

REPORT ON INFLATION

11 August 2016

July's inflation came broadly in line with expectations; underlying price dynamics gave little sign of acceleration

- Last month, the growth rate of consumer prices slid to -0.8% YoY down from -0.7% YoY in June (see Chart 1), the fresh report of the National Institute of Statistics showed, while our preferred *filtered inflation*¹ practically stagnated at 1.4% YoY (Chart 3). In month-over-month comparison, the CPI index shed 0.2% in July. The outcomes matched our expectations and were more or less in line with the market consensus (-0.7% YoY), carried out by Reuters one day before the data came out.
- It may also be worth mentioning that the four-percentage-point VAT reduction from January continues to weigh on the figures (Chart 2) and excluding this one-off item, the annual growth rate of consumer prices would stay in positive territory, but still pointing to sluggish dynamics.
- The primary reason behind July's month-over-month setback of the overall CPI was the movement of administered prices, as they registered a sharp contraction last month, after gas and electric energy prices were cut by 3.5% and 1.5% respectively. These two actions had an aggregated negative impact of around 0.2 percentage points on the monthly evolution of the headline data. Beyond administered CPI, fuel prices eased last month as well, after oil quotations bounced back from their June's peak (Chart 6) on worries about the high level of crude inventories. At the same time, in the context of a rather favourable perspective about this year's agricultural output, the evolution of unprocessed food prices surprised us with its quite sizeable upward movement (Chart 7). On the back of the sharp upswing, the negative impact coming from unprocessed foods turned quickly positive in July (Chart 5), but of course it remains to be seen if last month's upward change continues in the months ahead too.
- Looking back for the latest period, a moderate increase in the filtered inflation can be observed (Chart 3), with the indicator getting closer to the lower limit of the NBR's target (2.5% +/- 1%). Meanwhile, on high-frequency basis, a mildly rising trend took also shape in the first half of 2016 (Chart 4). Nevertheless, this was sustained primarily by processed foods, which seem to have limited upside potential, at least until agro-commodity prices remain subdued (Chart 8). Our tracking indicator, which summarizes the price evolution of different basic agricultural products on the Romanian market, such as wheat, sunflower, milk and live animal, suggests quite low underlying inflationary pressures from this side.
- The broader trends remained little changed in the case of goods too (Chart 9). In July, non-durables' annual inflation continued to wobble in the vicinity of 1.5%. However it may be noteworthy that there are a few items, considered to be more demand-sensitive (such as apparels), which gave signs of mild acceleration. The other main group of goods, namely durables sank further last month, while market services' inflation eased a bit as well (Chart 10). The latter was also influenced by the appreciation of the leu via telephone charges, but the growth pace of prices slowed even after the exclusion of the exchange-rate-related items. Admittedly, this surprised us to some extent, as we assumed that the rapidly increasing labour costs and the definitely strong demand for services had a more pronounced impact on the CPI of this group (we recall that market services remained the main driver of economic [growth](#) on the production side).
- In all, it seems that the big picture did not change significantly. External factors, such as the extremely low inflationary environment in the European Union (Chart 11), continue to weigh on price dynamics, but the excess domestic demand and the skyrocketing gains in real disposable [incomes](#) may lead to upward pressure on the CPI in the medium term.
- As it was also indicated in our last weeks' [MPC report](#), we slightly reduced our year-end inflation projection, to -0.3% YoY, from 0.0% YoY, primarily on the back of lower crude oil quotations. We also underscore that in the light of the recent developments, the NBR may raise the policy rate to 2.50% until the end of 2017, instead of 2.75%, as we expected earlier (for further details please see our latest [monetary policy](#) comment).

¹ *Filtered 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 and car prices, as these are strongly connected to the EUR/RON exchange rate.*

Headquarter Treasury Sales

Alexandru Tibuleac

+40372 31 85 85
alexandru.tibuleac@otpbank.ro

Cristian Ilie

+40372 31 85 86
ilie.cristian@otpbank.ro

Corina Bejan

+40372 31 85 84
corina.bejan@otpbank.ro

Andreea Nica

+40755 000 106
andreea.nica@otpbank.ro

Regional Treasury Sales

Szilamer Kozma - Cluj

+40755 000 400
szilamer.kozma@otpbank.ro

Tudor Zaman - Bucuresti

+40755 000 199
tudor.zaman@otpbank.ro

Alexandru Sabin - Arad

+40730 577 959
alexandru.sabin@otpbank.ro

Chief Economist

Gergely Tardos

+36 1 374 7273
tardosg@otpbank.hu

Analyst

Csaba Bálint

+4021 307 58 96
csaba.balint@otpbank.ro

Chart set:

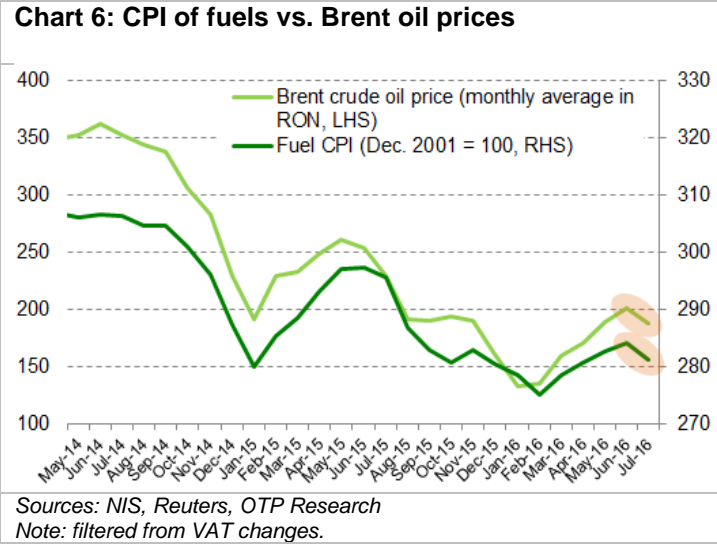
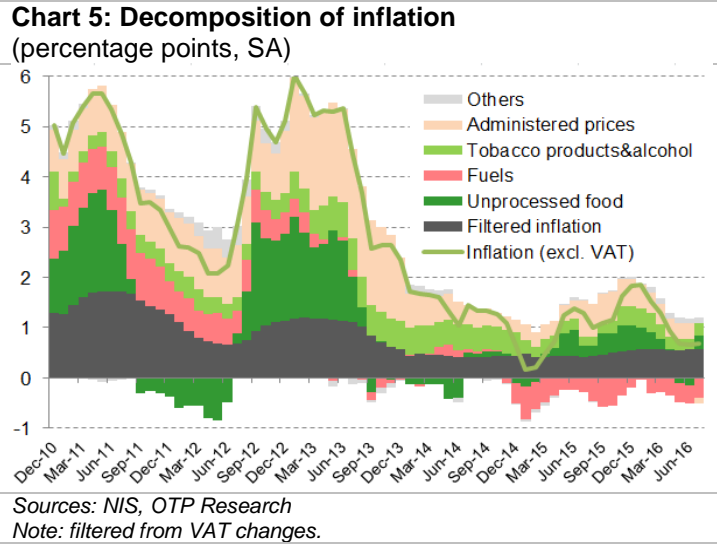
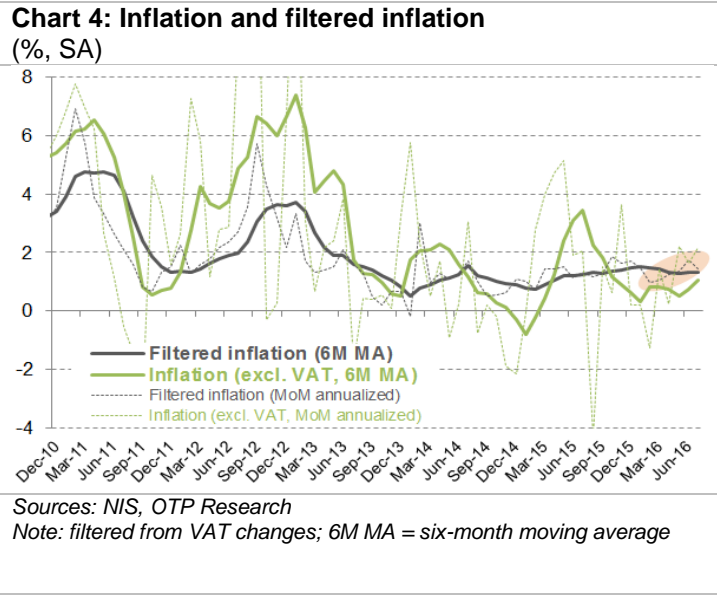
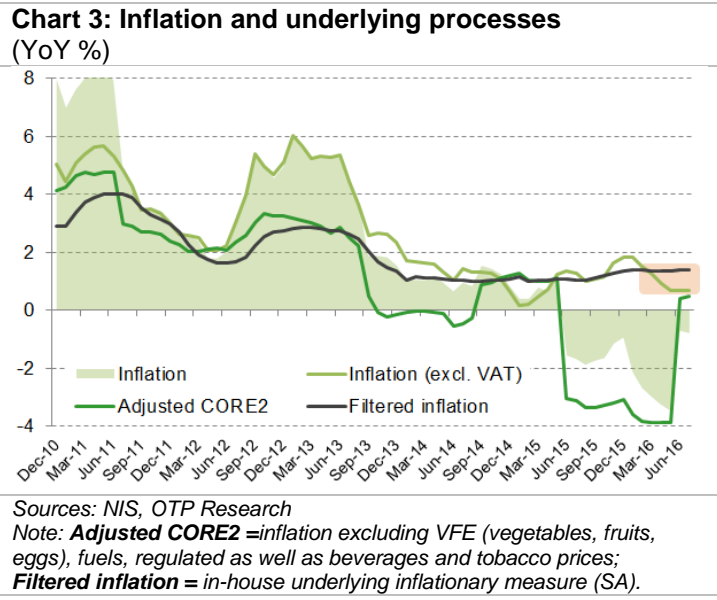
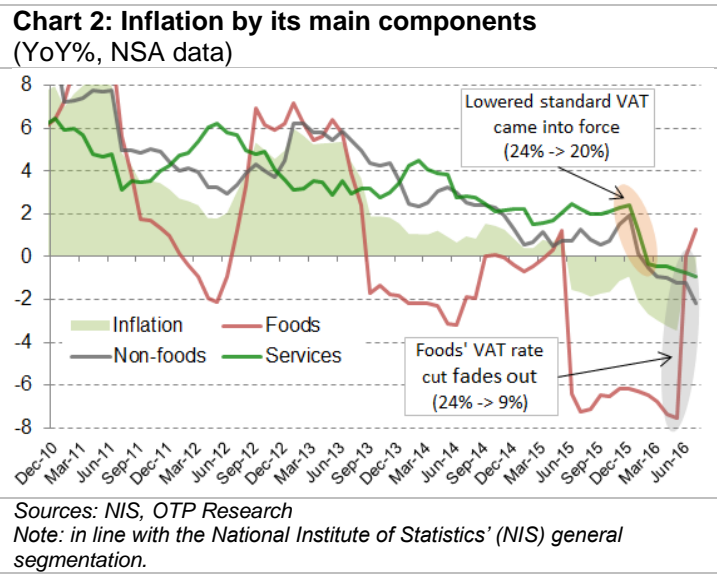
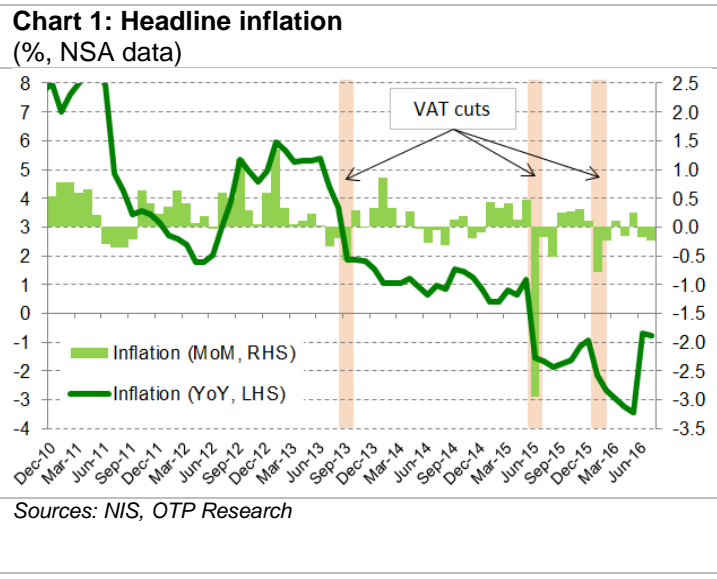
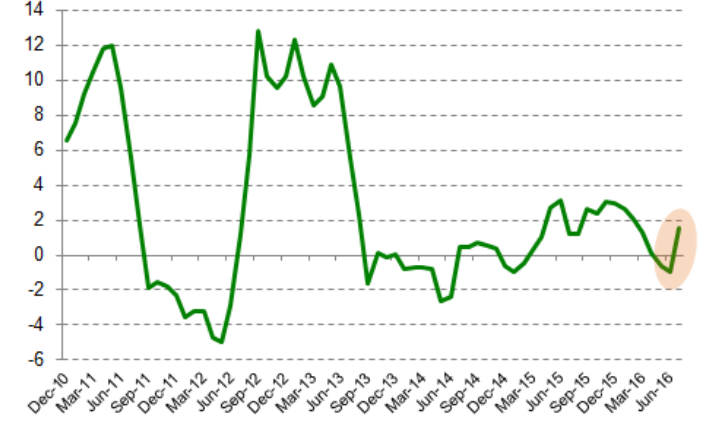
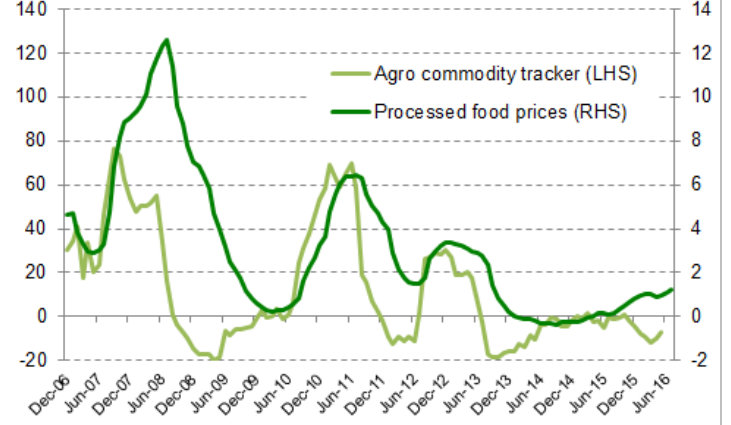


Chart 7: Unprocessed food prices
(YoY%, SA)



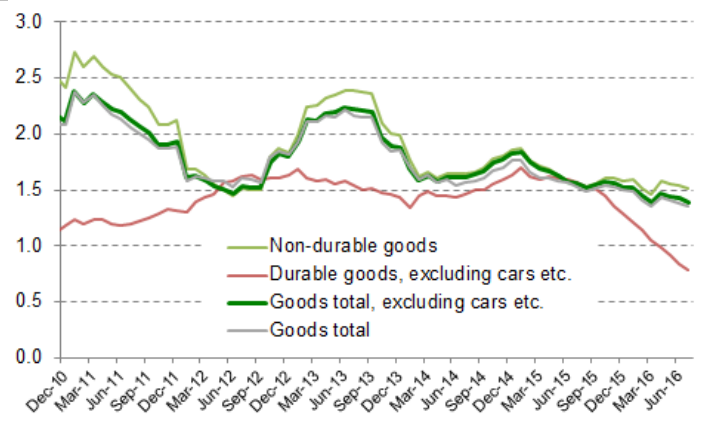
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 8: Processed food and agro-commodity prices
(YoY%, SA)



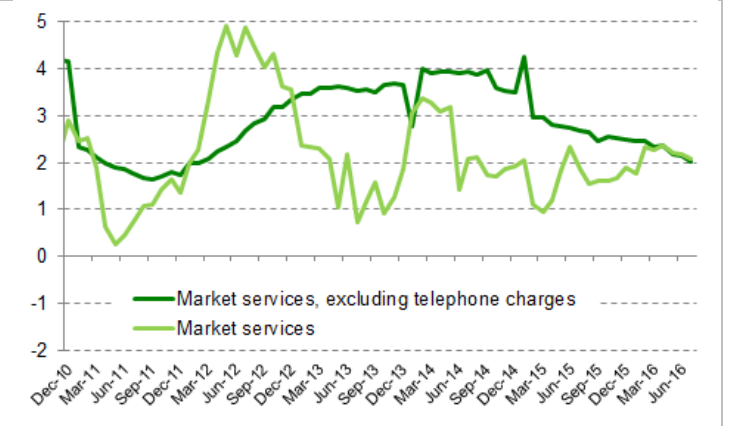
Sources: NIS, OTP Research
Note: filtered from VAT changes.

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



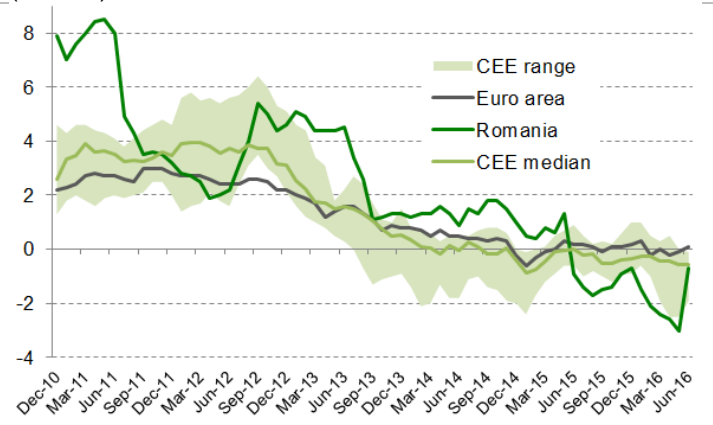
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 10: Market services
(YoY%, SA)



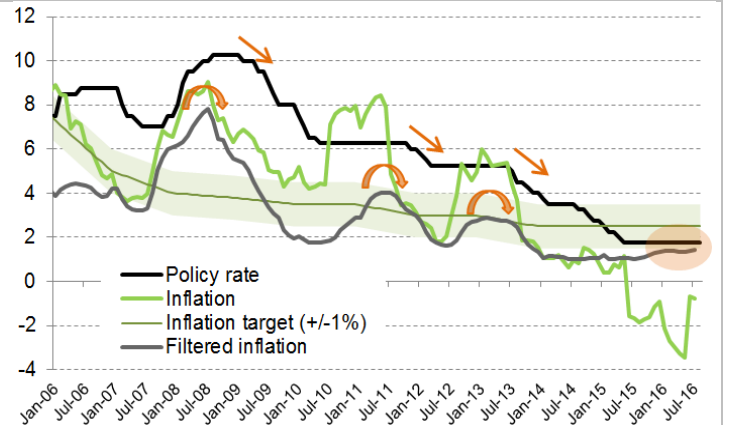
Sources: NIS, OTP Research
Note: filtered from VAT changes.

Chart 11: Harmonised index of consumer prices
(YoY %)



Sources: Eurostat, OTP Research
Note: CEE includes Bulgaria, Czech Rep., Croatia, Hungary, Poland and Slovakia

Chart 12: Policy rate and inflation
(%)



Sources: NBR, NIS, OTP Research

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