

# REPORT ON INFLATION

13 April 2018

## CPI growth hit 5%; underlying price pressures continued to strengthen

- Last month, Romania's headline inflation accelerated 4.95% YoY, up from February's 4.72% YoY (see Chart 1). Most of the increase was due to non-core items, driven by higher fresh fruits, vegetable, and fuel prices. Last month's outturn slightly overshot the market consensus (4.9%) and our projection (4.85%). The NBR had expected 4.9% headline data in its latest, February's inflation report. Underlying CPI indicators continued to march higher, with our *filtered inflation*<sup>1</sup> climbing 0.2 percentage points (versus the expected 0.1 pp) to 2.7% YoY. Meanwhile Core3 inflation, the central bank's preferred measure, hit 3.0% YoY (Chart 3).
- We [recall](#) that in Romania, consumer prices were subdued for an extended period, owing to several tax cuts and low commodity prices. But the CPI index marked a particularly sharp and broad-based revival in the past few quarters, fuelled by fundamental factors (Charts 5 to 8) and a series of one-off measures. Given this context, the NBR launched the policy normalisation cycle earlier than most of its peers. We also think that the headline inflation will peak a touch above the 5% threshold in the middle of this year, and then it may start to ease as the impact of large energy price hikes and fuel excise duty increases fades and crude oil futures also stabilise. Nonetheless, underlying price pressure could remain robust. Therefore the policy tightening cycle is likely to continue.
- Our forecast error mainly came from the upswing of unprocessed food prices (Chart 9), after its most volatile item group, fresh fruits and vegetables pointed to a pick-up (Chart 10). Probably this was the result of unfavourable weather conditions and, to a lesser extent, the early Easter holiday could also have played a role. Nonetheless, as fresh fruit and vegetable prices frequently register large swings, despite March's upside surprise, we do not alter our inflation forecast for seasonal unprocessed foods. Remaining on the subject of non-core items, the growth rate of fuel CPI also accelerated significantly in line with our expectations, propelling the headline data higher (Chart 9). Nonetheless, this was chiefly due to a base effect (Chart 11).
- The stronger than expected pick-up in our filtered inflation measure came from non-durable and market services CPI. These groups are among the most sensitive ones to the cyclical situation of the economy, underscoring that underlying price pressures are significant and even increasing. In March, non-durable goods inflation recorded a sharp advance (Charts 14 and 15). Moreover, this was a broad-based uptick with the large majority of the components pointing to stronger increases. On the other hand, durable goods inflation took a break last month, after rallying in the past few quarters (Chart 14). Most likely, the stabilisation of the EUR/RON exchange rate could have helped the moderation, and Easter discounts provided by merchants might have also resulted in some relief.
- Meanwhile, excluding the exchange-rate-sensitive telephone charges, market services inflation continued its increasing trajectory (Chart 16). Admittedly, high-frequency data pointed to early signs of stabilisation, but at an elevated level, in the range of 3% to 4% (Chart 17). In addition, there is an important risk that this relief proves to be transitory and the CPI growth will resume its increasing trend.
- Regarding processed food prices, it is worth mentioning that while our agro-commodity tracker indicates subdued pressures from raw materials, producer prices are still rising (Chart 13) most likely on the back of higher labour and transport costs.
- We think that in the following period, the price pressure coming from fundamental factors may ease to some extent, but overall it will remain rather robust. Therefore, further tightening steps may be needed to shepherd back and keep headline inflation inside the tolerance band (2.5% +/-1%). Early data for Q1 indicates that households' consumption slowed down remarkably, after registering [stellar growth](#) rates in 2017. With significantly lower real wage growth (Chart 18) and softer confidence (Chart 19), households' expenditures could stabilise at a more sustainable level. Unit labour costs probably will remain in double-digit territory owing to the tight conditions on the labour market, but some moderation is expected compared to 2017. At

<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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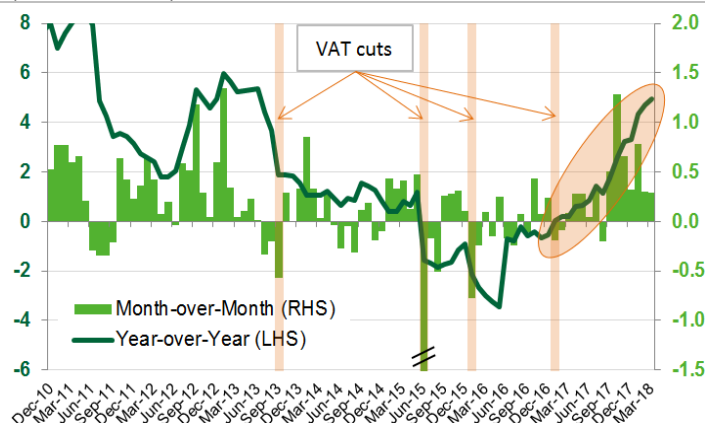
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global level, industrial producer prices (IPP) pointed to a relief most recently, driven by Chinese IPP dynamics. In the eurozone, the appreciation of the euro also played an important role in the softening. At the same time, the tightening steps of the NBR stopped the weakening trend of the leu and curbed inflation expectations too (Chart 8). That is to say the central bank won the battles so far but the war is not over yet.

- Owing to March's higher than expected underlying CPI indicators and also due to a hike in the case of tobacco products, we revised our year-end inflation forecast by 0.2 percentage points to 3.4% YoY. Regarding 2019's perspective, we think that headline inflation may stabilise around 3%, slightly above the midpoint of the NBR's target (2.5% +/- 1%). We expect the central bank to raise the policy rate by 25 bps points to 2.50% in its next rate-setting meeting in May, after it remained unexpectedly on hold in April. We continue to believe that the key rate will end this year at 2.75% and may be raised to 3.25% in 2019.
- Nonetheless, we also [reiterate](#) that the NBR will likely follow a data-dependent approach. This implies that in case of significant upside surprises, particularly if these will be accompanied by important weakening pressure on the leu, the central bank may become more aggressive. It should be added that given Romania's position in the economic cycle, the risks to the medium and long-term trajectory of inflation are more tilted to the upside. We also note that fiscal policy, the measures it chooses to keep the deficit under control, may have a crucial impact on inflation dynamics and accordingly on the overall stance of monetary policy.

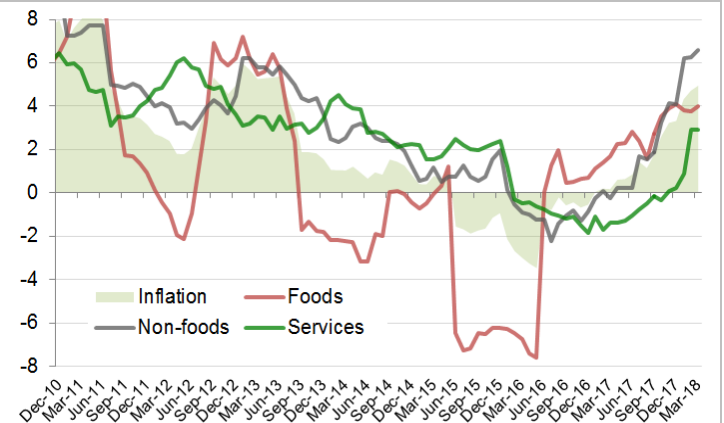
## Chart set:

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



Sources: NIS, OTP Research

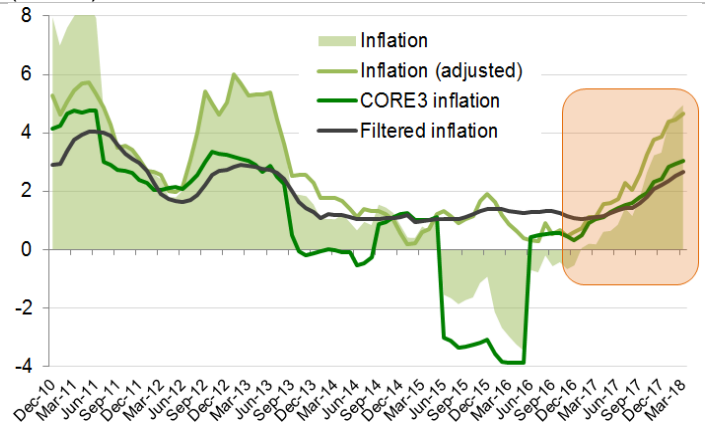
**Chart 2: Inflation by its main components**  
(YoY%, NSA data)



Sources: NIS, OTP Research

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

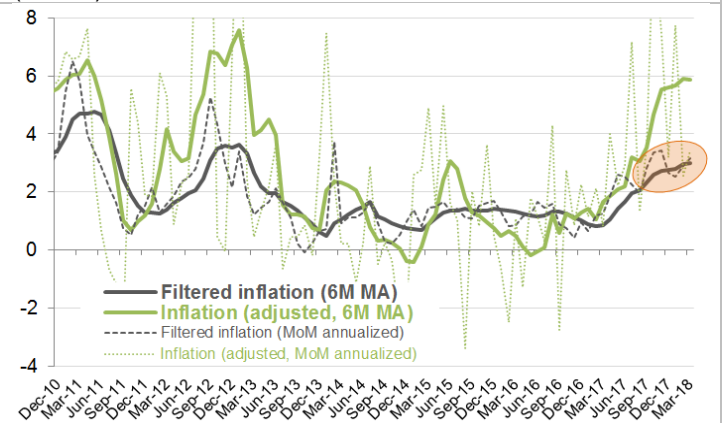
**Chart 3: Inflation and underlying processes**  
(YoY%)



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).

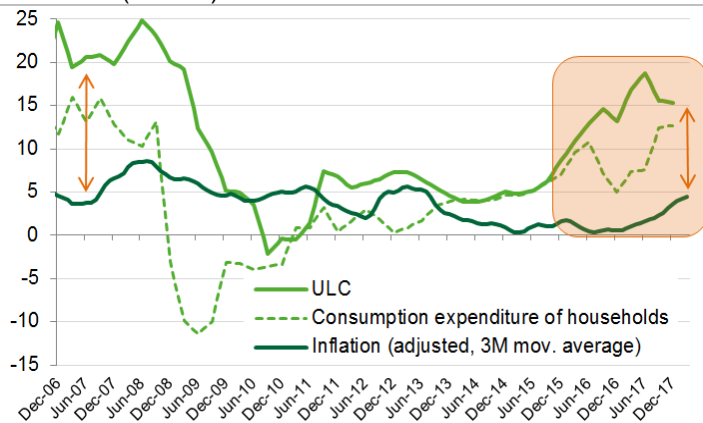
**Chart 4: Inflation and filtered inflation**  
(%, SA)



Sources: NIS, OTP Research

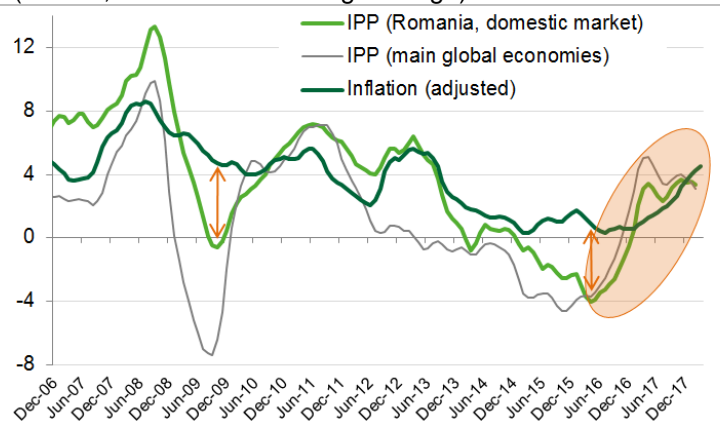
Note: adjusted by the impact of main tax changes; 6M MA = six-month moving average.

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



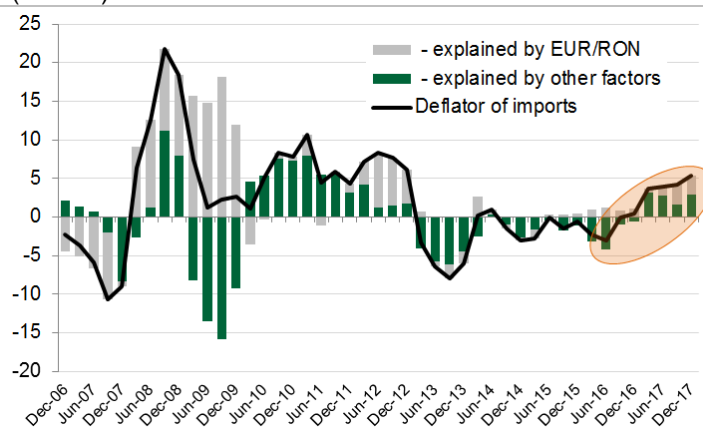
Sources: Eurostat, NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



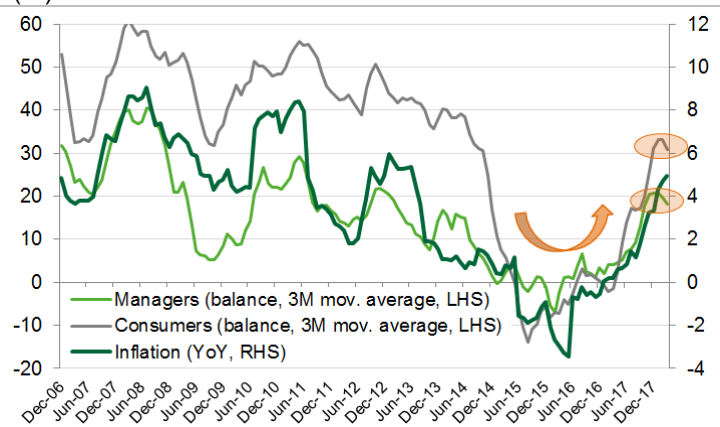
Sources: NIS, OECD, NBSC, OTP Research  
Note: adjusted by the impact of main tax changes; the IPP (main global economies) includes data from EU28, USA and China

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



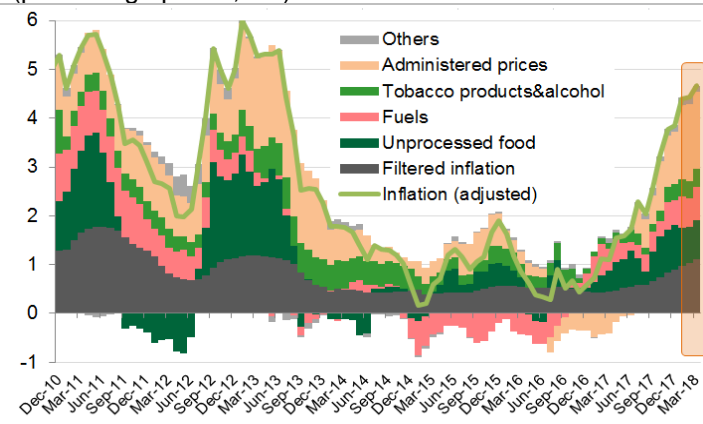
Sources: NBR, NIS, OTP Research

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



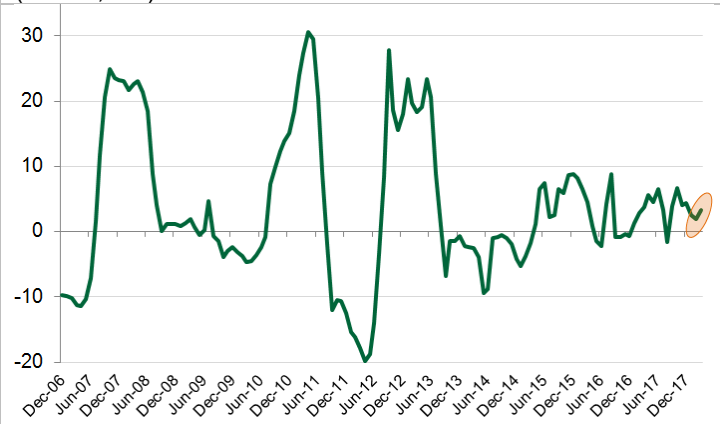
Sources: EC, NIS, OTP Research

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



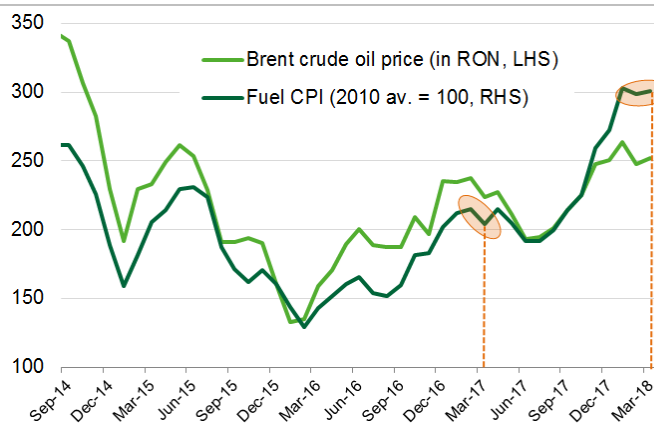
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 10: Seasonal unprocessed food inflation (YoY%, SA)**



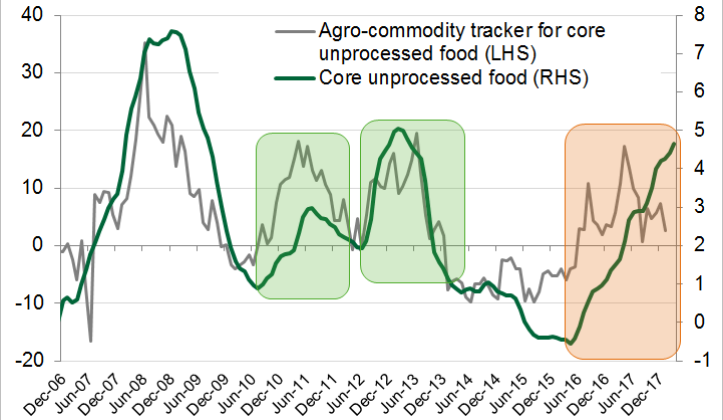
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



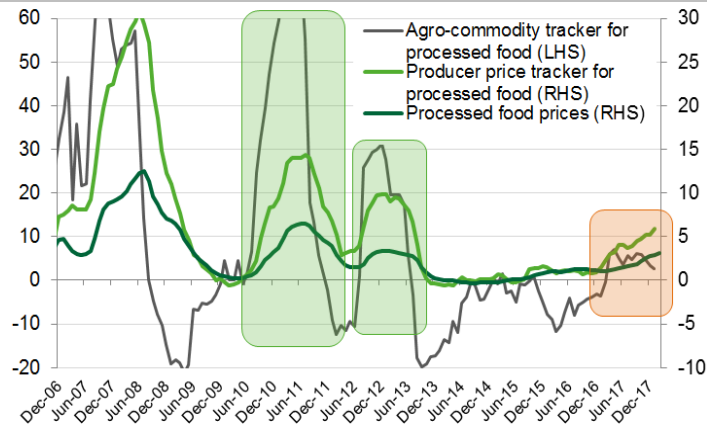
Sources: NIS, Reuters, OTP Research  
 Note: Fuel CPI is adjusted by the impact of main tax changes..

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



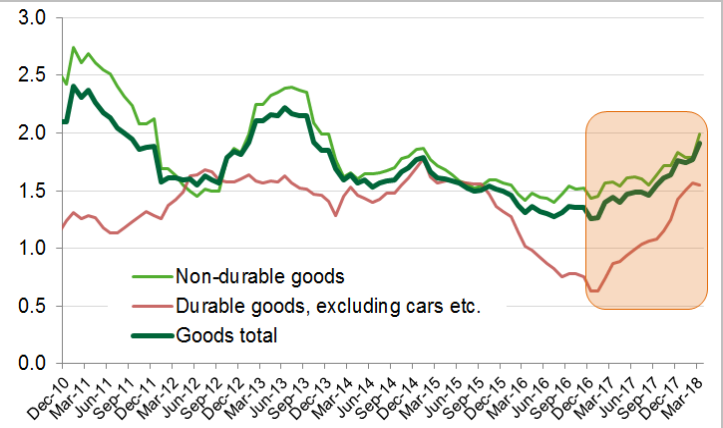
Sources: NIS, OTP Research  
 Note: adjusted by the impact of main tax changes.

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



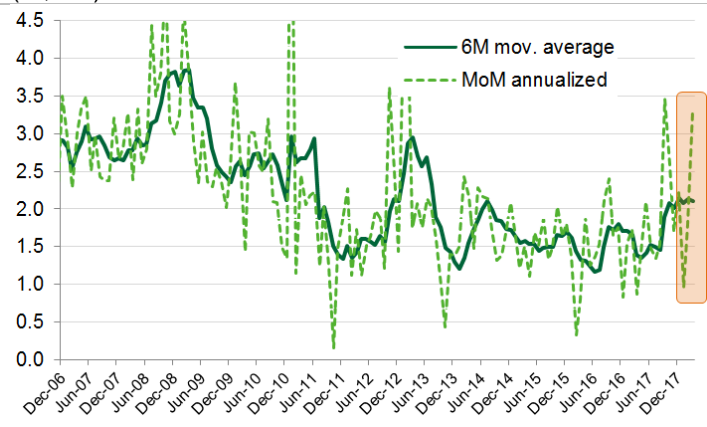
Sources: NIS, OTP Research  
 Note: adjusted by the impact of main tax changes.

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



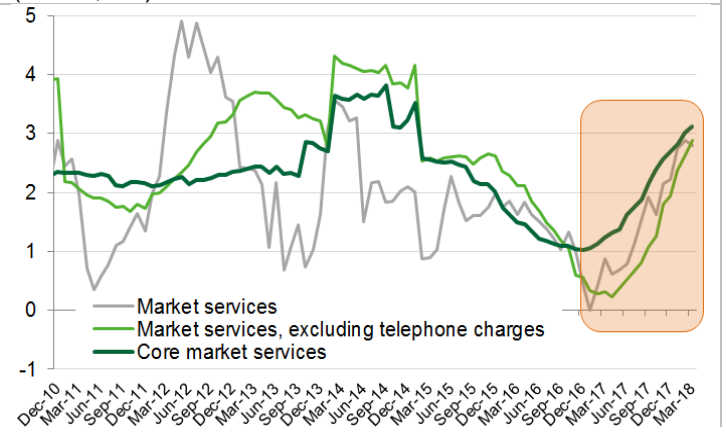
Sources: NIS, OTP Research  
 Note: adjusted by the impact of main tax changes.

**Chart 15: Non-durable goods (% SA)**



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

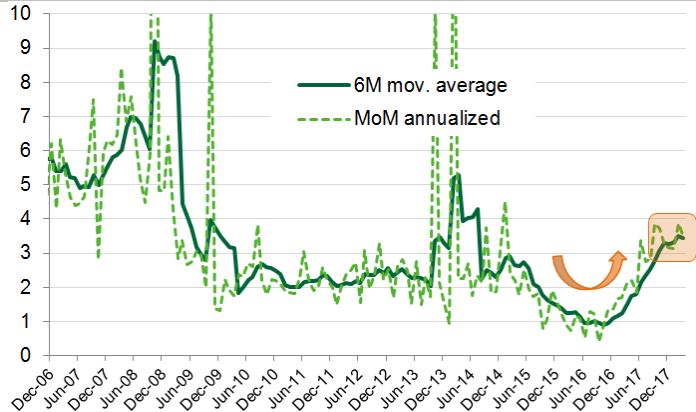
**Chart 16: Market services (YoY%, SA)**



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)

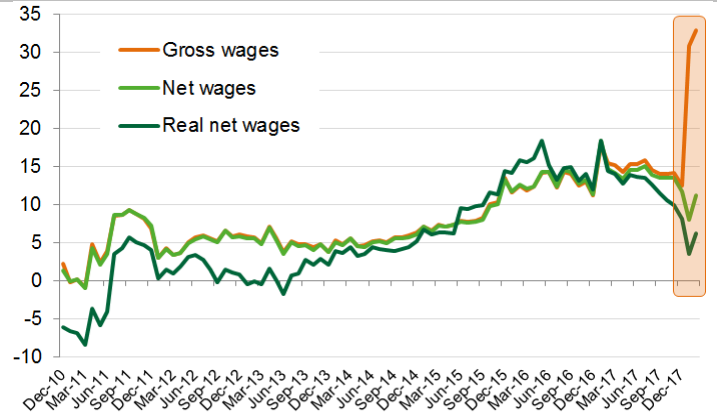


Sources: NIS, OTP Research

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

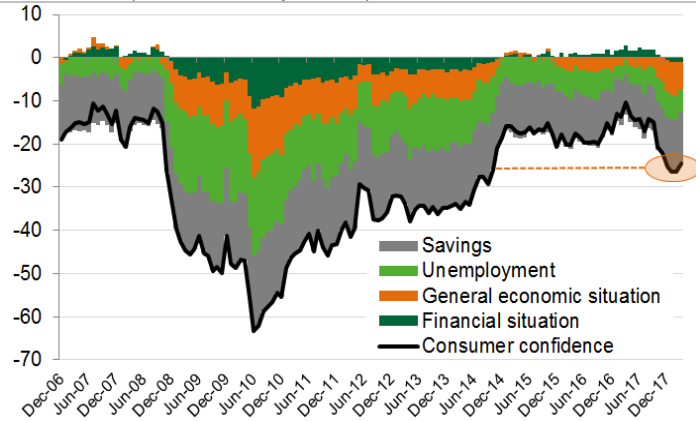
**Chart 18: Average wages**

(YoY%)



Sources: NIS, OTP Research

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

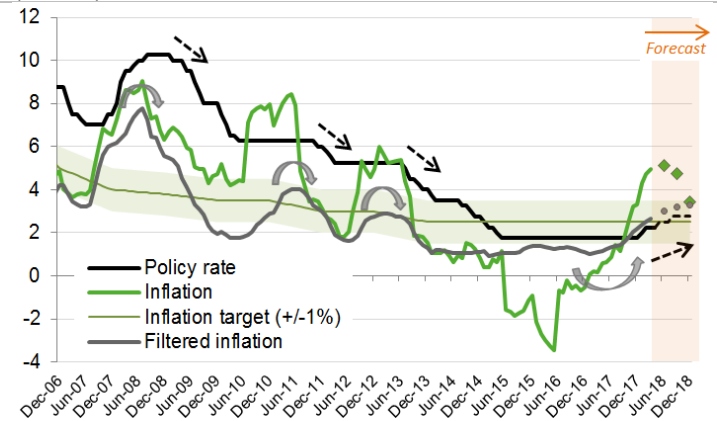


Sources: EC, OTP Research

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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