

REPORT ON INFLATION

12 May 2017

**Headline inflation rose by 0.4 pps, reaching 0.6%;
underlying CPI may gain momentum soon**

- Romania's annual inflation inched up in April, reaching 0.6% YoY, up from March's 0.2% YoY (see Chart 1). The fresh headline data slightly exceeded the expectations (both market consensus and our call had pointed to 0.5% rise). Compared to the previous month, consumer prices registered a relatively rapid advance, increasing by 0.3% MoM. At the same time, *filtered inflation*¹, our preferred underlying CPI measure, which excludes several volatile CPI items and the impact of major tax changes as well, stood at 1.1% YoY in April (Chart 3), showing a marginal acceleration compared to March (less than 0.1 percentage point).
- Our forecast error mainly came from two sources. First of all, administered prices surprised us on the upside, after natural gas prices increased by 2.5% MoM last month, while we had penciled in a slightly smaller rise based on the authorities' communication. Secondly, we had expected that fuel inflation could have slowed a bit in April, driven also by base effects, but actually it was able to go up slightly. Indeed to a much lesser extent, but unprocessed food prices caused a positive surprise as well (Chart 6), after egg prices accelerated significantly and the usually more smoothly moving CPI of unprocessed meat also got steam noticeably.
- Turning to the main components of our filtered inflation indicator, it is important to mention that processed food prices picked up, similarly to its unprocessed counterpart, posting 1.3% YoY gain last month, up from March's 1.1% YoY advance. Our in-house tracking indicators had signalled some acceleration (Chart 7), and we also suspect that the upward trend in the case of processed foods may continue in the following months, even though April's healthy uptick was presumably helped by a positive Easter effect too. Regarding processed foods, the acceleration seen last month was broad-based, with the large majority of products becoming more expensive.
- In our previous [report](#), we pointed out that seemingly an inflection point started to take shape in underlying inflation processes. Admittedly, there are still many uncertainties, but it is important to underscore that the developing U-turn got another confirmation in April's CPI statistics. Not as rapidly as in the previous month, but durable goods' inflation continued to climb higher (Chart 8), while high-frequency momentum indicators continued to point to an upswing (Chart 9). Simultaneously, core market services inflation, which among others excludes the exchange-rate-sensitive telephone charges and the noisy mandatory car insurance premiums (RCA) rose further (Charts 10 and 11). We recall that insurance premiums dragged down market services inflation, after a cap on RCA was introduced by the regulatory authorities. However, this upper limit is planned to be lifted in the second half of May. Therefore, the downward pressure from this direction presumably will ease.
- Regarding the perspectives, we assume that consumer prices may continue to accelerate in the following quarters, as both demand-pull and cost-push inflation factors support an upturn, and fading base effects could also help. We recall that households' consumption was the main driver of the economy last year, with a 7.5% gain, even outpacing the advance seen in 2008 (7.1%), while the positive trend is set to continue this year too. Simultaneously, given the reviving producer prices (Chart 12), entrepreneurs also could be compelled to gradually increase the prices of their finished products.
- In the light of April data, we are comfortable with our [previous](#) inflation projections: we deem that the headline figure may reach 1.6% YoY in December, and it could accelerate further in 2019 (for next year we foresee 2.9% average inflation). In this context, the NBR may start normalisation actions in H2 2017, by narrowing the interest rate corridor (for further details about monetary policy perspective please visit our latest [MPC report](#)).

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.

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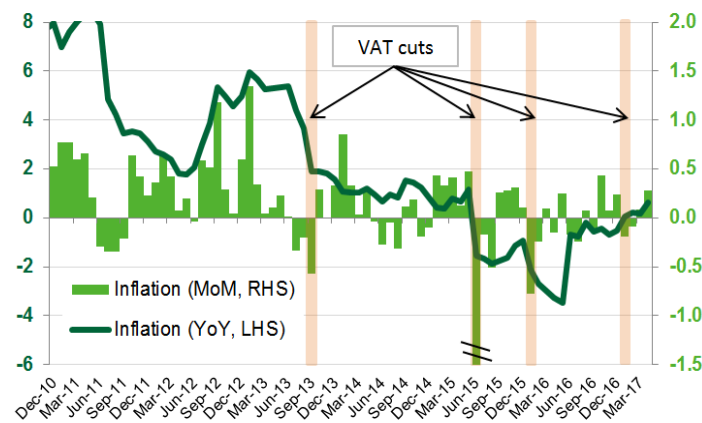
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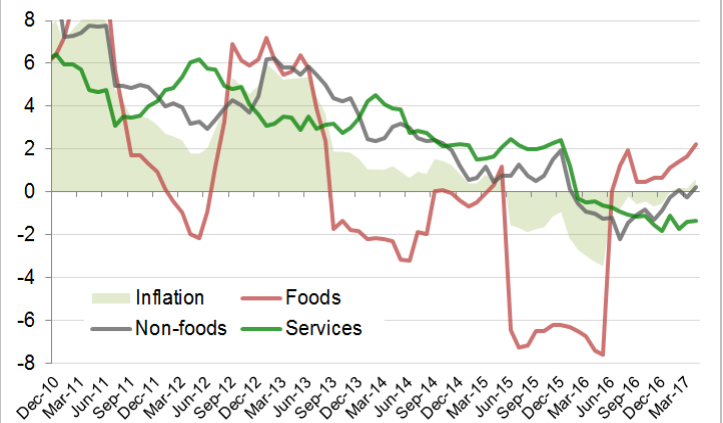
Chart set:

Chart 1: Headline inflation
(%, NSA data)



Sources: NIS, OTP Research

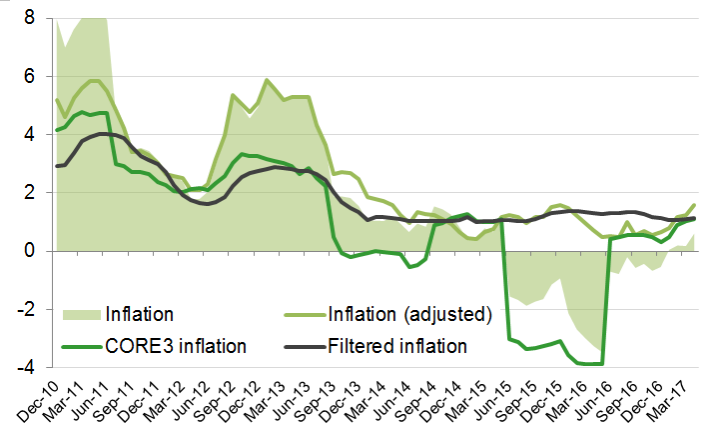
Chart 2: Inflation by its main components
(YoY%, NSA data)



Sources: NIS, OTP Research

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

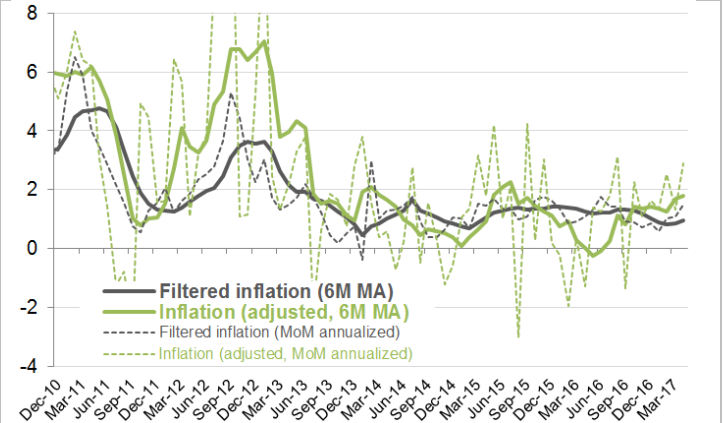
Chart 3: Inflation and underlying processes
(YoY%)



Sources: NIS, OTP Research

Note: **CORE3**=inflation excluding VFE (vegetables, fruits, eggs), fuels, regulated as well as beverages and tobacco prices; **Filtered inflation**=in-house underlying inflationary measure (SA).

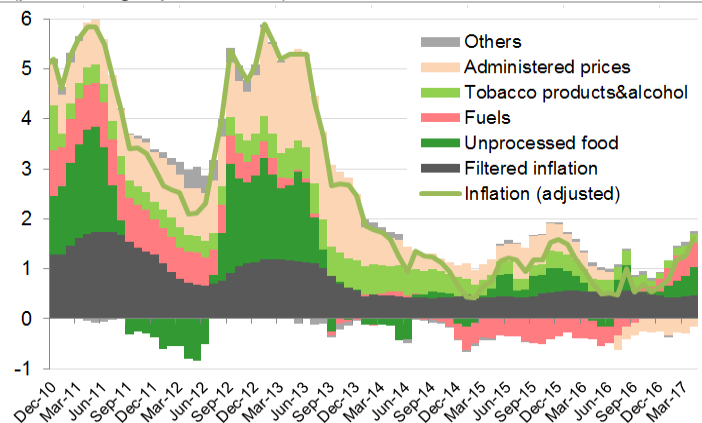
Chart 4: Inflation and filtered inflation
(%, SA)



Sources: NIS, OTP Research

Note: adjusted by the impact of main tax changes; 6M MA = six-month moving average.

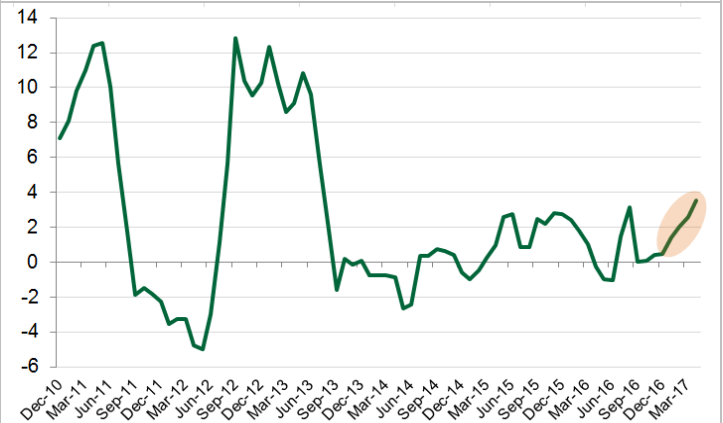
Chart 5: Decomposition of inflation
(percentage points, SA)



Sources: NIS, OTP Research

Note: adjusted by the impact of main tax changes.

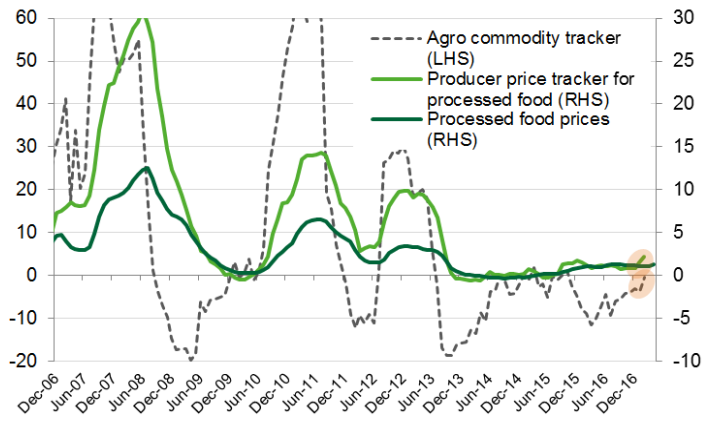
Chart 6: Unprocessed food prices
(YoY%, SA)



Sources: NIS, OTP Research

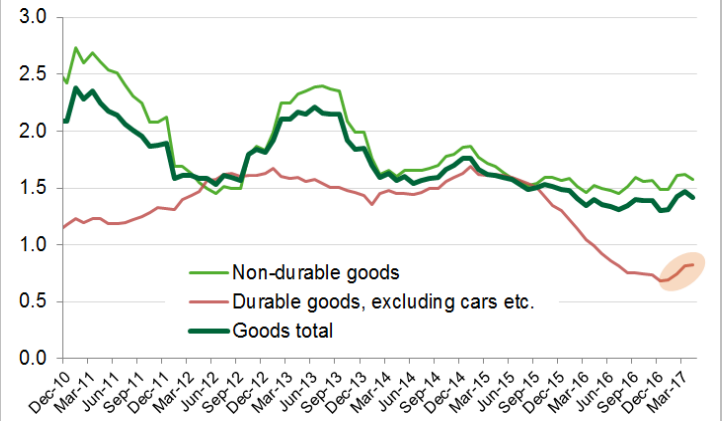
Note: adjusted by the impact of main tax changes.

Chart 7: CPI and PPI of processed foods vs. agro-commodity prices (YoY%, SA)



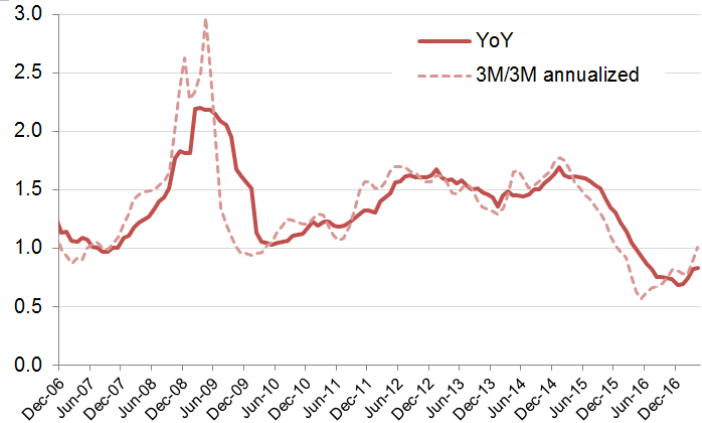
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 8: Goods' inflation (YoY%, SA)



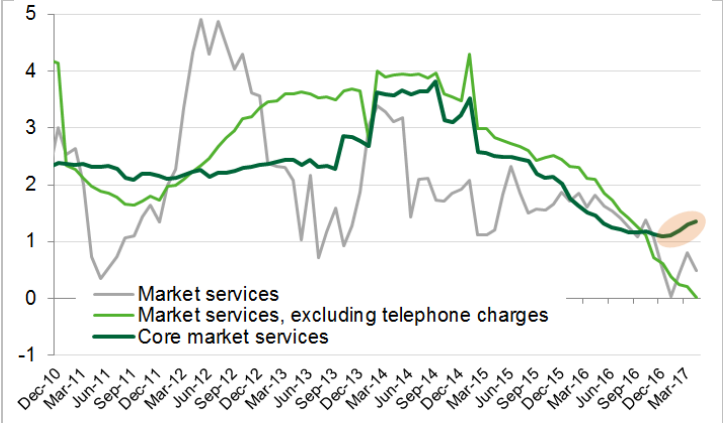
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 9: Durable goods, excluding cars etc. (% SA)



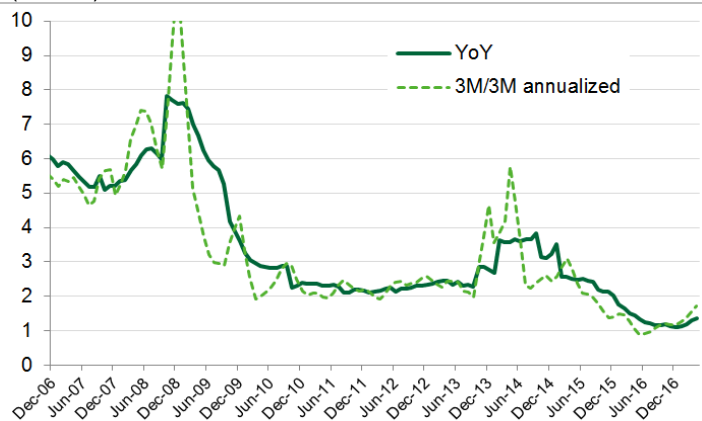
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 10: Market services (YoY%, SA)



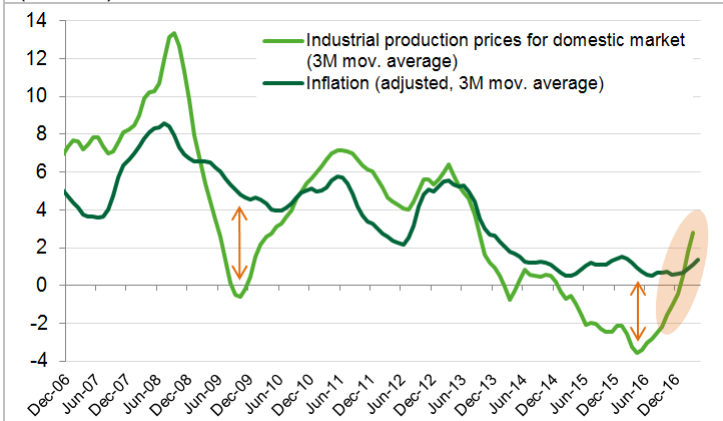
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services**, beyond the EUR/RON-related telephone charges, excluding the line of other services too, which covers mainly insurances.

Chart 11: Core market services (% SA)



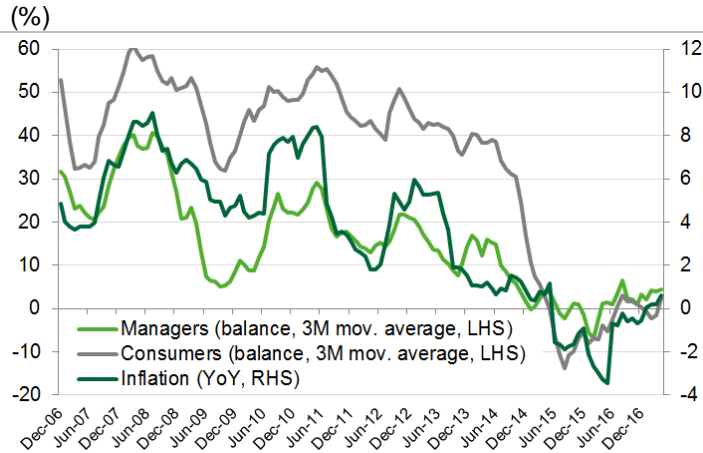
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services**, beyond the EUR/RON-related telephone charges, excluding the line of other services too, which covers mainly insurances.

Chart 12: Industrial production prices vs. inflation (YoY %)



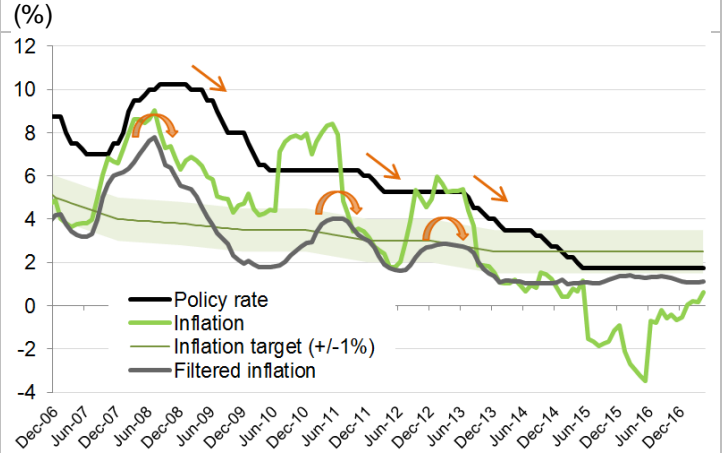
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 13: Price expectations vs. inflation



Sources: EC, NIS, OTP Research

Chart 14: Policy rate and inflation



Sources: NBR, NIS, OTP Research

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