

# REPORT ON INFLATION

14 March 2018

## ***Consumer prices continued to climb higher, as expected. Slowing real wage growth may contribute to the NBR's efforts to curb inflation pressures***

- In February, consumer prices continued to grow swiftly, posting 4.7% annual advance, the highest pace since June 2013 (see Chart 1). A month earlier, the CPI index rose by 4.3% YoY. On month-over-month basis, consumer prices rose by 0.3%, the report of the NIS also showed. These data matched the market's as well as our expectation and it was broadly in line with the NBR's projection too. February's acceleration mainly came on the back of fading base effects (the impact of the elimination of TV&radio fees dropped out) as well as a late pass-through of January's natural gas hike. Without the impact of main tax changes (e.g. the increase in fuel excise duty last autumn), the headline inflation would have been somewhat lower, at 4.4%, our in-house estimation found (Chart 3). Underlying inflation measures continued to climb higher in February, with the CORE3 inflation, the NBR's preferred indicator, reaching 2.9% YoY, up from 2.8% YoY a month earlier. Meanwhile, our filtered inflation rose to 2.5% (Chart 3), versus 2.4% in January.
- We [reiterate](#) that Romania's headline inflation hit historical low levels in 2015-2016, driven by aggressive tax cuts and sluggish commodity prices. Nevertheless, the CPI growth skyrocketed later, frequently surprising on the upside, as the impact of earlier one-off measures faded out and underlying price pressures showed up. Strong consumption rekindled demand-pull inflation, while rising unit labour costs, higher producer and import prices led to cost-push pressures (Charts 5-7). In addition, inflation expectations also pointed to a sharp rebound (Chart 8). On the back of the rapidly changing outlook, overheating fears, and also in order to curb CPI expectations, the NBR started the [tightening cycle](#) earlier than most of its peers in the EU.
- The rebound was definitely broad-based in the past few quarters, with all of main components of the inflation basket pointing to increases (Chart 9). Administered and fuel prices delivered a particularly large contribution to the upswing. In February, the general picture did not change significantly, as non-core items continued to play an important role. Nonetheless, we think that the pressures coming from the non-core side may start to soften toward the end of this year, as crude oil prices are expected to stabilise and the effect of earlier administered CPI hikes may also fade gradually.
- In February, unprocessed food inflation decreased for the second consecutive month, as the growth rate of vegetables' and eggs' CPI continued to ease (Chart 11). We recall that eggs became much more expensive after the outburst of the fipronil scandal. However, the spill-over effects of the shock started to fade most recently. Nevertheless, core unprocessed food inflation rose slightly, as higher raw meat and flour prices more than offset the softening CPI growth of milk. Owing to the vanishing negative effects of external shocks, as well as due to last year's good harvest, we think that unprocessed food inflation may moderate in the months ahead (Chart 12).
- After January's 2.9% YoY advance, processed food prices grew by 3.2% YoY last month, slightly surprising us on the upside. Based on our agro-commodity tracker indicator (Chart 13), we had expected a somewhat slower advance, but most likely, underlying factors, like rapidly rising unit labour costs continued to keep processed food inflation at relatively high level.
- We noted in our [previous report](#) that some early signs of moderation had shown up in January's core inflation indicators. Nonetheless, in the light of the fresh statistics, it seems that January's slowdown was rather transitory, with high-frequency data showing again a pick-up (Chart 4). Admittedly, some of the acceleration was due to processed foods (the largest component of our filtered inflation measure), but the growth rate of both durable and non-durable goods' CPI inched up too (Charts 14-15). In addition, after taking a breather in January, market services inflation also gathered speed (Charts 16-17), driven mainly by demand-sensitive items, like accommodation and cosmetic services.
- Summing it up, we continue to expect that Romania's headline inflation will mark a turning point around 5% in the middle of this year, and it may ease to 3.2% in December 2018, as the pressure coming from non-core items soften, and the base effect of last year's fuel excise duty hike drops out too. In 2019, the growth rate of consumer prices could remain close to the 3% threshold. This trajectory is fully in line with our [earlier](#) projection.

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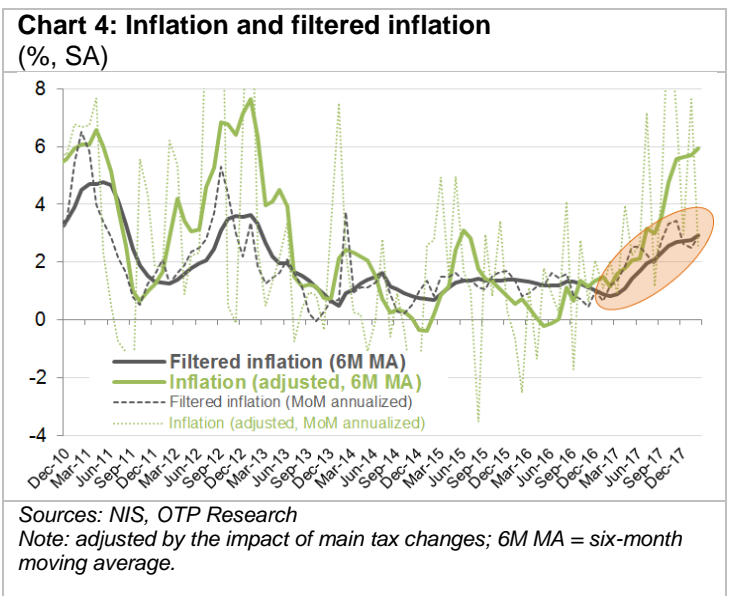
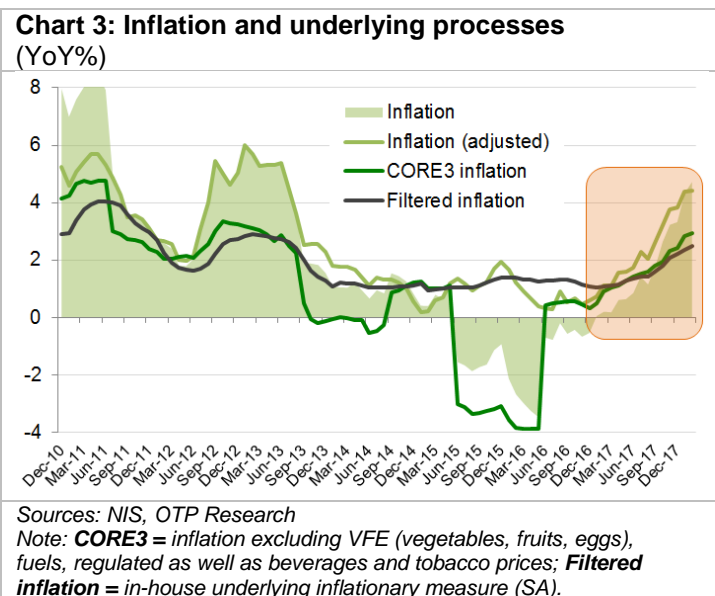
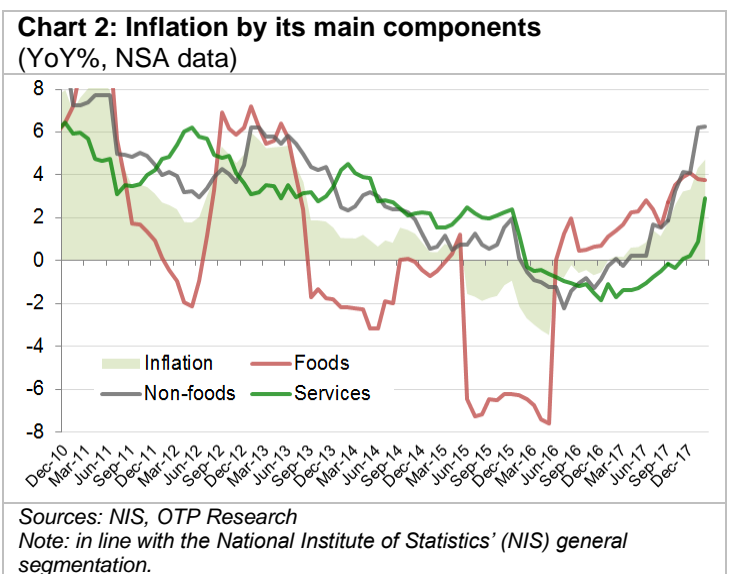
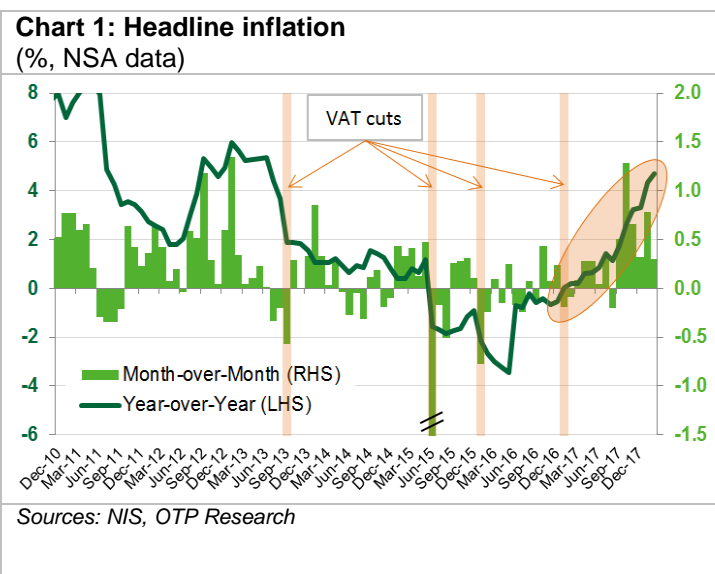
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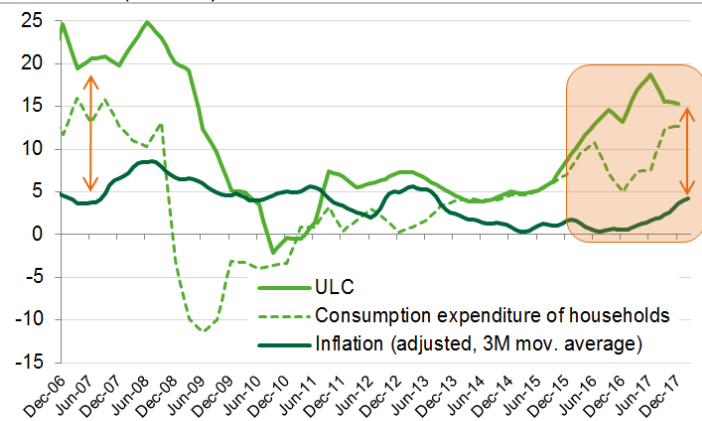
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- It is important to add that real wage dynamics sharply decelerated in the latest period (Chart 18). Undoubtedly, employers lifted gross salaries significantly, underpinned also by another minimum wage hike. However, it seems that this was not enough to maintain the growth rate of net wages at the earlier levels, as the transfer of the burden coming from social contributions weighed. We recall that the government redesigned the payment system, transferring the majority of social contributions from employers to employees, starting from January 2018. The latest statistics of the NIS showed that net wages grew by 8.0% YoY in January, down from December's 11.7% YoY. Moreover, on the back of reviving inflation, real net wages posted only 3.5% YoY gain, well below 2017's average of around 13%.
- This, together with lower consumer confidence (Chart 19) could help the NBR's efforts to contain inflation expectations and, accordingly, shepherd the headline data back into the tolerance band (2.5% +/-1%). The latest statistics already showed some early signs of stabilisation in the case of inflation expectations (Chart 8). In this context, we maintain our earlier forecast about the path of the policy rate. The key rate may end this year at 2.75% and reach 3.25% before taking a longer break in H2 2019 (Chart 20). Most likely, the next rate hike will come in April's policy meeting. Owing to the still rapidly strengthening underlying inflation, we think that the risks are tilted on the upside.

## Chart set:

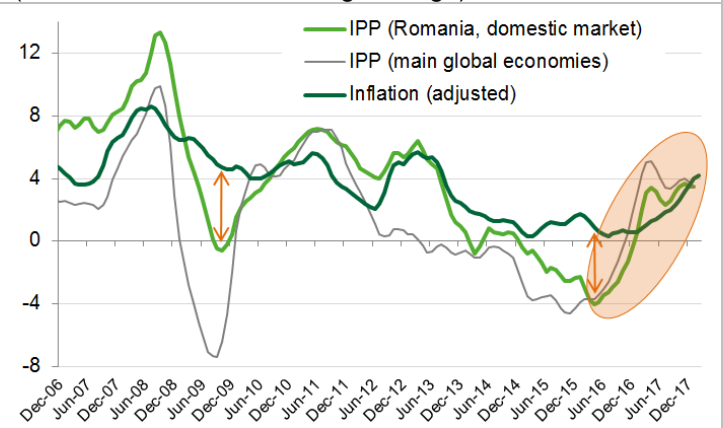


**Chart 5: ULC and households' consumption vs. inflation (YoY %)**



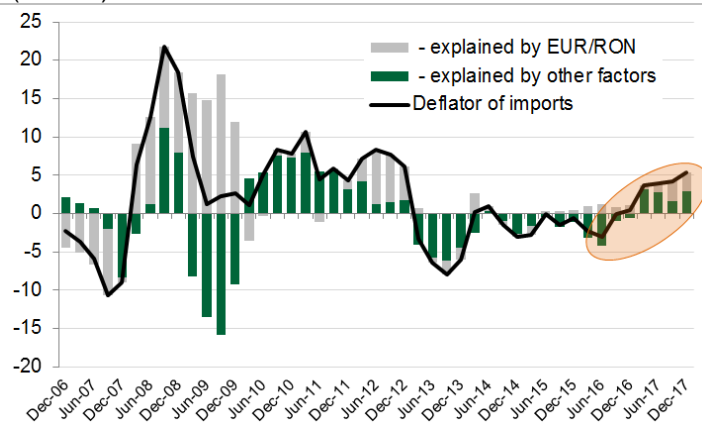
Sources: Eurostat, NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 6: Industrial production prices vs. inflation (YoY %, three-month moving average)**



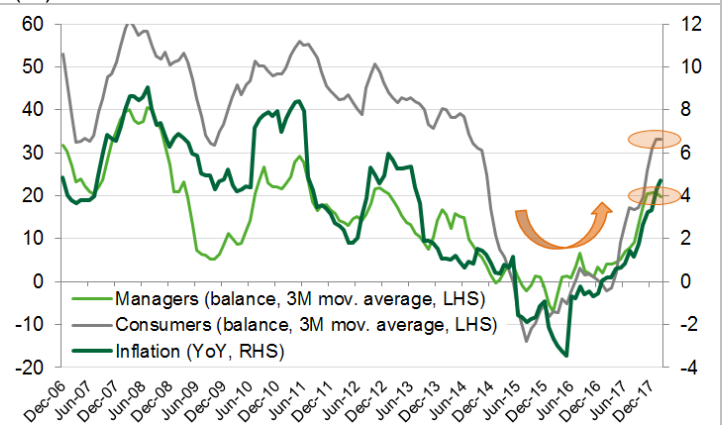
Sources: NIS, OECD, NBSC, OTP Research  
Note: adjusted by the impact of main tax changes; the IPP (main global economies) includes data from EU28, USA and China

**Chart 7: Decomposition of imports' deflator (YoY %)**



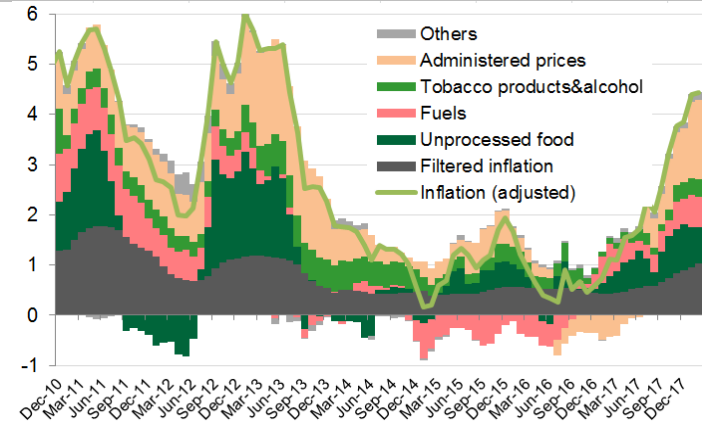
Sources: NBR, NIS, OTP Research

**Chart 8: Price expectations vs. inflation (%)**



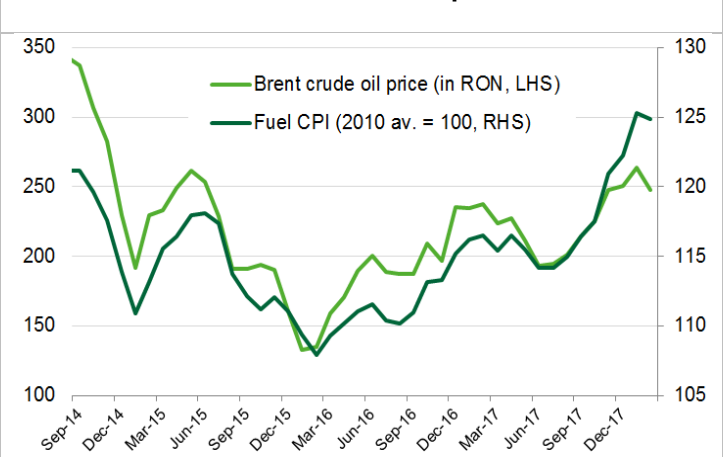
Sources: EC, NIS, OTP Research

**Chart 9: Decomposition of inflation (percentage points, SA)**



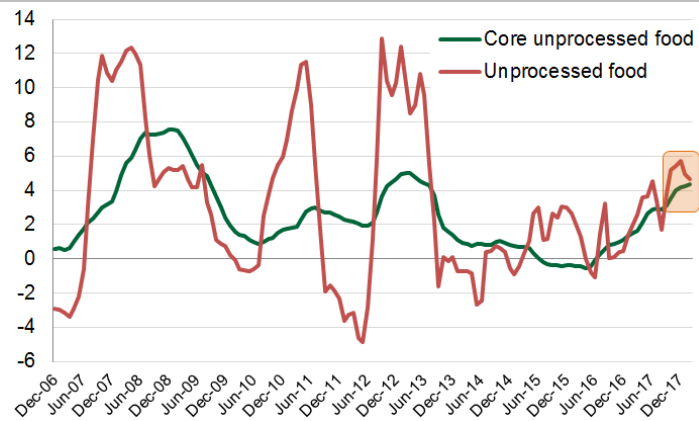
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 11: CPI of fuels vs. Brent oil prices**



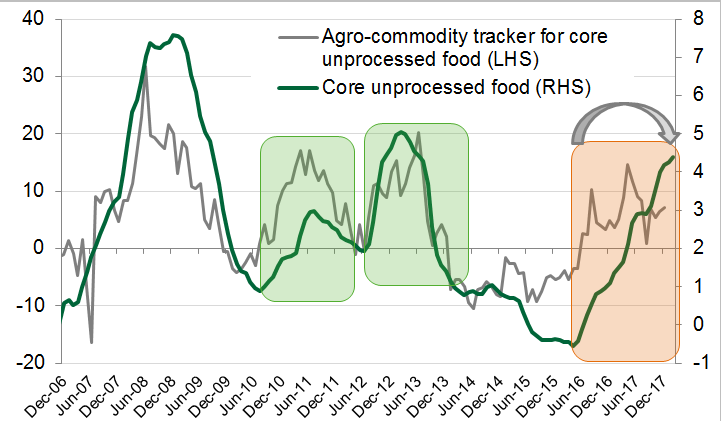
Sources: NIS, Reuters, OTP Research  
Note: Fuel CPI is adjusted by the impact of main tax changes.

**Chart 11: Unprocessed foods' inflation (YoY%, SA)**



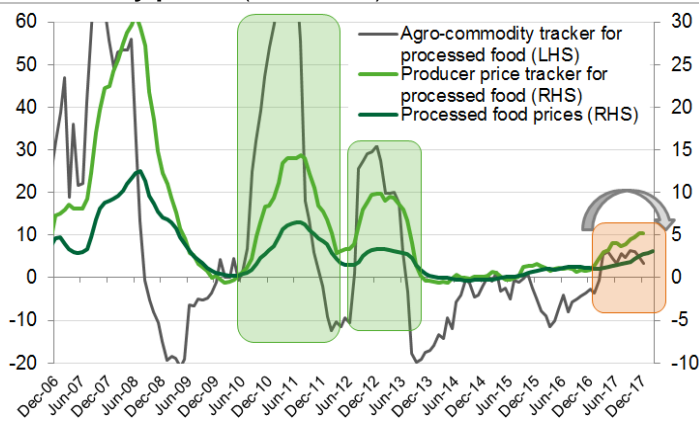
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 12: CPI of core unprocessed foods vs. agro-commodity prices (YoY%, SA)**



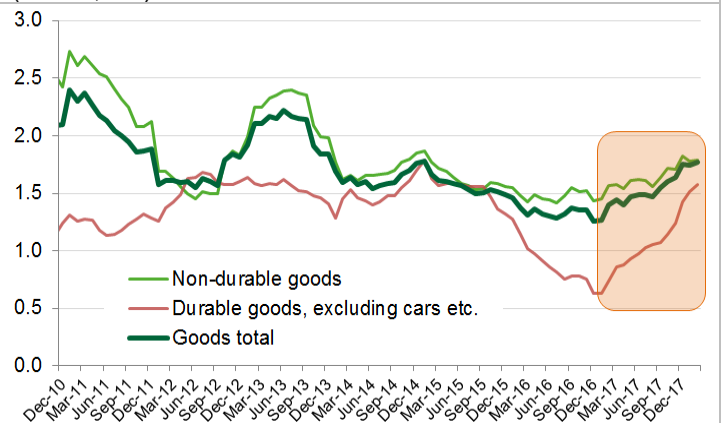
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 13: CPI and PPI of processed foods vs. agro-commodity prices (YoY%, SA)**



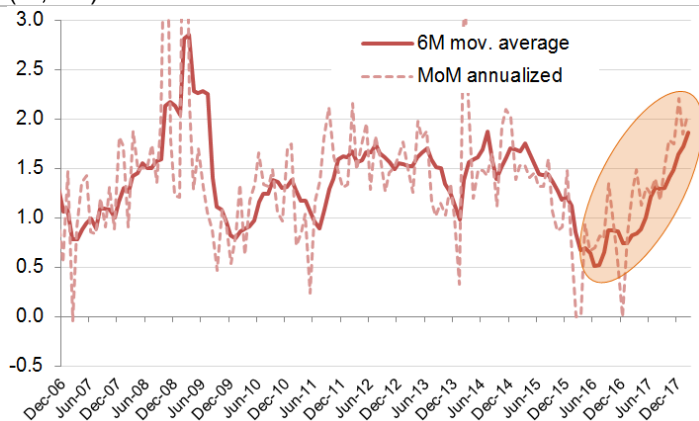
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 14: Goods' inflation (YoY%, SA)**



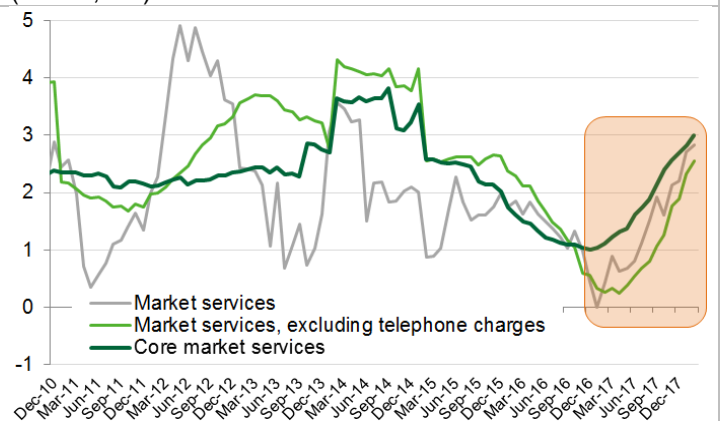
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 15: Durable goods, excluding cars etc. (% SA)**



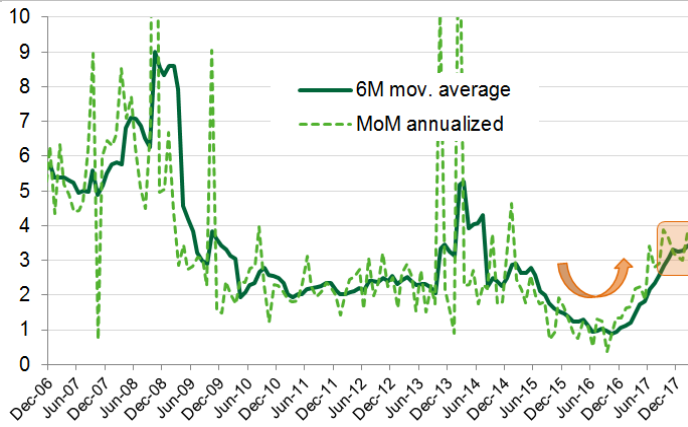
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 16: Market services (YoY%, SA)**



Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes; **Core market services**, excludes the EUR/RON-related telephone charges as well as insurances

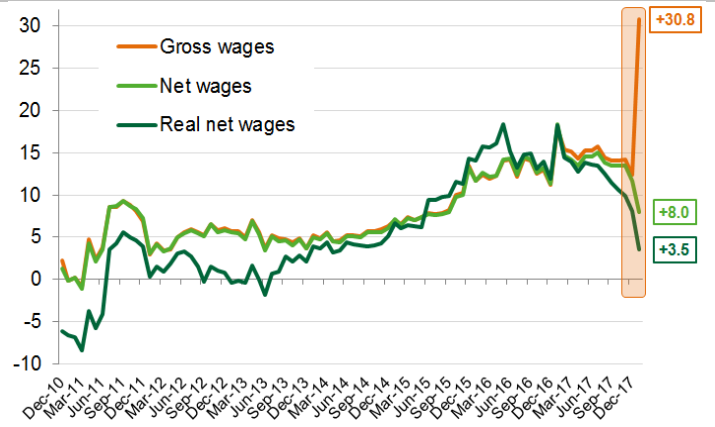
**Chart 17: Core market services**  
(%, SA)



Sources: NIS, OTP Research

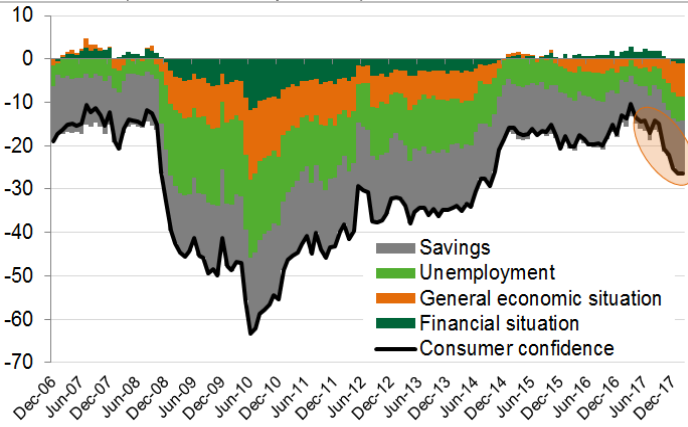
Note: adjusted by the impact of main tax changes; **Core market services** excludes the EUR/RON-related telephone charges as well as insurances.

**Chart 18: Average wages**  
(YoY%)



Sources: NIS, OTP Research

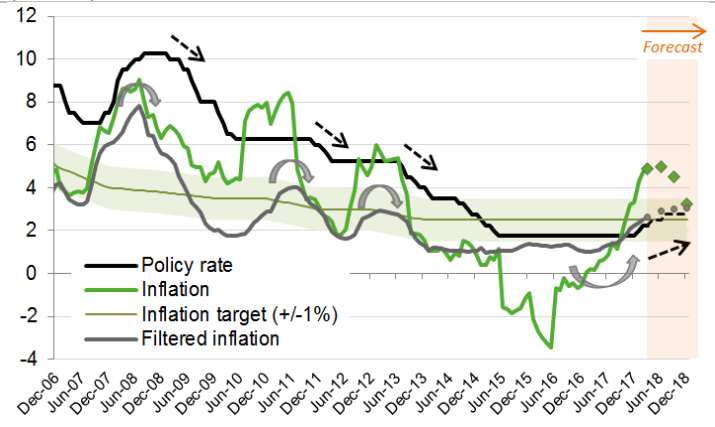
**Chart 19: Decomposition of consumer confidence indicator**  
(balance of opinions)



Sources: EC, OTP Research

Note: the components of the consumer confidence indicator reflects the expectation of households over the next 12 months

**Chart 20: Inflation vs. NBR's inflation target**  
(YoY%)



Sources: NIS, OTP Research

Note: **Filtered inflation** = in-house underlying inflationary measure (SA).

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