

REPORT ON INFLATION

18 January 2016

Headline inflation ended last year at -0.9% YoY, up from November's -1.1% YoY, mostly on fading base effect from fuels, while core CPI measures also increased slightly

- Romania's headline inflation ended 2015 at -0.9% YoY, inching up from November's -1.1% YoY, while it recorded 0.1% growth rate in monthly comparison (see Chart 1). The upward drift was foreseen by the majority of analysts, including us, but its size was missed marginally, as the market consensus stood slightly higher, at -0.8% YoY (Reuters), in line with our call. We noted in our previous [report](#) that inflation excluding VAT effect exceeded 1.5% in November and climbed further to 2% in December, so it re-entered the NBR's target range of 2.5% +/- 1%. This latter fact was confirmed by Governor Isarescu as well, on his latest press conference about monetary policy [decisions](#). (Nevertheless, it is worth noting regarding the VAT adjusted figures that they may be subject to some estimation uncertainty, coming from the statistical model applied.)
- Regarding the underlying CPI measures, the adjusted CORE2 inflation continued to climb gradually higher in parallel with our filtered indicator¹, which could rise to around 1.2% YoY, from 1.1% YoY a month earlier (see Chart 3), as it was expected. Albeit this in-house core measure still seems to be subdued on the long term, it could provide some evidence of acceleration in recent months (see Charts 4&5).
- The upward movement of the annual inflation rate in December was helped by the vanishing base effect of fuels. Taking into consideration the recent fall in crude oil quotes, we assumed a larger drop of prices at the petrol pumps (Chart 6). However, this deviation may translate into a higher monthly decrease in January, as market participants fully incorporate the effect of lower oil prices. On the other hand, the evolution of tobacco and alcohol products, as well as unprocessed food prices (Chart 7) lagged behind our expectations. Vegetables became more expensive, as last year's less favourable weather conditions would also indicate, but the upswing was offset by a sharp decline in citrus and other tropical fruit prices.
- As we foresaw, the CPI of processed foods¹, which have the largest weight in the filtered inflation measure, accelerated somewhat last month, while producer prices also seem to follow an ascending trend, suggested by our in-house tracker indicator too (Chart 8). First of all, this acceleration was due to the group of oils and fats, similarly to November, as sunflower prices advanced more significantly.
- Overall, goods' inflation remained roughly unchanged in December, staying close to 1.5% (Chart 9), which is the lower limit of the central bank's target. However, after excluding cars, auto and bike accessories, which group is strongly related to the evolution of the EUR/RON, goods' inflation declined a bit. While non-durable product prices were in relatively better shape, indicated also by short-term data (Chart 10), durables' prices are subdued. The persistently sluggish price dynamics, seen in the case of goods in the analysed period, might be put down to the low level of commodity prices. Nevertheless, labour costs' growing faster than productivity could exert upward pressure (Chart 11). Let us not forget that a newer significant (+19%) minimum wage hike will be introduced starting from May.
- After the EUR/RON went up by 1.3% in December, pointing to the largest monthly upswing during 2015, market services' prices also inched up more rapidly (around +0.7% MoM), lifting the YoY growth rate to nearly 1.9%. Excluding telephone charges, market services' monthly evolution was less impressive (around 0.2% MoM), but this gain was enough to keep the annual advance at 2.4% YoY, which missed the NBR's mid-point target by a thin margin. Moreover demand-sensitive items, such as services related to cosmetics and hygiene, as well as accommodations continued to accelerate.
- 2016's inflation dynamics is surrounded by high uncertainties, primarily coming from January's standard VAT rate cut (from 24% to 20%). Earlier experiences and preliminary data on basic consumer goods indicate that the transmission rate could be quite high, but this should not be necessarily true in the case of more sophisticated services.
- Taking into account the recent market turmoil, triggered by fears about the slowing Chinese economy, which put newer pressure on commodity prices, as well as an electric energy reduction in January, **we lower our 2016 year-end inflation forecast to 1.0% YoY, from 1.2% YoY.**
- **Summing up the outlook, 2016 will be characterized by several one-off effects, hence the headline inflation rate will be significantly lower than it would be under usual conditions, so the focus should be on the adjusted measure. There are already tentative signs of an overheated economy, such as the deteriorating current account balance and the strong dynamics of average wages, which should be closely followed during this year. As a result, we suspect that the NBR will keep its [policy](#) rate unchanged in 2016 (especially in the light of a large fiscal stimulus).**

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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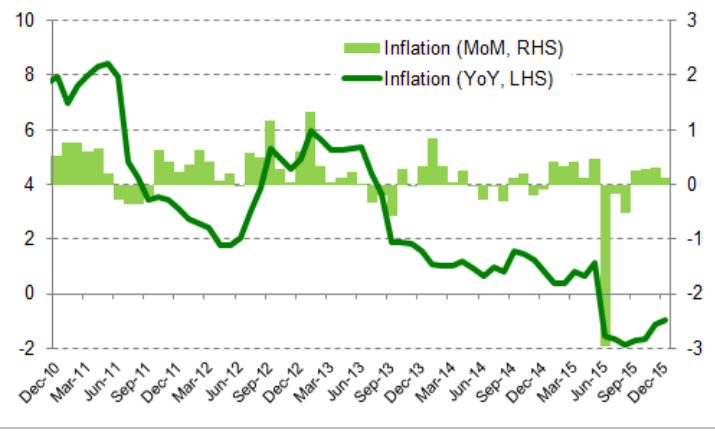
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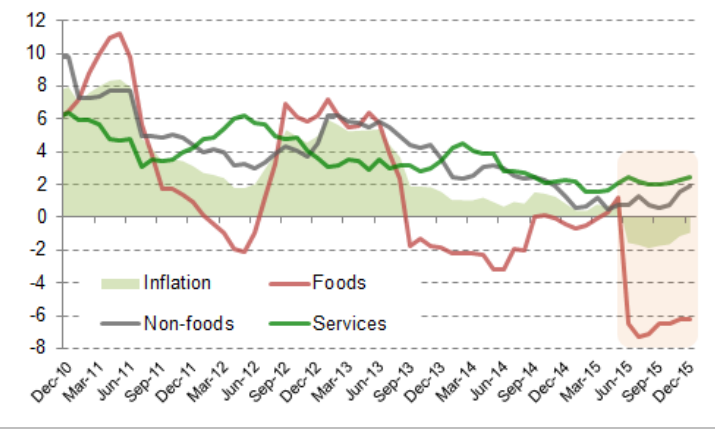
Chart set:

Chart 1: Headline inflation
(%, NSA data)



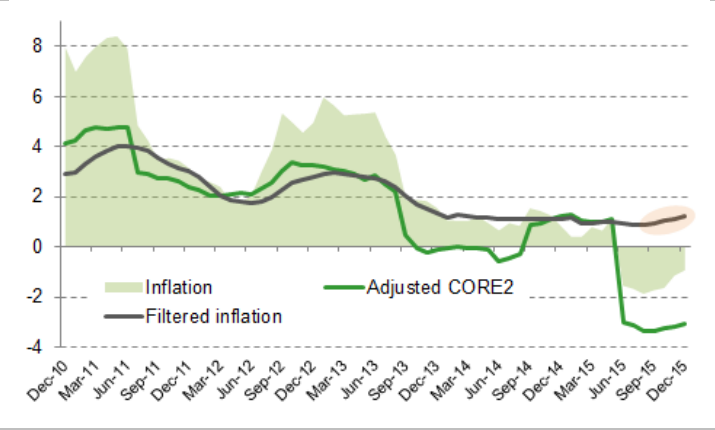
Sources: NIS, OTP Research

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



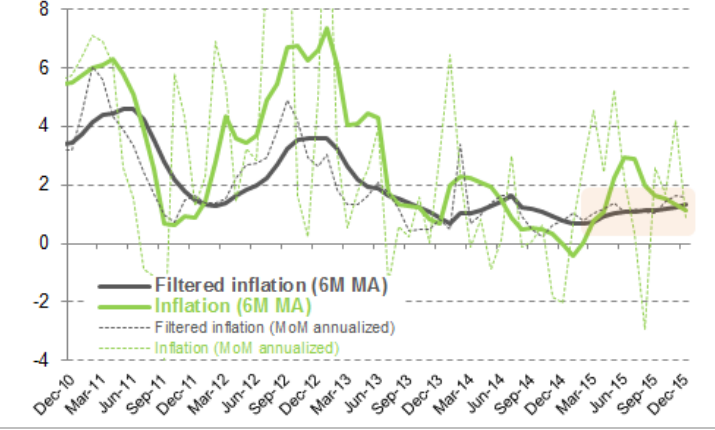
Sources: NIS, OTP Research
Note: in line with the National Institute of Statistics' (NIS) general segmentation.

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



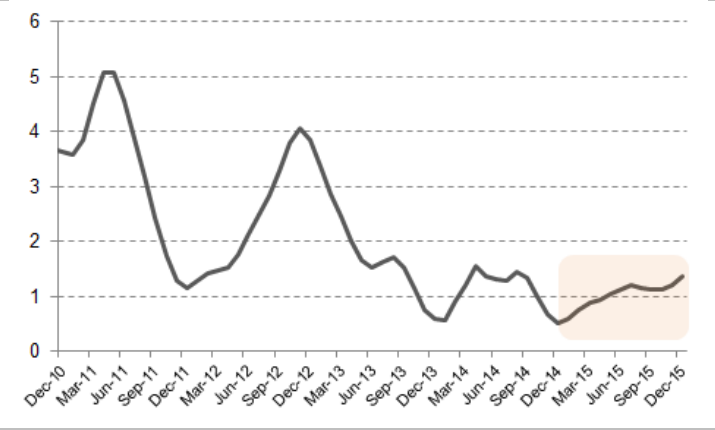
Sources: NIS, OTP Research
Note: **Adjusted CORE2** =inflation excluding VFE (vegetables, fruits, eggs), fuels, regulated as well as beverages and tobacco prices;
Filtered inflation = in-house underlying inflationary measure (SA).

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



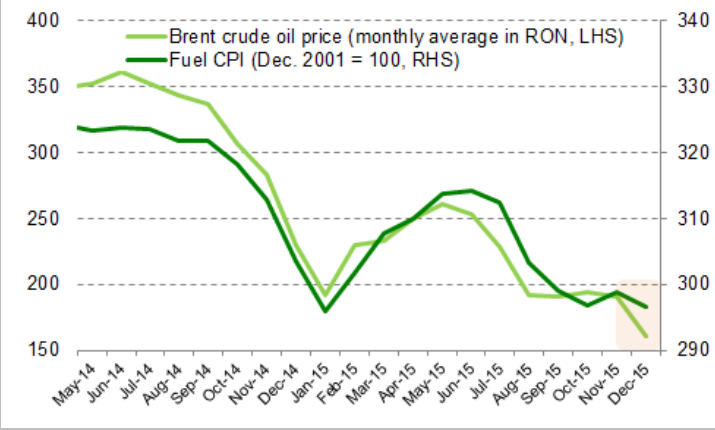
Sources: NIS, OTP Research
Note: the headline inflation is also filtered from indirect tax changes.

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



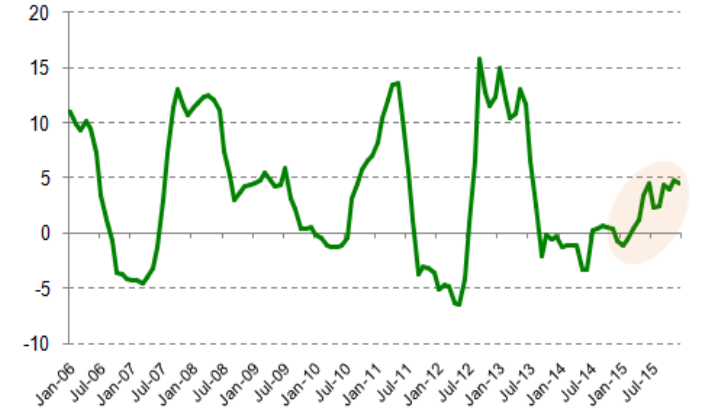
Sources: NIS, OTP Research

Chart 6: Oil prices and fuel's CPI
(NSA)



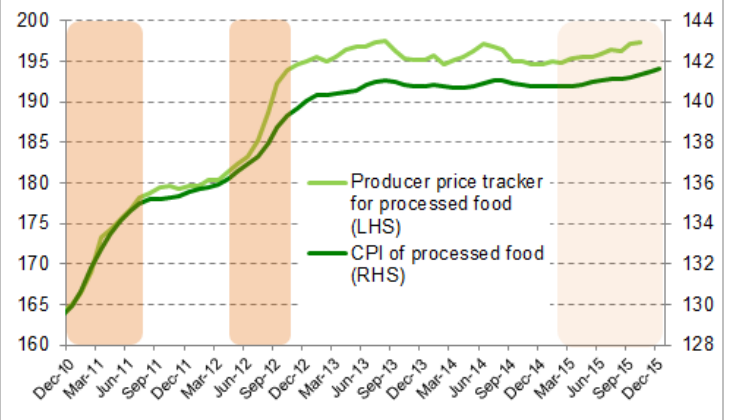
Sources: Reuters, NIS, NBR, OTP Research

Chart 7: Unprocessed food prices (YoY%, SA)



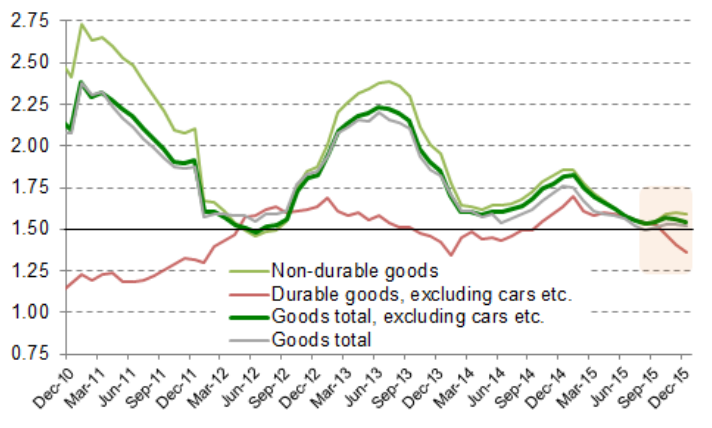
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 8: CPI of processed food and its producer price tracker (Dec. 2001 = 100)



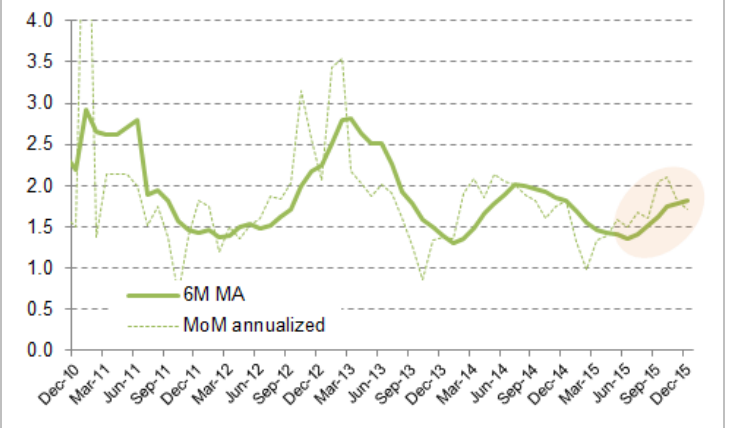
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 9: Goods' inflation (SA, YoY%)



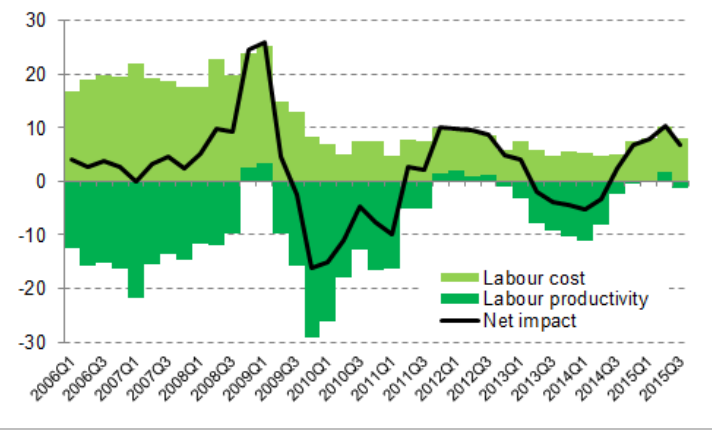
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 10: Non-durable goods' inflation (% SA)



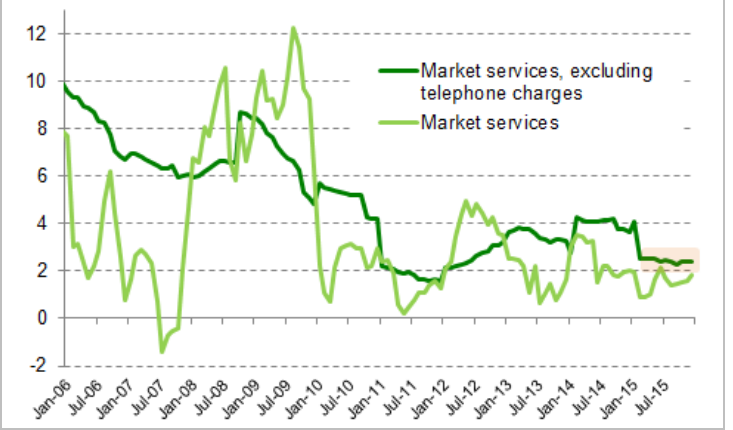
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 11: Quarterly labour cost and productivity in manufacturing (YoY%, NSA)



Sources: NIS, OTP Research

Chart 12: Market services (SA, YoY%)



Sources: NIS, OTP Research
Note: filtered from VAT changes.

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