

REPORT ON INFLATION

11 September 2023

Another step in disinflation, with a few minor flaws

- Hungary's headline inflation decelerated to 16.4% YoY in August, from 17.6% in July. The data matched our forecast and delivered slight negative surprise for market expectations (16.2%). In its latest Inflation Report (published in late June), the MNB had forecasted 15.6% inflation for August, so the incoming data is above the national bank's trajectory.
- The improvement of underlying indicators continued in August. The closely watched constant tax core inflation decreased to 15.2% from 17.5% YoY. Our trend inflation indicators also slowed to 14.8% from 16.2% YoY, while the annualized 3M/3M change decelerated to 8.7% from 11.5%. The MNB's sticky price inflation gauge sank to 14.0% from 15.2% YoY. The extra MoM repricing in constant tax core inflation remained around 0%.
- All in all, global food disinflation, lower energy prices, the re-appreciation of the HUF and the sharp weakening of domestic demand due to falling real wages, fiscal and monetary tightening are all suppressing inflationary pressures.
- There was a significant uncertainty about the August inflation data because the price cap on selected food products was withdrawn, while mandatory special offers were introduced. The published data showed that in most cases the food prices that were under price caps did not converge to their "shadow" prices. Our shadow price calculation is based on the price development of close substitute products (e.g. ESL and UHT milk). We think prices will gradually converge on the forecast horizon.
- There was a positive development in the MoM inflation of market services, which is closely monitored by the MNB. Nevertheless, we have to point out that the very low MoM figure was a consequence of a one-off item: there was a 2.5% MoM drop in telecommunication prices, which lowered the MoM market service inflation by 0.3ppts. If we take into the account this one-off effect, we see that the MoM figure in August was still much lower than in the previous year, but clearly higher than the 2020 and 2021 figures. Our 'core-service' inflation – which contains the most labour-cost-and-demand-sensitive items and does not include telecommunication services – has showed slight but gradual improvement in recent months, and this tendency continued in August, too.
- The decline of the YoY goods inflation continued in August, but there are some indications that the strong disinflationary effect, which came from the goods inflation in the past six months, can weaken. In the case of the most exchange-rate-sensitive goods, the price level stagnated or slightly decreased in the past six months, but picked up in August. This may indicate that the current level of the EUR/HUF exchange rate cannot drive the goods' (MoM) disinflation further.
- Based on detailed second-quarter GDP data, households' consumption stagnated on a QoQ basis in Q2, while at the beginning of the summer, monthly real wage growth turned positive again. Although we do not think that this would lead to as sharp recovery in household consumption as the previous decline was, renewed growth could weaken disinflation. It also seems that only a weak disinflation effect is expected from the exchange rate side. In addition, the effect of ending price caps has not yet fully appeared in inflation, and it seems very likely that additional measures from the budget side will be necessary to maintain the deficit targets. Most likely, these measures may also be rather inflationary. And last but not least, there is considerable

Analyst

Győző Eppich
EppichGyo@otpbank.hu

Institutional Sales Desk

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

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

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

Péter Nagy
+36 1 288 7551
Peter.Nagy.4@otpbank.hu

Judit Kornis
+36 1 288 7548
Judit.Kornis@otpbank.hu

Corporate Sales Desk

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

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

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

Borbála André
+36 1 288 7541
Borbala.Sarolta.Andre@otpbank.hu

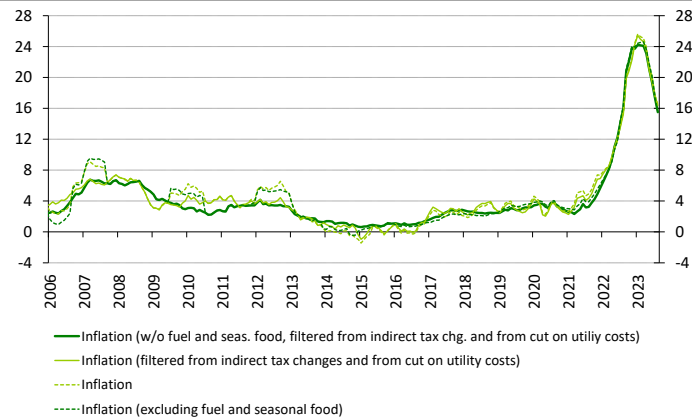
István Fodor
+36 1 288 7555
Istvan.Fodor.1@otpbank.hu

Péter Huck
OTP Trader
+36 1 288 7543
Peter.Huck.2@otpbank.hu

uncertainty surrounding minimum wage hikes. Based on newspaper reports, it cannot be ruled out that an additional minimum wage increase may take place this year, or that there may be a larger increase at the beginning of next year. Based on the published news, it is possible that the current minimum wage and the guaranteed minimum wage ("minimum wage for skilled workers") will be merged at the beginning of 2024. This would mean that minimum wages could rise by as much as 30-35% next year.

- We raised our 2023 and 2024 inflation forecasts from 17.6% and 4.5% to 17.9% and 4.8% respectively, partly because of higher oil prices. The other reason for this is connected to abolishing price caps. We expect the rate of inflation to decline to around 7% by the end of this year.
- The August inflation data paved the way for the most likely outcome of another 100 bps cut on the MNB's next rate-setting meeting in September, which would close the gap between the interest rate of the one-day deposit tender and the base rate. We think that this data will not change the expected pattern of quickly receding inflation in the new Inflation Report, which will also be published in September.

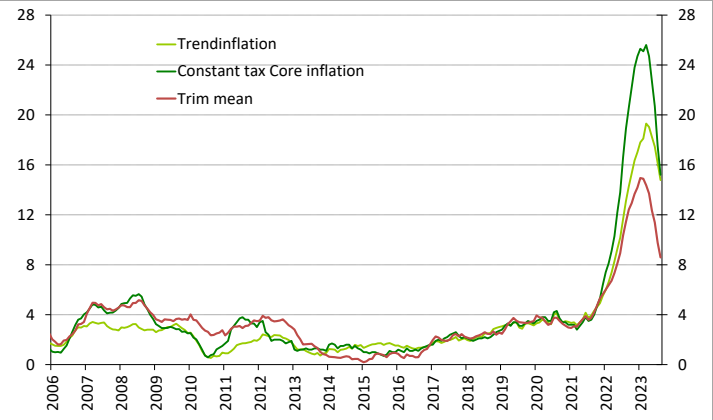
Chart 1: Summary chart of inflationary processes*
(annual changes, %)



Sources: KSH, OTP Research

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

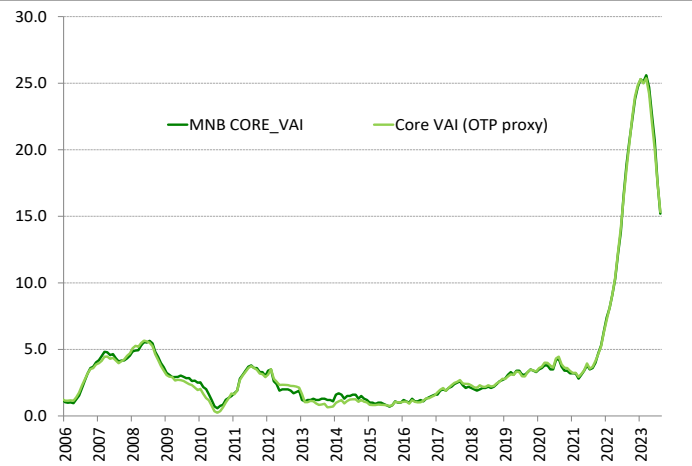
Chart 2: Core, trend* and trimmed mean inflation
(annual changes, %)



Sources: KSH, OTP Research

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

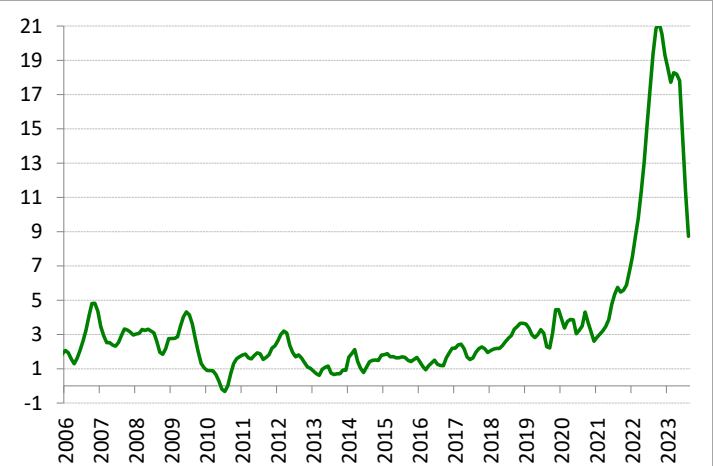
Chart 3: Constant tax core inflation and our proxy*
(annual changes, %)



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.

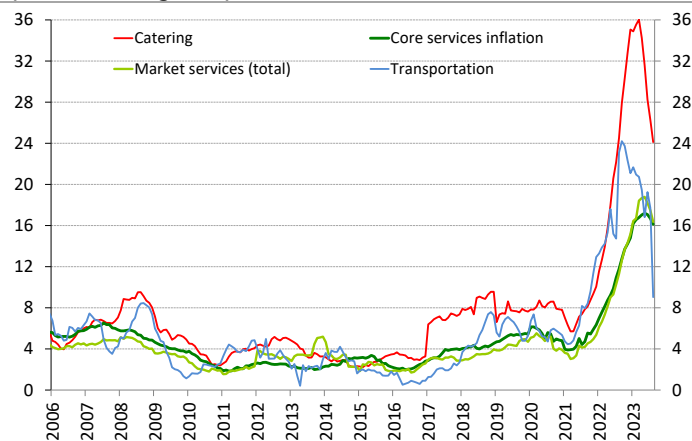
Chart 4: Trend inflation*
(3M/3M annualized change, %)



Sources: KSH, OTP Research

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

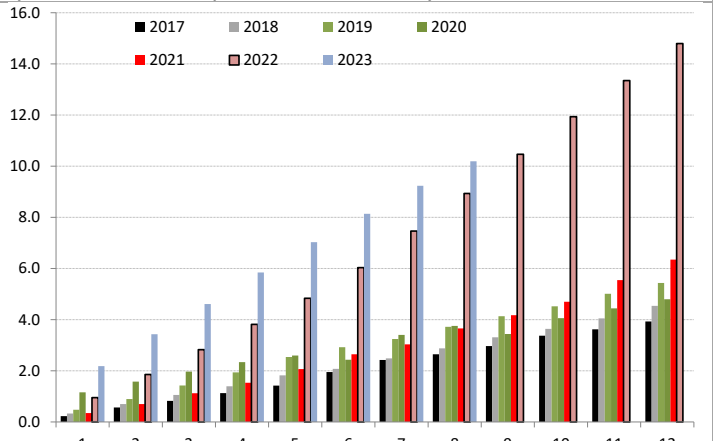
Chart 5: Services inflation*
(annual changes, %)



Sources: KSH, OTP Research

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

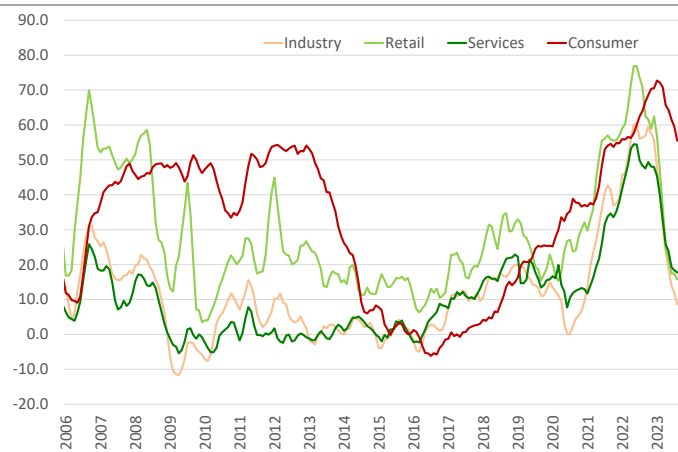
Chart 6: Intra-year price setting in core services*
(cumulated, over previous Dec, %, SA)



Sources: KSH, OTP Research

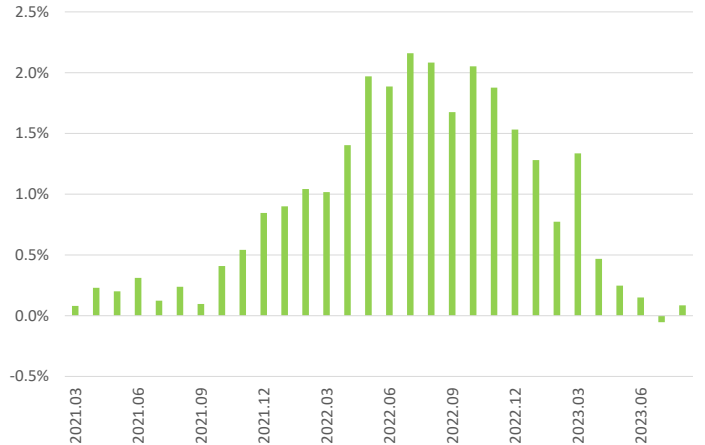
* Aggregation of the most demand-sensitive and labour-intensive services, filtered from indirect tax and visit fee changes

Chart 7: Inflation expectations* (balance points)



Sources: European Commission, OTP Research

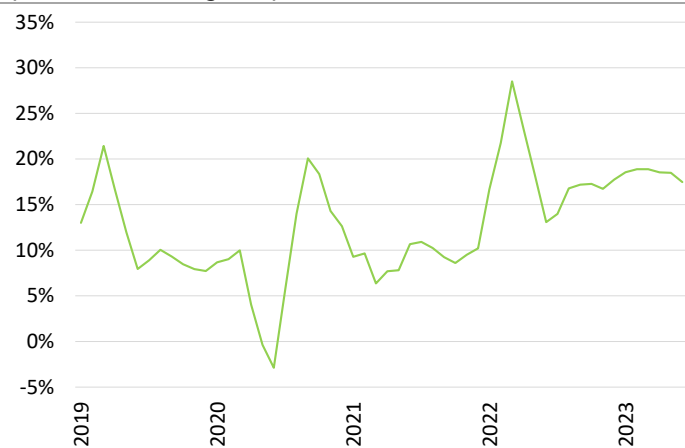
Chart 8: Extra re-ricing* in the constant tax core inflation (%point)



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

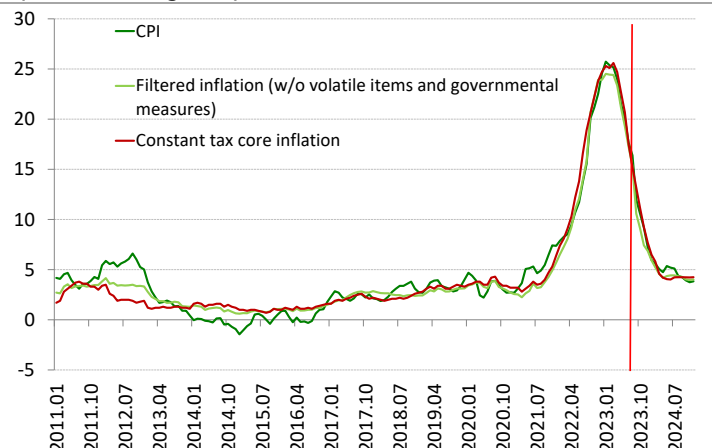
Chart 9: Rolling 3M/3M wage growth in the private sector* (annualized changes, %)



Sources: KSH, OTP Research

*: w/o financial intermediation; data contains not only the full-time but the part-time workers

Chart 10: Forecasts of main inflation indicators (annual changes, %)

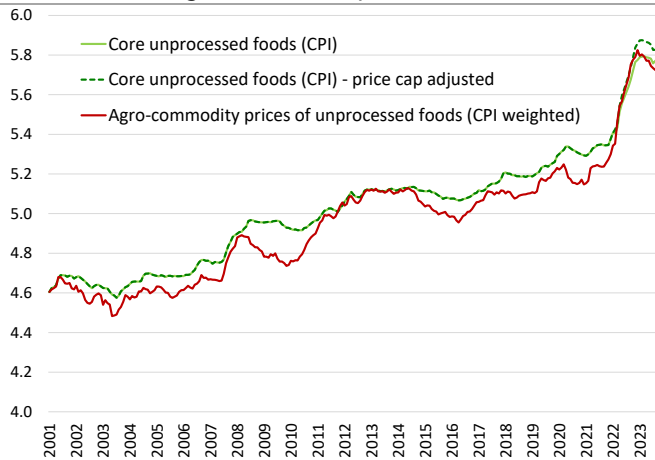


Sources: KSH, OTP Research

Inflation Pressure Monitor

Unprocessed Food supply chain monitor

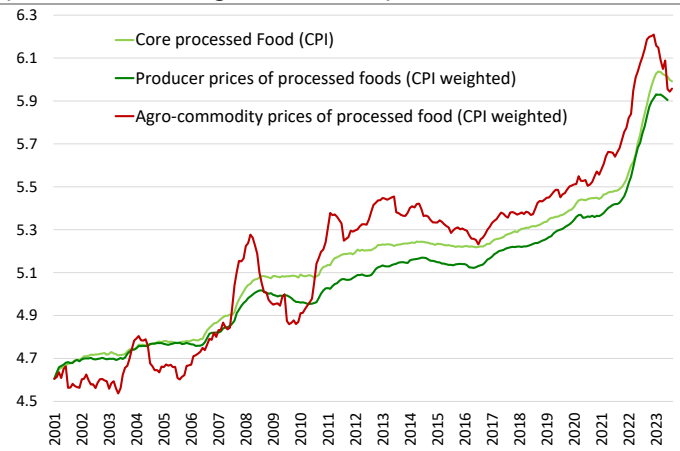
(2001.01=100 on logarithmic scale)



Sources: KSH, OTP Research

Processed Food supply chain monitor

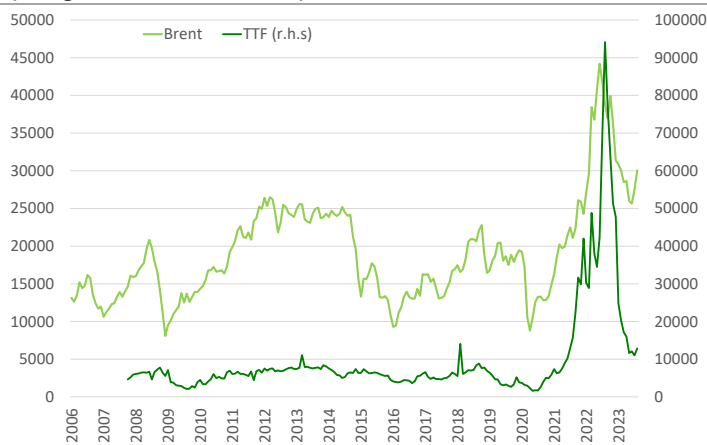
(2001.01=100 on logarithmic scale)



Sources: KSH, OTP Research

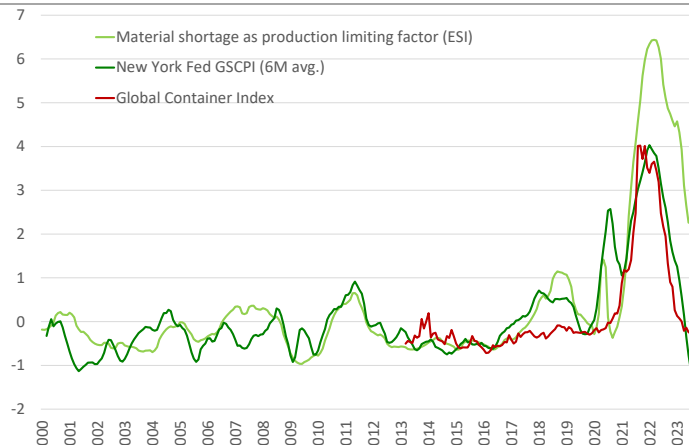
Energy prices

(TTF gas and Brent in HUF)



Sources: Datastream, MNB, OTP Research

Supply chain problems*



Sources: New York Fed, European Commission, Bloomberg, OTP Research

*: normalized values (adjusted by the mean and divided by the standard deviation)

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