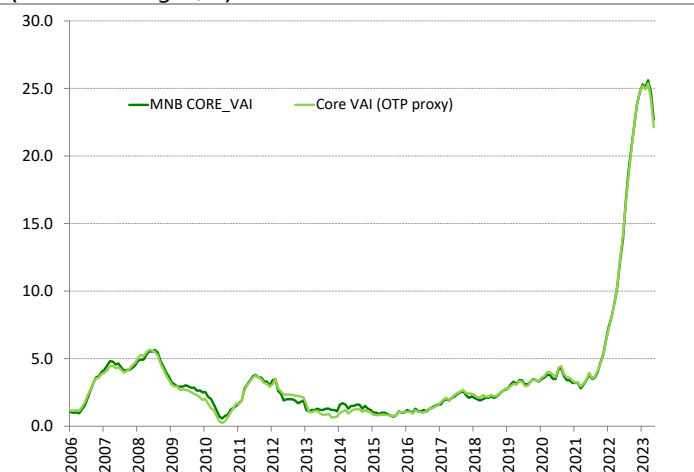


Sources: KSH, OTP Research

*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, %)

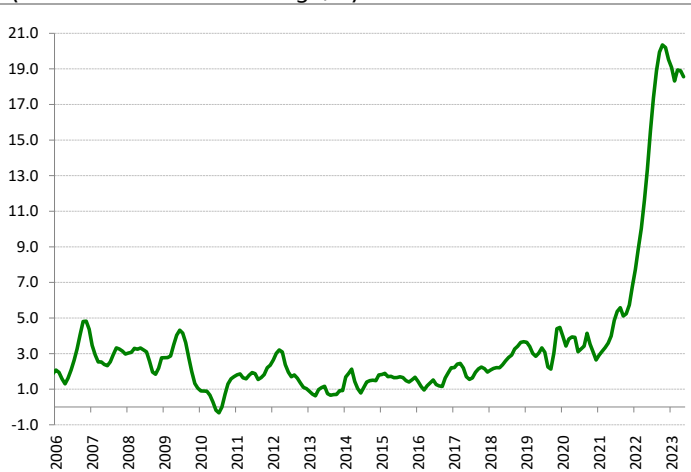


Sources: KSH, OTP Research

* 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, %)

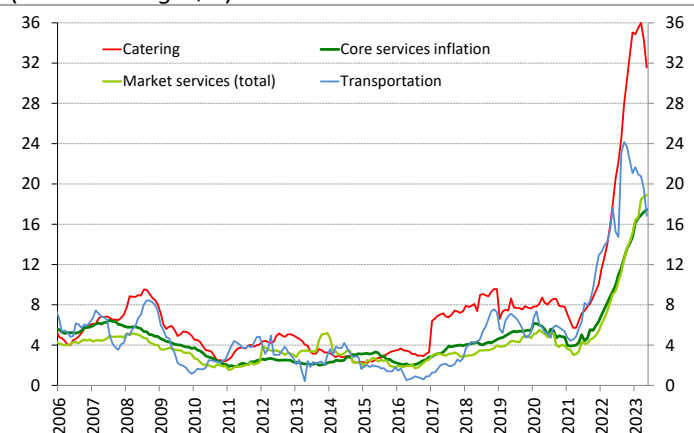


Sources: KSH, OTP Research

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

Chart 5: Services inflation*

(annual changes, %)

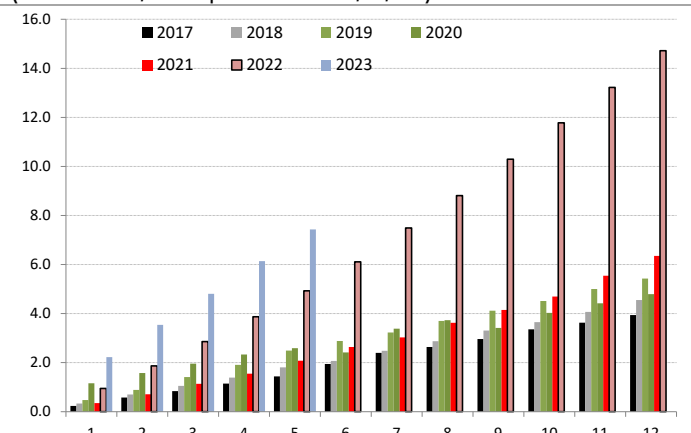


Sources: KSH, OTP Research

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

Chart 6: Intra-year price setting in core services*

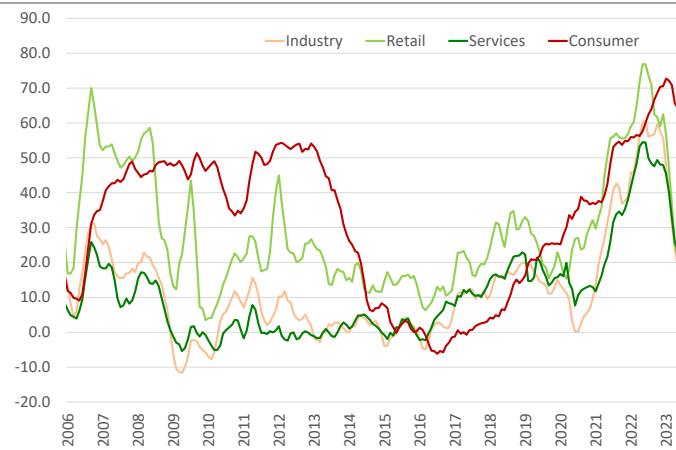
(cumulated, over previous Dec, %, SA)



Sources: KSH, OTP Research

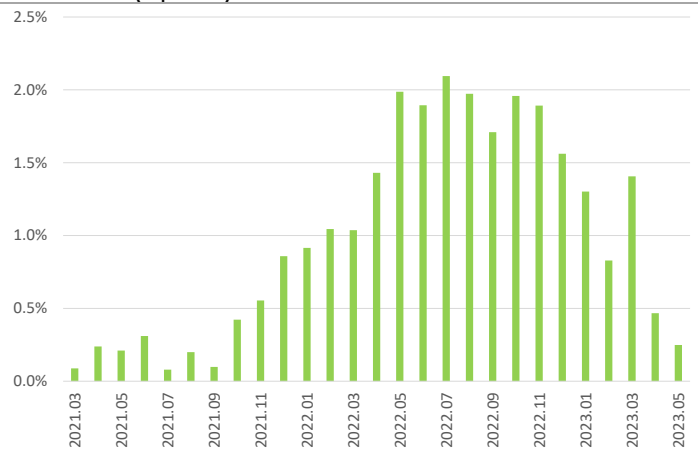
* Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

Chart 7: Inflation expectations* (balance points)



Sources: European Commission, OTP Research

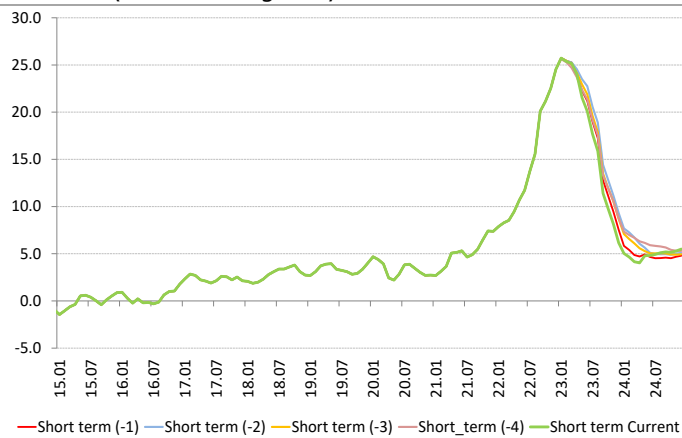
Chart 8: Extra re-pricing* in the constant tax core inflation (%point)



Sources: KSH, OTP Research

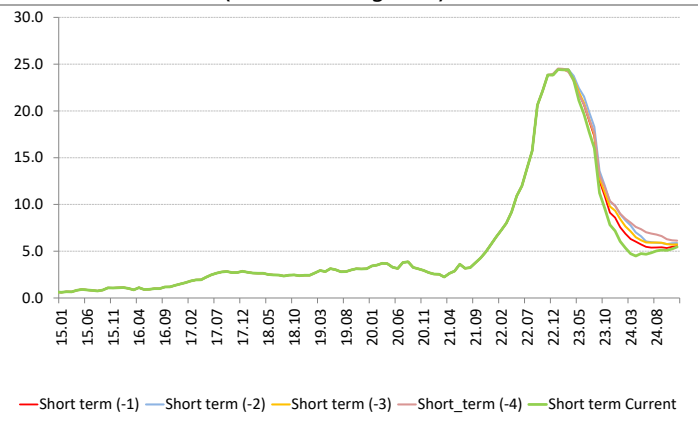
*: %point difference of MoM changes compared to the average MoM rate of given month in the 2017-2019 period; from February 2022, data are adjusted by the effect of the price caps on vegetable oils, sugar, and milk

Chart 9: Effect of the incoming data on our inflation forecast (annual changes, %)



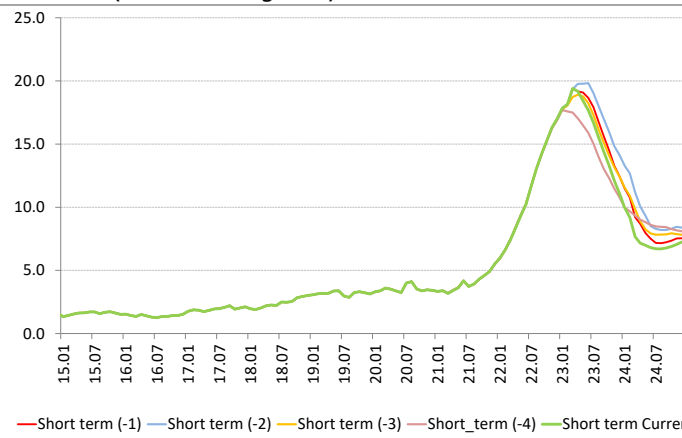
Sources: KSH, OTP Research

Chart 10: Effect of the incoming data on our filtered inflation forecast (annual changes, %)



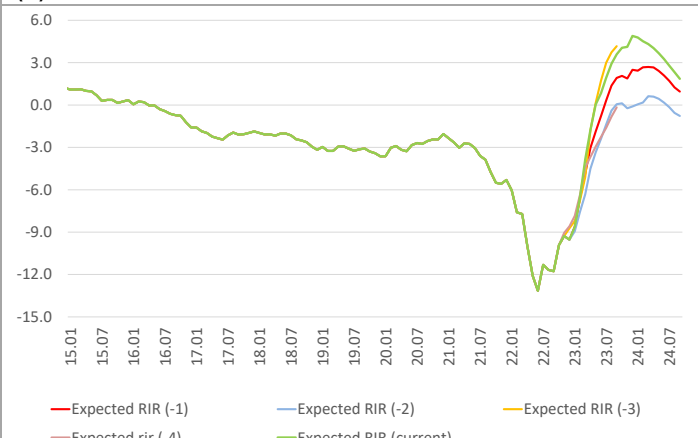
Sources: KSH, OTP Research

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



Sources: KSH, OTP Research

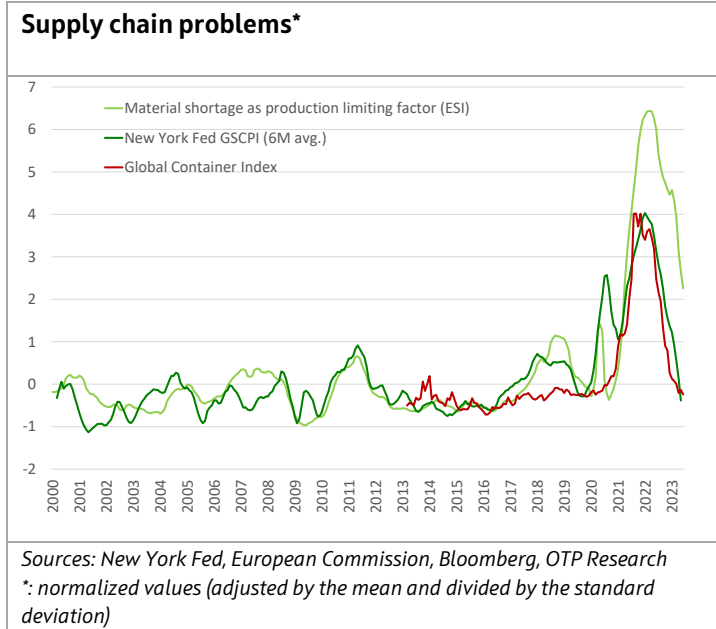
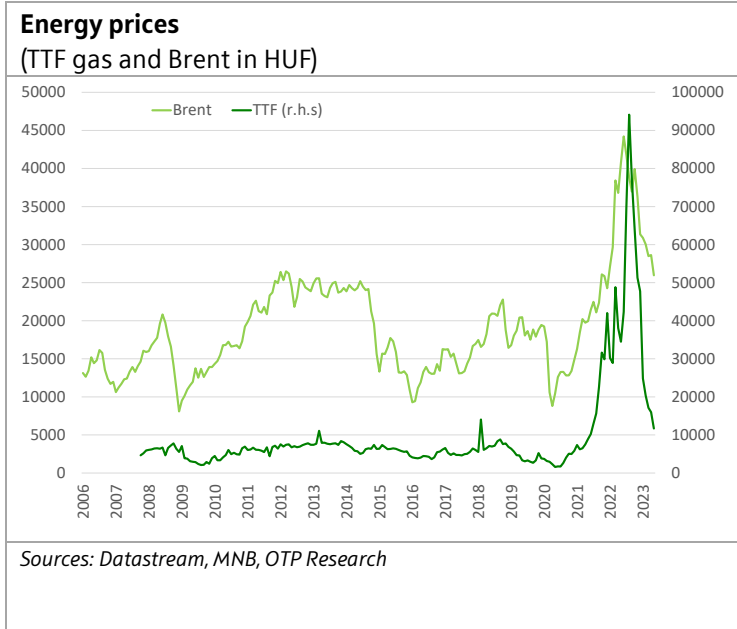
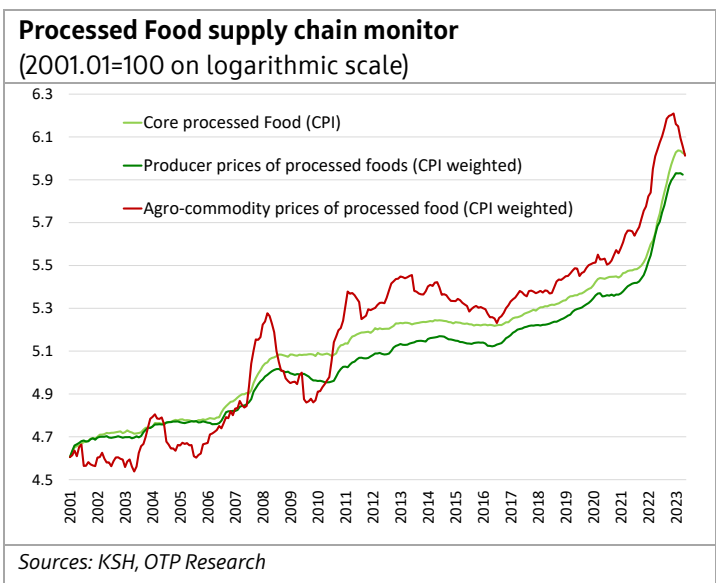
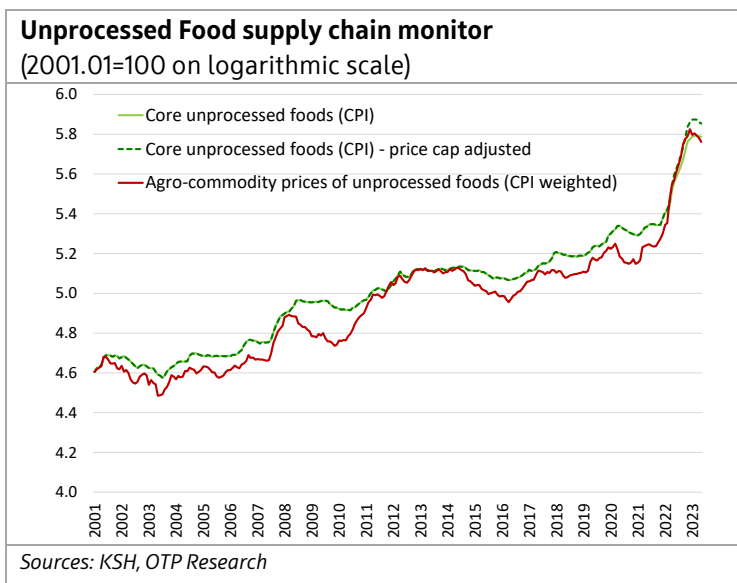
Chart 12: Expected ex ante real interest rate* (%)



Sources: KSH, OTP Research

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

Inflation Pressure Monitor



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