

# REPORT ON INFLATION

13 June 2017

## *The fall in fuel prices masked a more general acceleration in CPI indicators; underlying inflation gained momentum*

- In May, consumer price inflation was unchanged at 0.6% YoY, while on month-over-month basis the CPI index rose by 0.3%, the fresh report of the NIS showed (see Chart 1). The figures matched market expectations; Reuters' consensus had pointed to 0.6% YoY rise as well. Our call was 0.7%, with the forecast error coming entirely from rounding (more precisely, we had pencilled in a 0.66% YoY advance, while the fact data stood at 0.64%). Underlying CPI indicators showed a broad-based acceleration last month, as we had assumed in our [previous report](#). Accordingly, *filtered inflation*<sup>1</sup>, our in-house indicator, which disregards volatile items and among others also adjust for the impact of tax changes, picked up from 1.1% YoY, to 1.2% YoY in May (Chart 3).
- This acceleration is in line with the more general picture, as both cost-push and demand-pull inflation factors provide grounds for a revival in core CPI measures. It should be added that several one-off items still put significant pressure on price dynamics: the one-percentage-point reduction of the standard VAT rate as well as the elimination of the special excise duty on fuels and the radio&TV fee. Excluding the transitory impacts coming from these tax modifications, headline inflation would have been at around 1.6% YoY, our estimation showed. This level is within the target band of the NBR's objective (2.5% +/- 1%), but admittedly is significantly below the midpoint (2.5%).
- The fall in fuel prices masked a more general acceleration in the headline inflation (Chart 5), the detailed statistics showed. The drop of crude oil futures in May, coupled with a negative base effect (in the same period of the previous year, fuel prices were on the rise), resulted in a significant slowdown in fuels' CPI growth rate. This setback was a bit larger than we had expected. Nevertheless, administered as well as tobacco and alcohol prices offset the negative impact coming from fuels. Administered CPI was driven by electric energy, after the latter grew by 1% MoM. This was surprising to some extent, as a general increase of electric energy prices was planned only for July. Simultaneously, the growth pace of tobacco and alcohol inflation accelerated as well in May. In the case of tobacco, the pick-up probably can be explained by the additional costs of companies, given the delayed implementation of the EU's Tobacco Products Directive.
- Beyond these groups of items, unprocessed food prices marched higher too, broadly in line with our anticipations. It is important to underscore that May's acceleration was primarily the result of the usually more smoothly moving core unprocessed foods (mainly meat and milk; see Chart 6). Meanwhile, the very volatile prices of vegetables and fresh fruits lost steam in last month.
- Regarding the main components of our filtered inflation measure, it is worth noting that processed food accelerated from 1.3% YoY to 1.4% YoY in May. This pace is somewhat slower than we have anticipated based on our tracker indicators (Chart 7), but still pointed to a healthy advance compared to the previous periods. It is also quite likely that the pass-through will be more smoothed and therefore, further advances will come in the following months.
- A few months [earlier](#) we emphasized that durable goods and core market services' inflation apparently bottomed out (Chart 8&10). This view about a potential turning point was supported by May's detailed statistics too (Chart 9&11). In addition, not only the core, but the other market services' indicators also indicated a brighter picture last month, given the fact that the upper limit on car insurance premium was phased out (but indeed an indicative reference fee remained in place) and the leu lost ground against the common European currency.
- Regarding the outlook, we think that consumer price inflation may continue to go up gradually in the following period, supported by fundamental factors, but also on the back of fading base effects. Owing to the tight labour market, the growth pace of nominal wages is set to remain definitely robust, even though a modest slowdown is expected, as the public salary hikes planned for H2 2017 were postponed. Rapid wage growth will keep domestic demand and unit labour costs at high levels (Chart 12). Moreover, producer prices and imported inflation point to rising pressures (Charts 13 and 14) and both consumers' and managers' inflation expectations inched up most recently (Chart 15). Admittedly, the evolution of fuel prices poses some downside risk, but at this moment we remain comfortable with our 1.6% YoY projection for the end of this year. For 2018, we foresee 2.9% average inflation, in line with our previous forecast.

<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.*

### Headquarter Treasury Sales

**Alexandru Tibuleac**  
+40372 31 85 85  
alexandru.tibuleac@otpbank.ro

**Ionut Constandache**  
+40372 31 85 86  
ionut.constandache@otpbank.ro

**Corina Bejan**  
+40372 31 85 87  
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

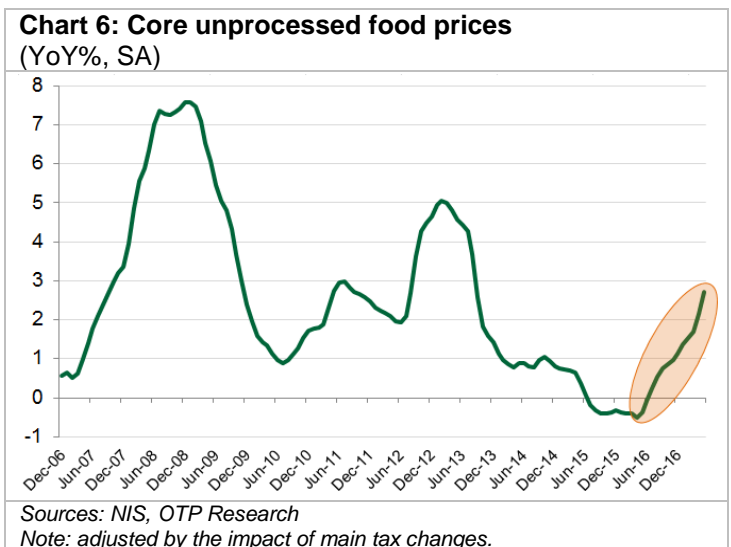
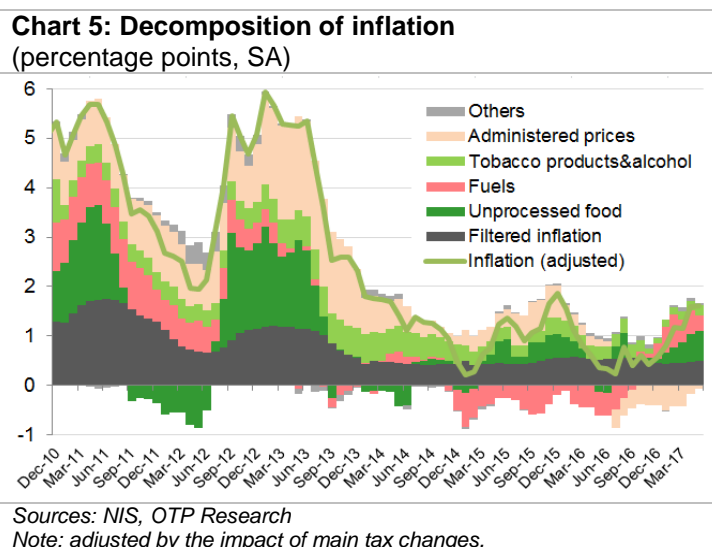
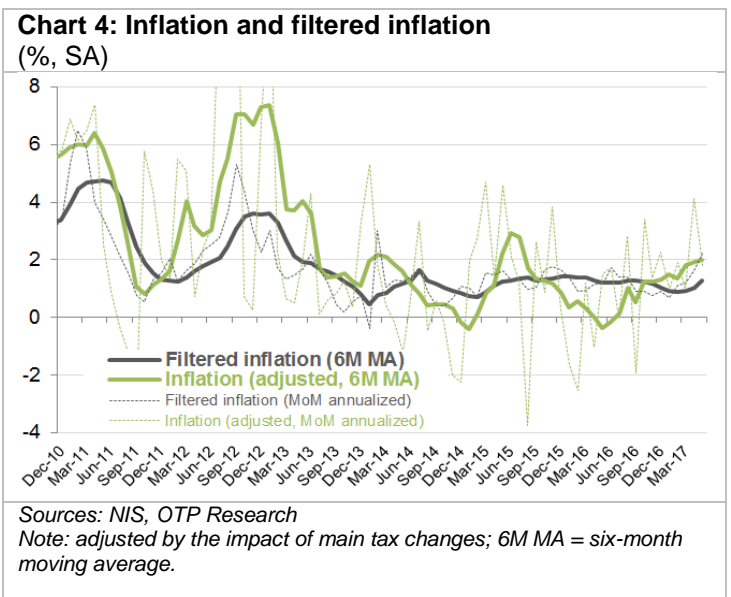
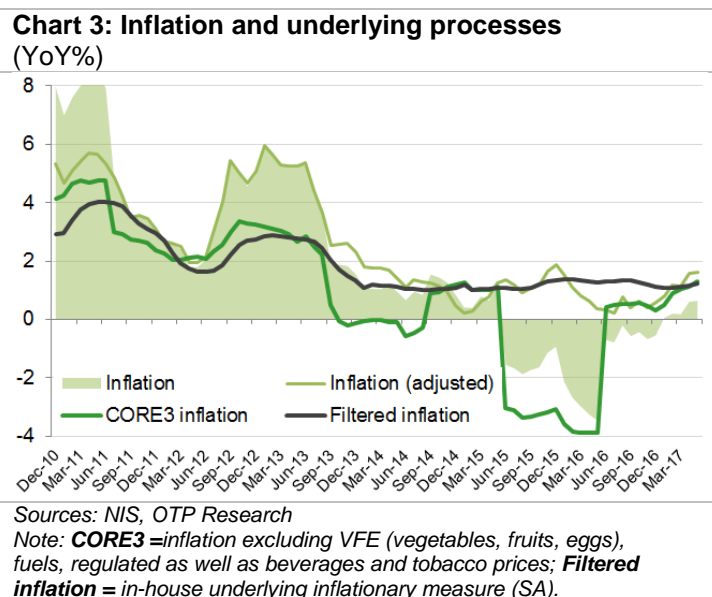
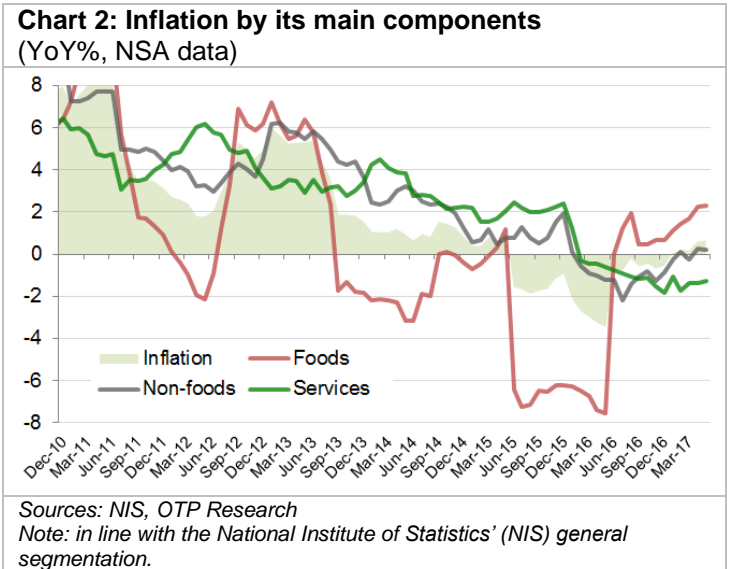
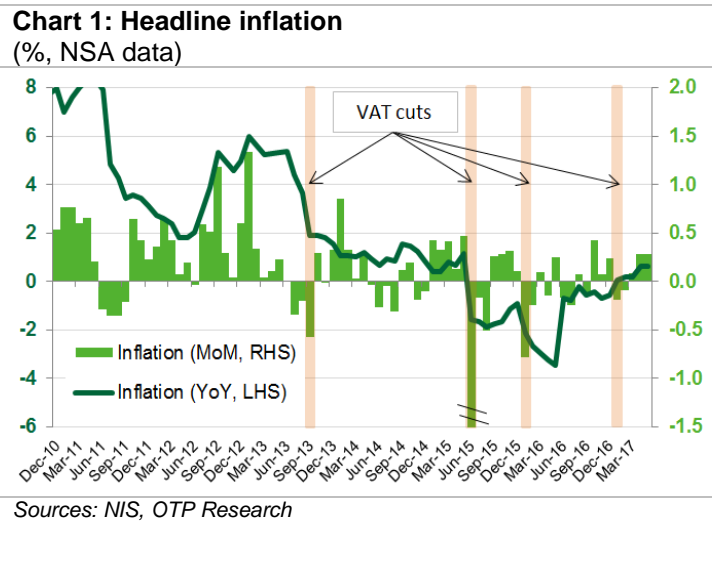
### Chief Economist

**Gergely Tardos**  
+36 1 374 7273  
tardosg@otpbank.hu

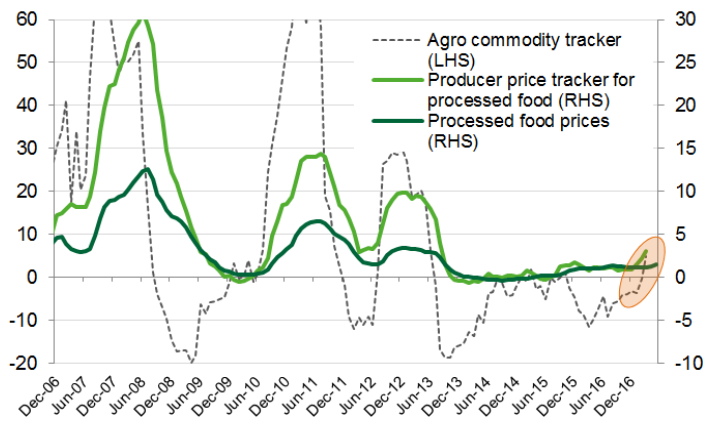
### Analyst

**Csaba Bálint**  
+4021 307 58 96  
csaba.balint@otpbank.ro

## Chart set:

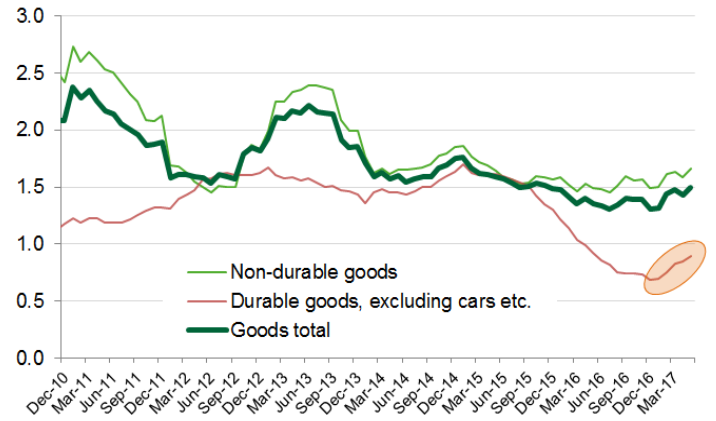


**Chart 7: CPI and PPI of processed foods vs. agro-commodity prices (YoY%, SA)**



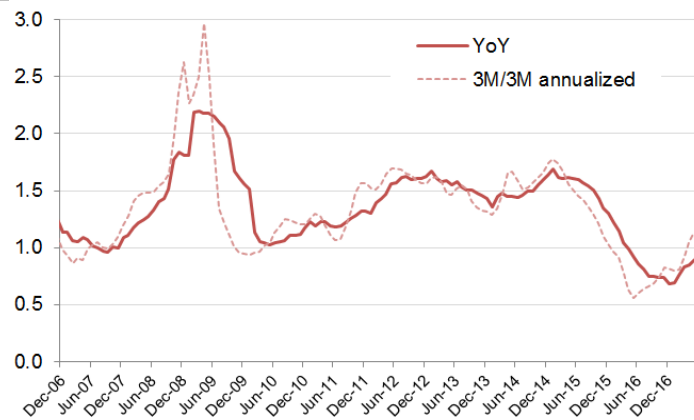
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



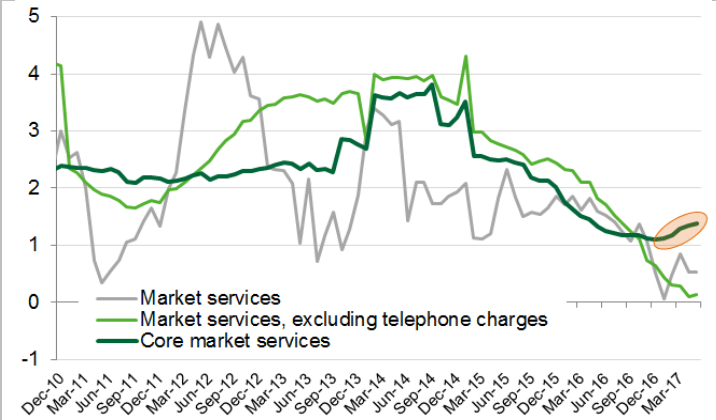
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



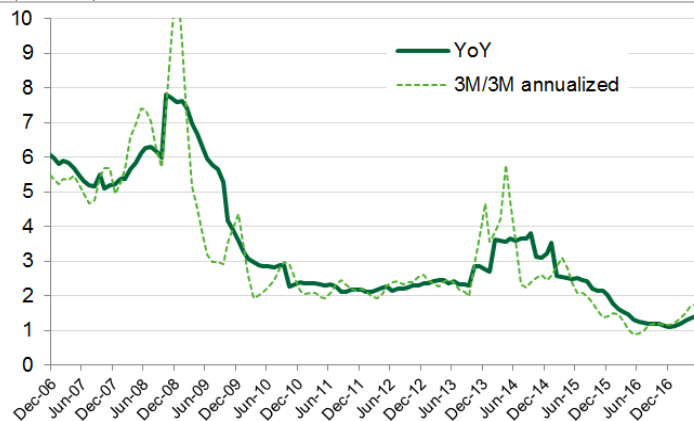
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 10: Market services (YoY%, SA)**



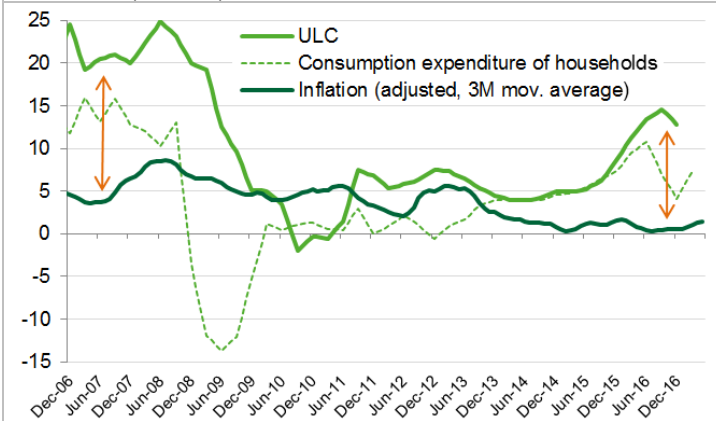
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes; **Core market services**, beyond the EUR/RON-related telephone charges, excluding the line of other services too, which covers mainly insurances.

**Chart 11: Core market services (% SA)**



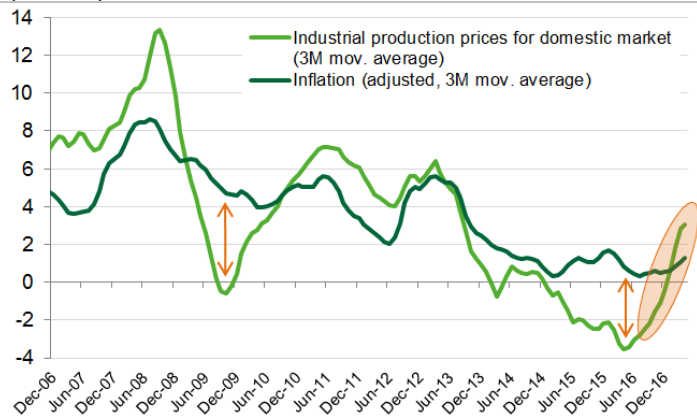
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes; **Core market services**, beyond the EUR/RON-related telephone charges, excluding the line of other services too, which covers mainly insurances.

**Chart 12: ULC & households' consumption vs. inflation (YoY %)**



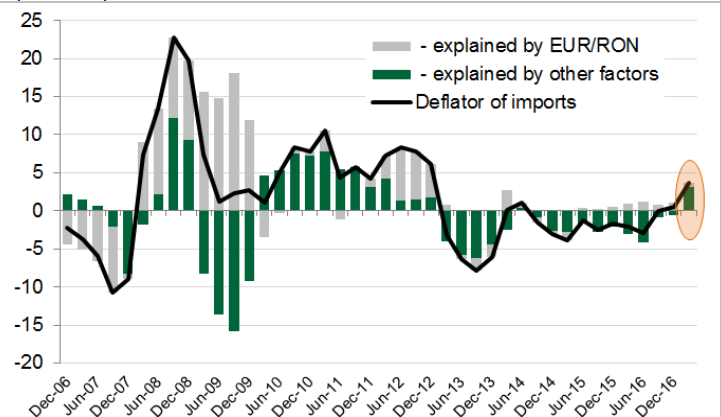
Sources: Eurostat, NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 13: Industrial production prices vs. inflation (YoY %)**



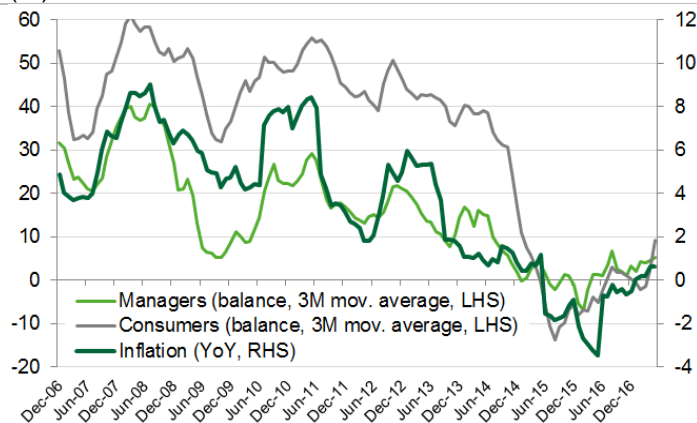
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 14: Decomposition of imports' deflator (YoY %)**



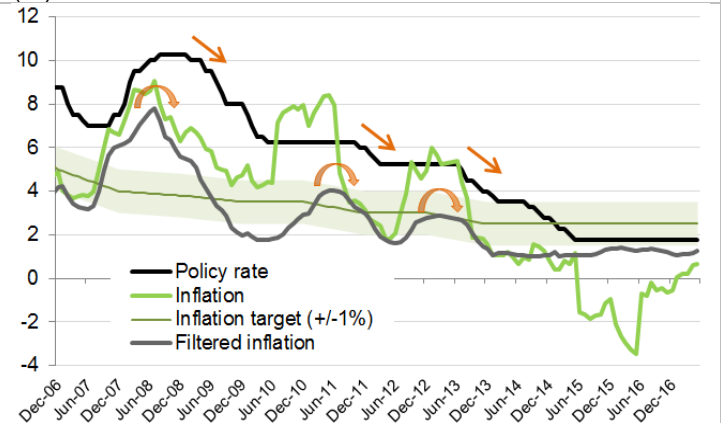
Sources: NBR, NIS, OTP Research

**Chart 15: Price expectations vs. inflation (%)**



Sources: EC, NIS, OTP Research

**Chart 16: Policy rate and inflation (%)**



Sources: NBR, NIS, OTP Research

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