

# REPORT ON INFLATION

16 February 2017

**Annual inflation left negative territory for the first time since May 2015, as the effects of last year's 4-pp-VAT cut mostly faded out**

- In January 2017, Romania's annual inflation returned into positive territory for the first time since May 2015, pointing to a 0.05% YoY increase, after it posted 0.54% YoY drop a month earlier (see Chart 1). The movement was basically in line with our expectation (0.0% YoY) and matched the market consensus of 0.1% YoY (Reuters poll). At the same time, *filtered inflation*<sup>1</sup> (our preferred underlying price measure, which among others excludes the impact of tax modifications), slowed a bit more than we had projected, starting the year near 1% (Chart 3). However, as uncertainties around the pass-through of the fresh tax changes still prevail, this figure should be treated with some reservation for the time being. Upon new information, it may be revised later, in order to reflect the fundamental price dynamics in a more reliable way.
- The significant increase in the headline figure came from fading base effects, as the impact of last year's four-percentage-point VAT reduction largely vanished last month. Nonetheless, we are not out of the woods yet, as several levies were scaled back starting from January, including the relief on standard VAT, from 20% to 19% (Chart 1).
- The details of the inflation statistics paint a fairly mixed picture. First of all, the evolution of fuel prices surprised us on the upside, as they gained further momentum in annual terms, despite the elimination of a special excise duty. The unusual movement could be the result of a delay that is of fully statistical origin, but we do not exclude that the price setting behaviour of agents has also modified somewhat at the beginning of this year. Beyond fuel prices, unprocessed foods' CPI also rose quite rapidly. Admittedly, we projected a pick-up, but the fact data overshoot our expectations. It appears that the unusually cold weather conditions together with the abundant precipitation had a quite large impact on unprocessed food prices.
- On the negative side, administered prices put further pressure on the headline data, after authorities reduced electric energy prices in January again. In addition, railway tariffs also dipped more than the one-pp VAT cut would have suggested.
- The slow-down in the VAT-adjusted core inflation measures was primarily due to market services' CPI (Chart 8), after the group of other services, covering first of all insurances, became even cheaper. We recall that the price index of insurances started to swiftly decrease on the back of intensified tensions around the mandatory car insurance premiums as well as the actions of the Financial Supervisory Authority to limit maximum tariffs. Regarding telephone charges, it may be worth mentioning that the timing of the VAT pass-through showed a different pattern this year. It seems that the full impact of the one-percentage-point VAT change passed into consumer prices already in January, while a year earlier there was a one-month delay. This had a negative impact on January's headline inflation, but it will turn into a positive base effect in February. Other core CPI components, like processed foods (Chart 6) and goods inflation (Chart 7) remained relatively stable, broadly in line with our expectations.
- Further tax changes (like on TV and radio subscriptions) are set to put pressure on consumer price dynamics in February too. Therefore, before January's data came out, we reduced our year-end inflation forecast to 1.8% YoY, down from 2.2% [earlier](#). As uncertainties around the tax modifications still prevail, including potential delays in their pass-through too, presumably we will have a really clear picture only at the end of Q1. However, it is important to note that in essence the overall situation remained unchanged. As the negative effects of the one-off items fade out and domestic price pressures intensify (Chart 9&10), while there are also signs of a global reflation process, we think that consumer prices will gain momentum in the following quarters, with the perspective of further acceleration in 2018 (we expect 2.9% average inflation for next year). Therefore, we maintain our [previous view](#) that monetary policy normalisation could start in H2, as Mr Isarescu also confirmed at his latest press conference.

<sup>1</sup> *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.*

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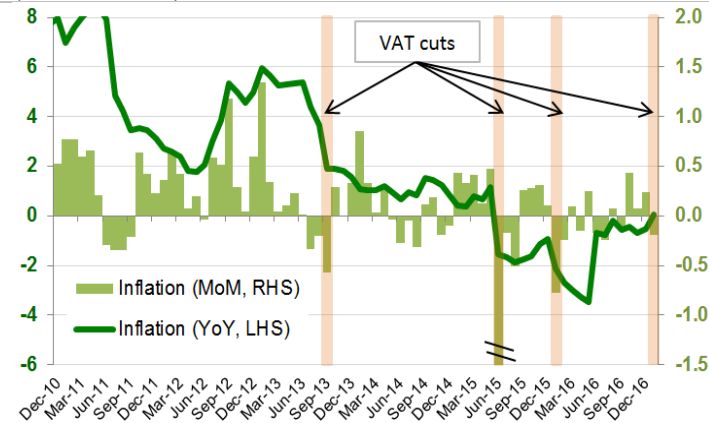
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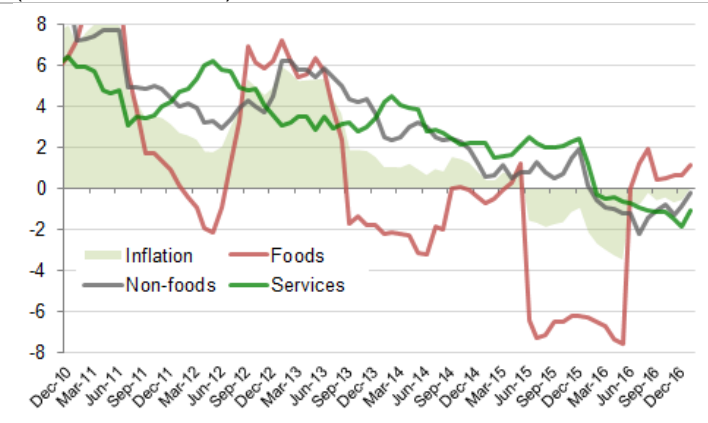
## Chart set:

**Chart 1: Headline inflation**  
(%, NSA data)



Sources: NIS, OTP Research

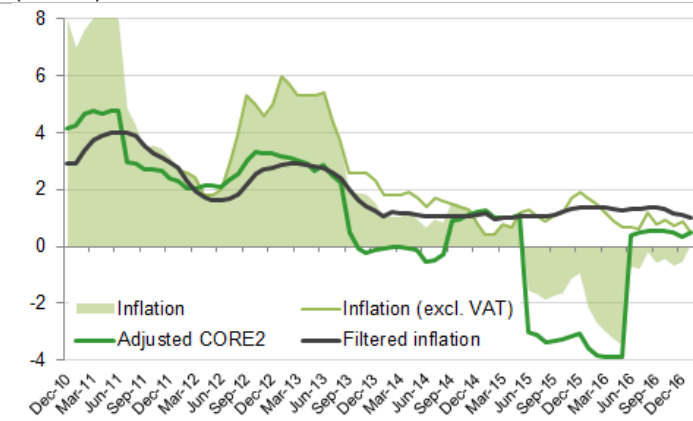
**Chart 2: Inflation by its main components**  
(YoY%, NSA data)



Sources: NIS, OTP Research

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

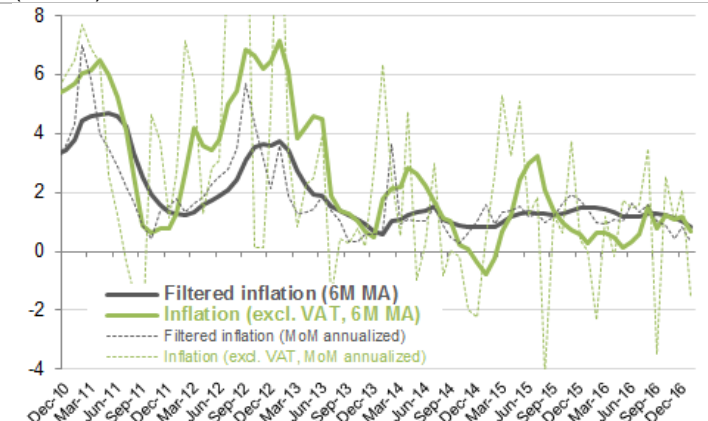
**Chart 3: Inflation and underlying processes**  
(YoY%)



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).

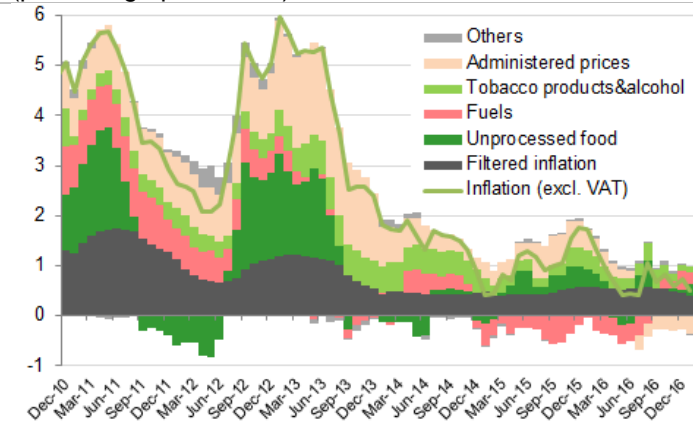
**Chart 4: Inflation and filtered inflation**  
(%, SA)



Sources: NIS, OTP Research

Note: filtered from VAT changes; 6M MA = six-month moving average

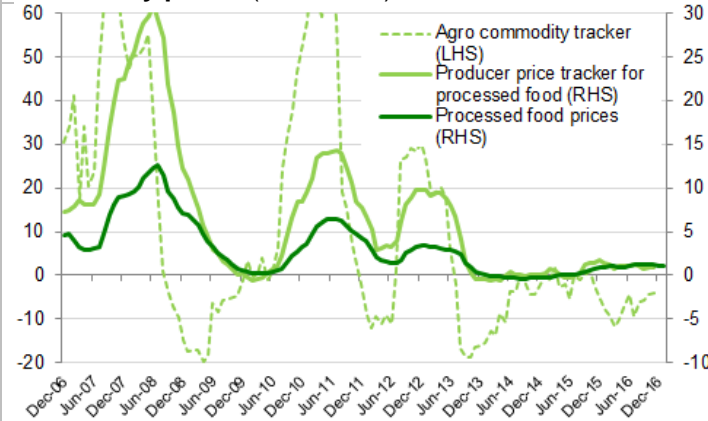
**Chart 5: Decomposition of inflation**  
(percentage points, SA)



Sources: NIS, OTP Research

Note: filtered from VAT changes.

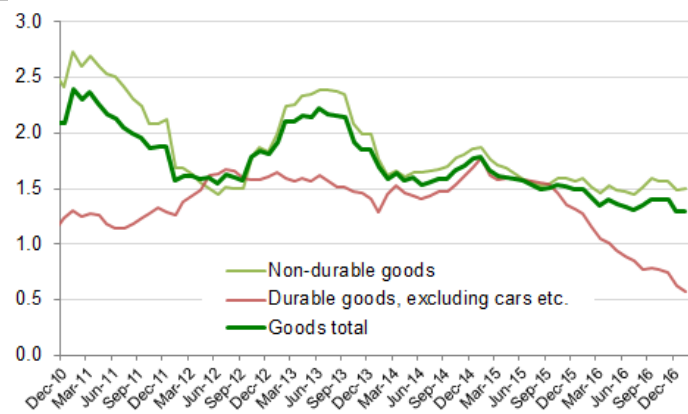
**Chart 6: CPI and PPI of processed foods vs. agro-commodity prices**  
(YoY%, SA)



Sources: NIS, OTP Research

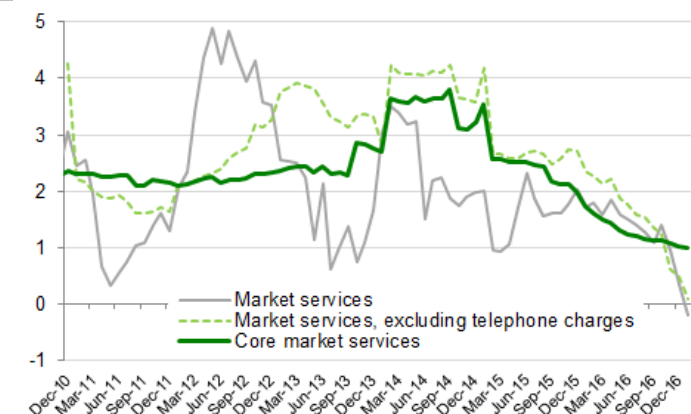
Note: filtered from VAT changes.

**Chart 7: Goods' inflation**  
(YoY%, SA)



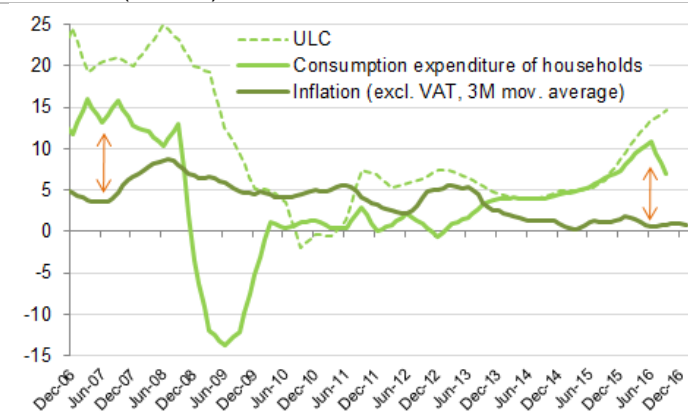
Sources: NIS, OTP Research  
Note: filtered from VAT changes.

**Chart 8: Market services**  
(YoY%, SA)



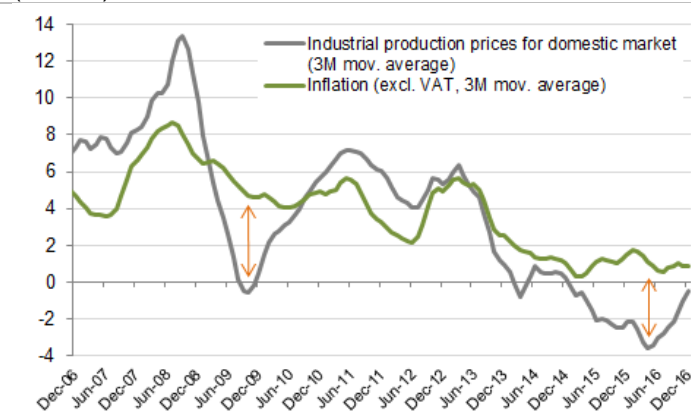
Sources: NIS, OTP Research  
Note: filtered from VAT changes; **Core market services**, beyond the EUR/RON-related telephone charges, excluding the line of other services too, which covers mainly insurances.

**Chart 9: ULC & households' consumption vs. inflation (YoY %)**



Sources: Eurostat, NIS, OTP Research

**Chart 10: Industrial production prices vs. inflation (YoY %)**



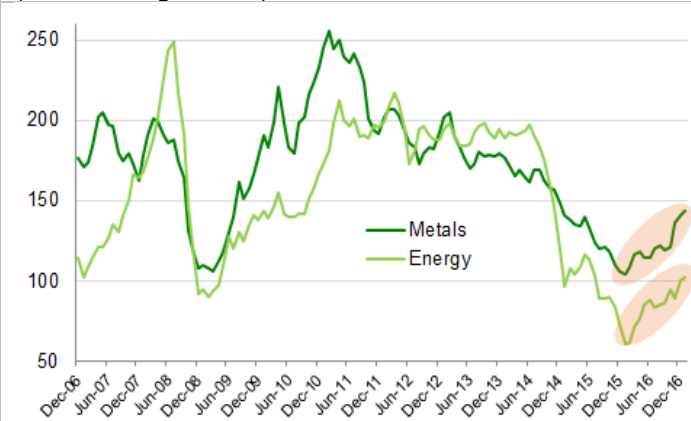
Sources: NIS, OTP Research

**Chart 11: Global food prices**  
(2002-2004 average = 100)



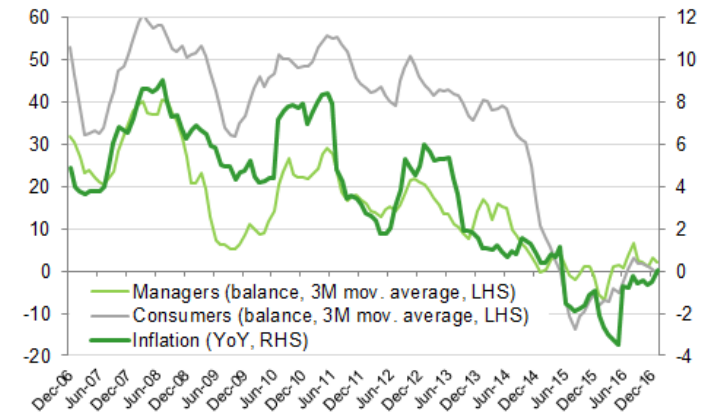
Sources: FAO, OTP Research

**Chart 12: Commodity indices of metals and energy**  
(2005 average = 100)



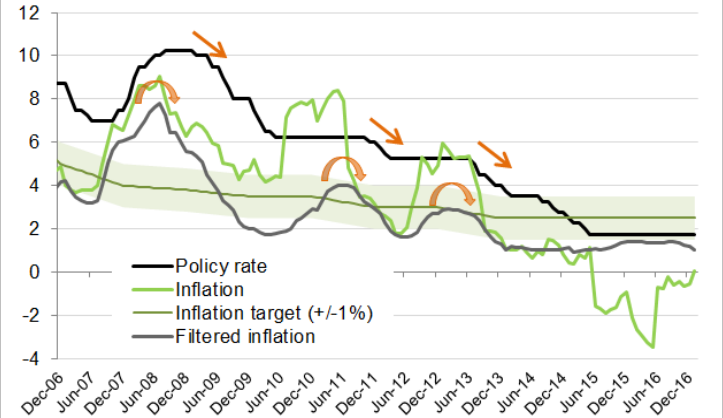
Sources: IMF, OTP Research

**Chart 13: Price expectations vs. inflation (%)**



Sources: EC, NIS, OTP Research

**Chart 14: Policy rate and inflation (%)**



Sources: EC, NIS, OTP Research

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