

REPORT ON INFLATION

15 December 2015

Romania's inflation rate climbed higher primarily due to fading oil base effect and rising unprocessed food prices

- In November, the annual inflation rate increased to -1.1%, after -1.6% a month earlier, while on month-on-month basis consumer prices advanced 0.3% (see Chart 1). The headline figure was in line with market consensus (Reuters: -1.1% YoY) and marginally outpaced our expectation (-1.2% YoY). Simultaneously, the adjusted CORE2 inflation, which is also closely monitored by the NBR, rose by 0.2% compared to October, while in annual terms it fell less than in the previous month (-3.2% vs. -3.3%; see Chart 3). This slight upward movement was replicated by our filtered inflation¹ measure too, which inched up a bit for the third consecutive month, to around +1.1% YoY.
- Romania's inflation rate slipped deep into the negative territory, after food's VAT rate cut (from 24% to 9%) in June 2015. Accordingly, food's CPI shrank significantly, while prices at non-food products and services remained basically unaffected (see Chart 2). Without this one-off item, both the headline and the core inflation rates should stay above zero. Our in-house estimation indicates that the yearly growth rate of consumer prices should have to re-enter into the NBR's target band (2.5% +/- 1%) in November, exceeding the lower threshold of 1.5% by a narrow margin, while the adjusted CORE2 inflation might reach around +1.1% YoY, without the recent tax changes.
- Beyond the transitory impact of VAT reduction, the sharply declining crude oil quotations also weighed on the headline index in the recent period through fuel prices at the petrol pump. Nonetheless, this pull-back effect started to fade out starting with October, shaving off less than 0.4 percentage points from the headline figure last month, compared to a maximum of 0.6 pps in September (Chart 6). At the same time, the evolution of tobacco and alcohol products also helped inflation to climb higher, with a larger-than-expected upward swing, which most probably will not occur again in the next few months. In addition, unprocessed food prices accelerated too (Chart 7), driven by vegetables, presumably due to the summer drought, which resulted in lower agricultural output.
- Turning back to the underlying dynamics, filtered inflation appeared to bottom out, albeit very slowly, in the latest period (Chart 3), while its month/month indicators also seemed to stabilize at somewhat higher levels (Charts 4&5). Among others, this may be the result of marginally increasing processed foods' CPI, as manufacturing prices of foods started to mark a turning-point (Chart 8). However, this was maintained primarily by the segment of oils and fats production on the back of more rapidly rising sunflower prices, while the other segments did not show clear signs of a strongly accelerating trend.
- Regarding goods, price pressures remained relatively subdued (Chart 10), broadly in line with our expectation, but durable goods' inflation slightly surprised us on the downside. We thought that durable's CPI could be helped to a larger extent by the strengthening domestic demand. Nonetheless, the slower than forecasted evolution might be a result of one-off items, such as higher discounts applied by some retailers of electronic products during November. On the other hand, non-durable goods' prices overall still point to some acceleration this year (Chart 11).
- Excluding telephone charges, the growth rate of market services' CPI remained almost unchanged at 2.4% YoY in November (Chart 12), while certain sections, supposed to be more demand-sensitive, such as services related to hygiene and cosmetics, together with accommodations advanced faster than a month earlier.
- First of all, with the newer VAT rate cuts on the horizon, we think that the headline inflation may stay in the negative territory until the middle of next year, ending 2015 at -0.8% and 2016 at around 1.2% YoY, while it could get closer to the mid-point target (2.5%) at the beginning of 2017. Simultaneously, the underlying inflation indicators may gradually increase because of the strengthening domestic demand. According to the central bank's latest projection, Romania's negative output gap should turn into the positive territory in 2016 (Chart 13), bolstered also by sizeable fiscal stimulus and significant wage hikes.
- This may cause the NBR to remain cautious in the following period, maintaining the [monetary policy](#) rate at 1.75% until 2017, but we still believe that MRR (mandatory reserve requirement) reductions could come.

¹Filtered inflation is an in-house measure of underlying inflation dynamics. It excludes unprocessed food, fuels, administered as well as beverage and tobacco prices, filtering out the first-round impact of indirect tax changes. Moreover, it eliminates certain other items too, such as telephone charges or car prices, as these are strongly connected to the EUR/RON exchange rate.

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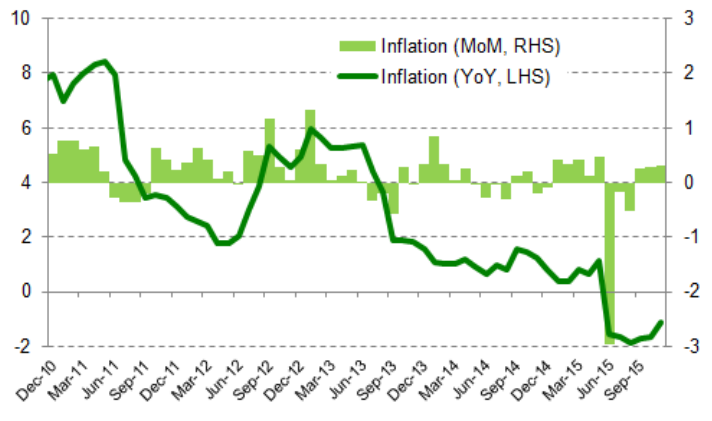
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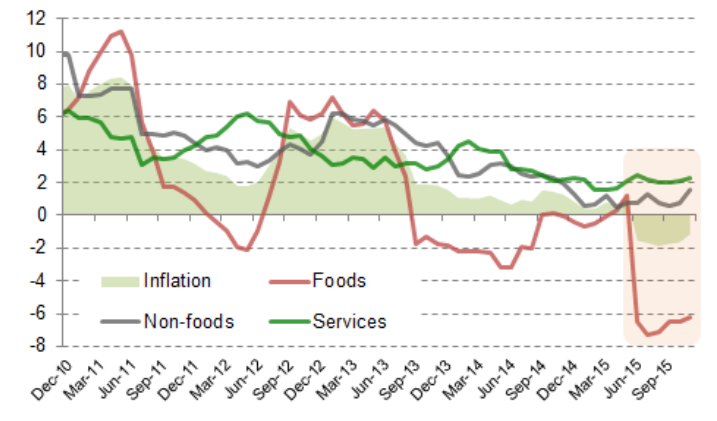
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Chart 1: Headline inflation
(%, NSA data)



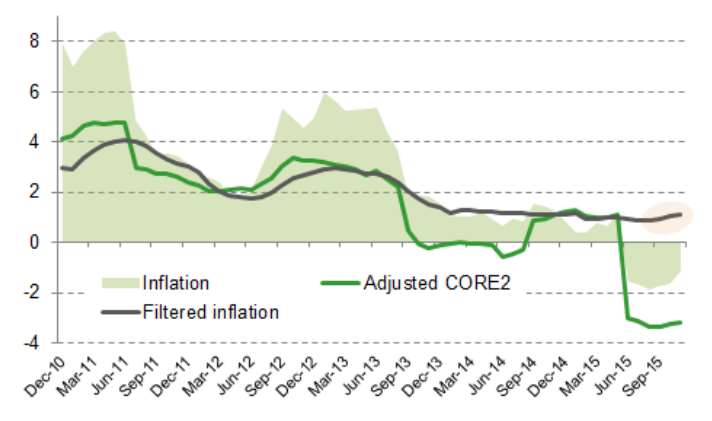
Sources: NIS, OTP Research

Chart 2: Inflation by its main components
(YoY%, NSA data)



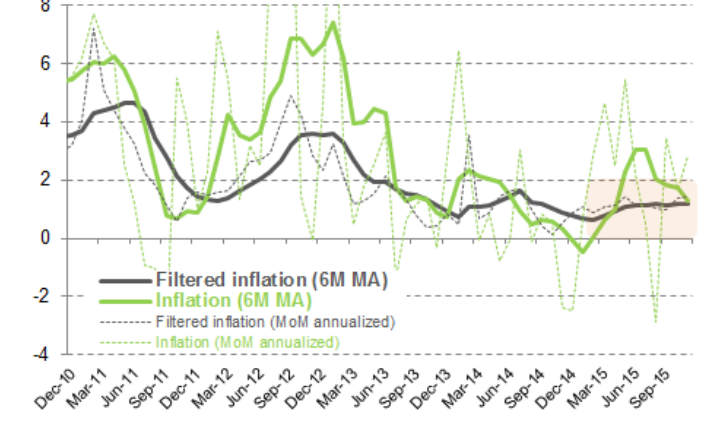
Sources: NIS, OTP Research
Note: in line with the National Institute of Statistics' (NIS) general segmentation.

Chart 3: Headline inflation and underlying processes
(YoY%)



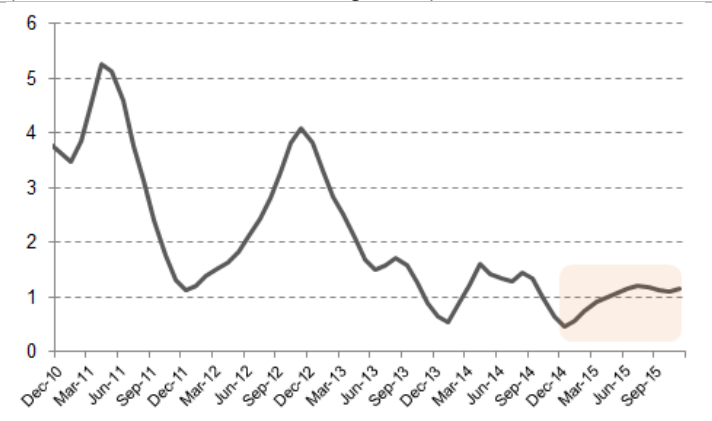
Sources: NIS, OTP Research
Note: **Adjusted CORE2** =inflation excluding VFE (vegetables, fruits, eggs), fuels, regulated as well as beverages and tobacco prices;
Filtered inflation = in-house underlying inflationary measure (SA).

Chart 4: Headline inflation and filtered inflation
(%, SA)



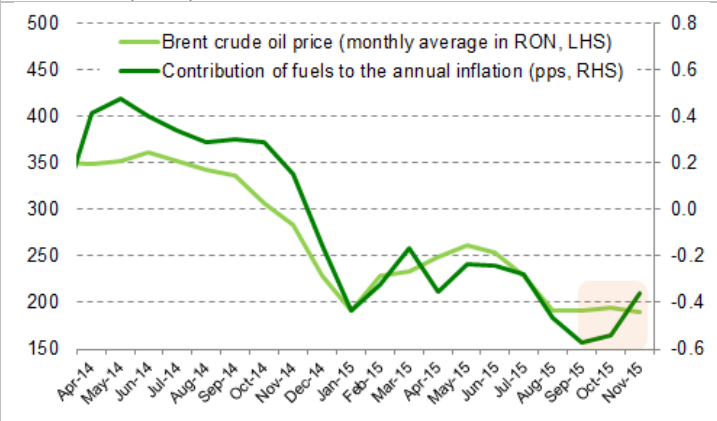
Sources: NIS, OTP Research
Note: the headline inflation is also filtered from indirect tax changes.

Chart 5: Filtered inflation
(SA, annualized 3M/3M changes, %)



Sources: NIS, OTP Research

Chart 6: Oil prices and fuel's contribution to annual inflation
(NSA)



Sources: Reuters, NIS, NBR, OTP Research

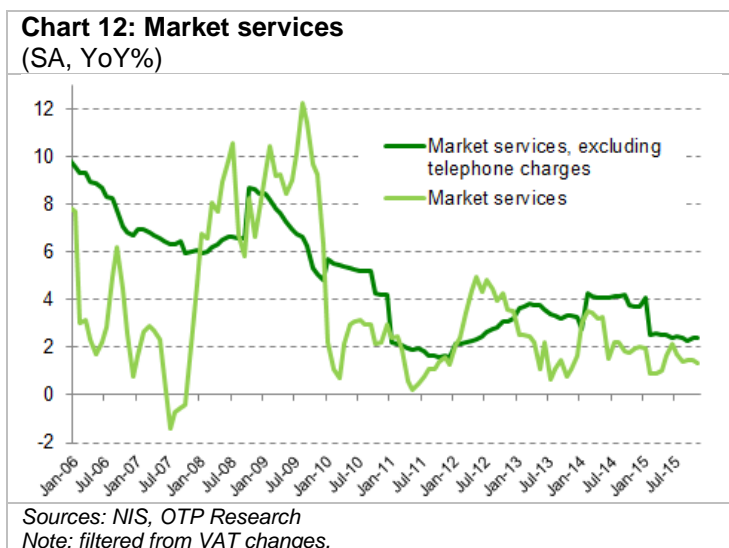
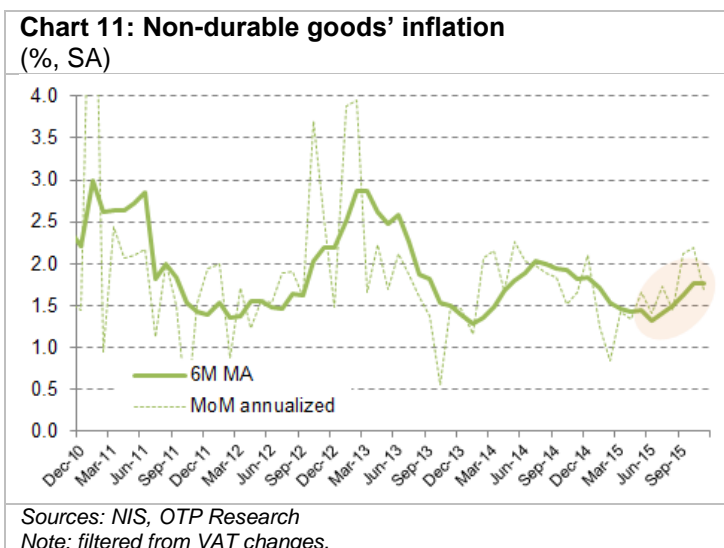
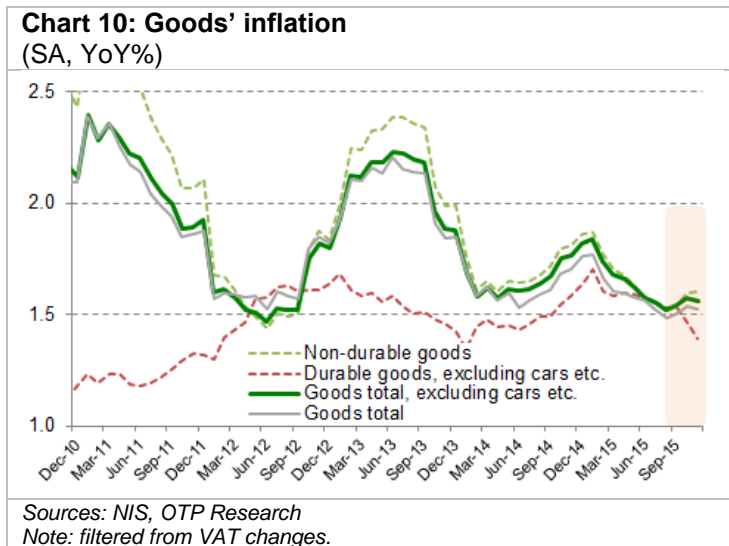
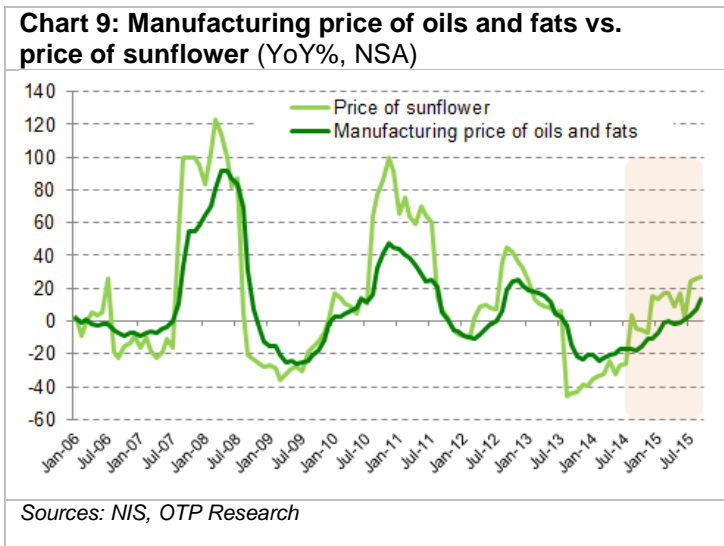
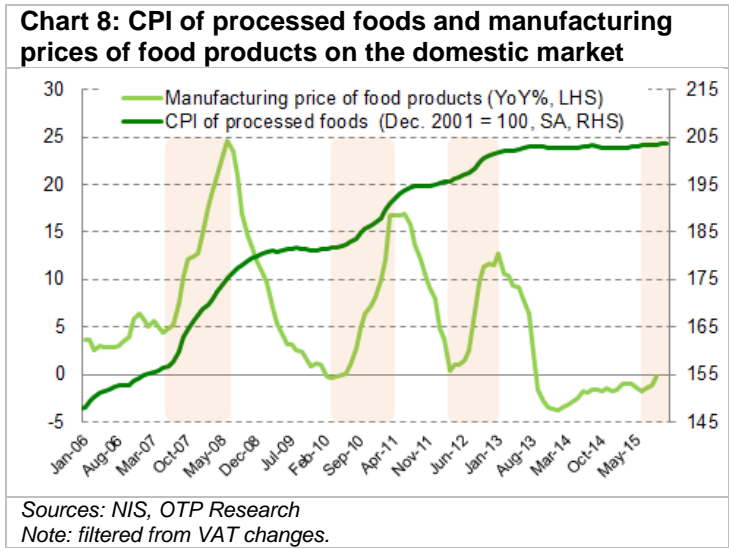
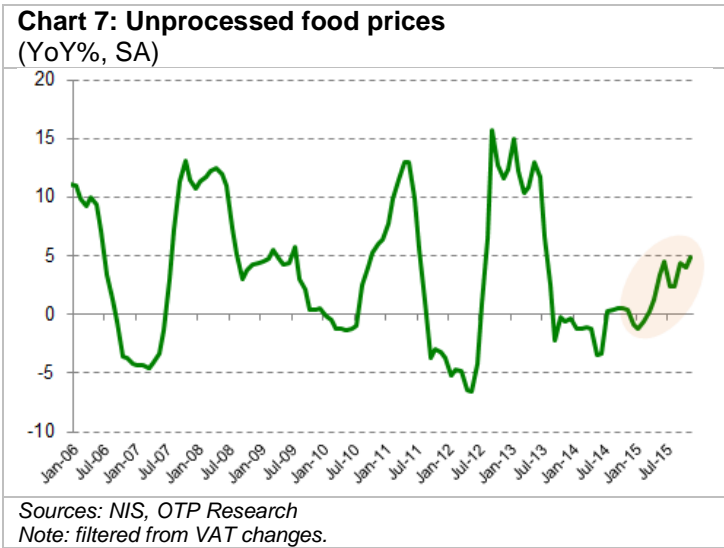
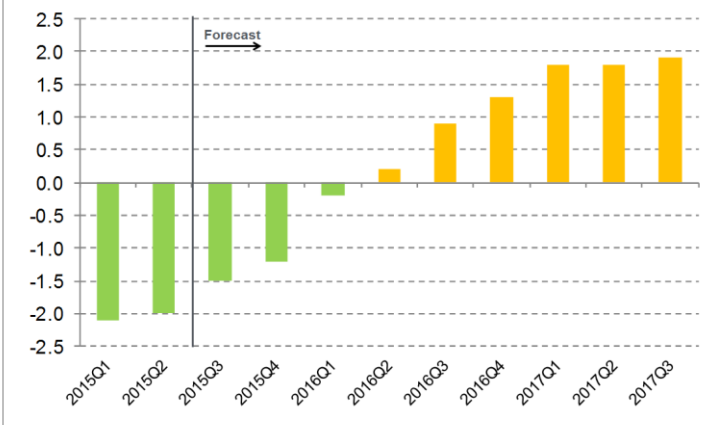
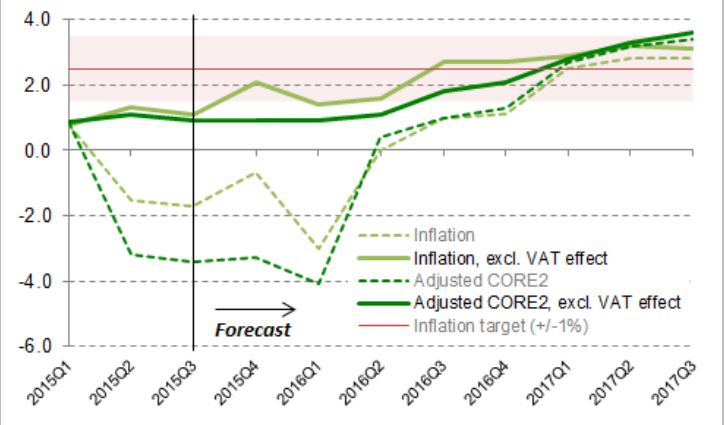


Chart 13: Output gap
(% against potential GDP)



Sources: NBR, OTP Research

Chart 14: November's inflation forecasts of the NBR
(YoY%)



Sources: NBR, OTP Research
Note: end of quarter

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