

REPORT ON INFLATION

16 May 2018

April's data hint at early signs of stabilisation

- In April, Romania's consumer price inflation continued to climb higher, reaching 5.2% YoY, after March's 5.0% (see Chart 1). This was in line with our expectation as well as the market's call (Reuters survey). In month-over-month comparison, the CPI index rose by 0.5%. Last month's pick-up primarily was due to a significant hike in tobacco prices, more expensive fuel as well as an increase in natural gas prices. Meanwhile, our in-house *filtered inflation*¹ measure increased marginally (less than 0.1 percentage point), and the NBR's preferred Core3 indicator rose slightly (from 3.0% YoY to 3.1% YoY; Chart 3), mainly as food prices showed evidence of stabilisation.
- We [reiterate](#) that consumer prices marked a particularly sharp and broad-based revival in the past few quarters, as the positive base effect of tax cuts dropped out, regulated and fuel prices rose sharply, and underlying inflation factors also appeared. In this context, and also owing to the escalating overheating fears, Romania's central bank has started the policy normalisation process in H2 2017.
- In month-over-month comparison, tobacco and cigarette prices rose by 2.4% in April, mostly as a result of an excise duty hike. This came on the top of other several large increases in the past few quarters, lifting the annual growth indicator to 8.1% (Chart 10). Simultaneously, prices at the petrol pump went up significantly, getting a boost from the surging Brent price (Chart 11). Crude futures increased significantly in recent times and continued to soar in the first half of May too. Among others, the rally was buoyed by the US administration's move to abandon an international agreement aimed to restrict Iran's nuclear programme. Administered prices also climbed higher last month, mainly owing to a hike in natural gas tariff (4.3% MoM).
- On the other hand, unprocessed food inflation was practically flat, first of all, as the large shock triggered by the fipronil scandal continued to vane, keeping eggs inflation on a downward trajectory. At the same time, core unprocessed (meat, milk and milling products) as well as processed food inflation lost some steam. On the back of last year's good harvest, we have expected this moderation for a while. Most recently, the annual growth rate of agro-commodity prices entered even into negative territory, easing the cost-push pressure on the CPI of food products (Chart 12 & 13). Nevertheless, we do not expect a sharp decline, as the rapid rise of unit labour cost is set to offset, at least partially, the effect of softer raw material prices.
- Goods' inflation has continued the recovery process, marking a new multi-year high at 2%. The increase was mainly fuelled by business-cycle-sensitive non-durable goods, but the inflation of durables also rose a bit (Chart 14). However, short-term indicators hint at some signs of stabilisation (Chart 15). Market services painted a similar picture, with the annual growth rate of services' CPI still rising (Chart 16) but high-frequency data marking a peak (Chart 17). However, it should be noted that the stabilisation was not homogeneous as, among others, the price index of personal care and cosmetic services accelerated further.
- Regarding the most recent evolution of Romania's economy (Chart 18), it is important to underscore that Q1's [GDP](#) outturn undershot expectations. On the expenditure side, most likely household consumption was the primary driver of the slowdown, after real disposable incomes lost momentum, borrowing costs surged, and consumer confidence fell sharply. Meanwhile, short-term inflation expectations entered a correction phase too (Chart 8). These developments, together with the signs of flattening CPI indicators, may alleviate to some extent the overheating and inflation fears.
- Nevertheless, after the softer outcomes in January and February, wage growth picked up again in March (Chart 19). Some of this rebound was due to hikes in public health and education, but private sector wages also gathered steam and, given the tight conditions on the labour market,

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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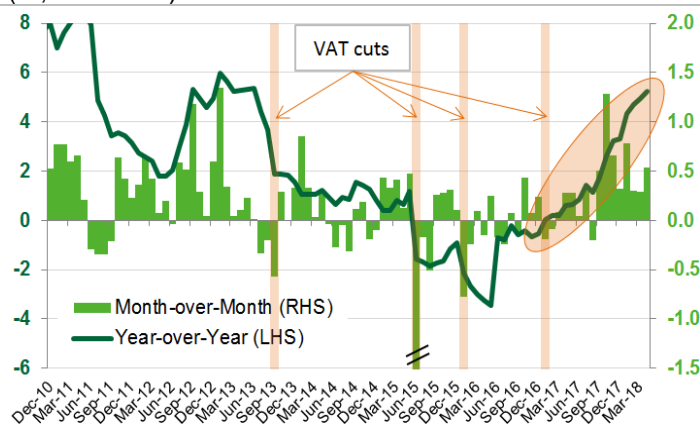
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strong dynamics are set to prevail. This should provide an important support for consumption and, coupled with rallying fuel prices, translate into important risk to the inflation outlook.

- Summing it up, we reiterate that April's underlying CPI indicators provided early signs of stabilisation and as the base effect of earlier one-offs (e.g. large electricity price hike, fuel excise duty increase) will fade, headline data is expected to peak near current level and to moderate at the end of this year. However, the fight against inflation is not over yet. Given the tight labour market, the risks coming from underlying factors remain elevated, while rising crude oil prices also adds to the pressure. Therefore we think that the NBR may continue the normalisation process, following a cautious, data-dependent approach. We expect the key-rate to reach 2.75% in 2018 and it may be raised to 3.25% in 2019. Owing to the recent rally of crude oil prices, we increased our year-end inflation forecast by 0.2 percentage points, to 3.6%.

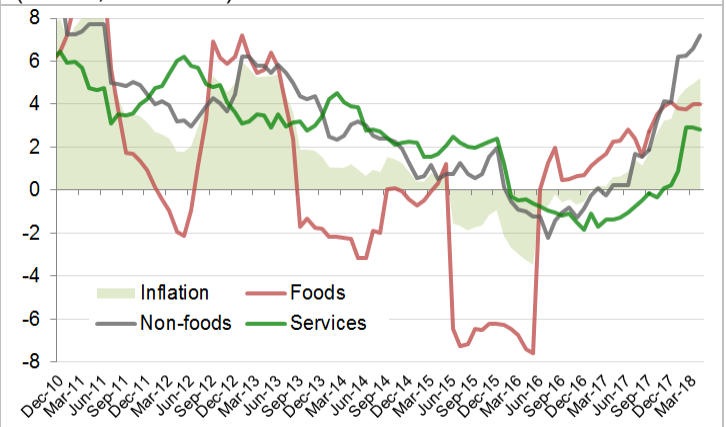
Chart set:

Chart 1: Headline inflation
(%, NSA data)



Sources: NIS, OTP Research

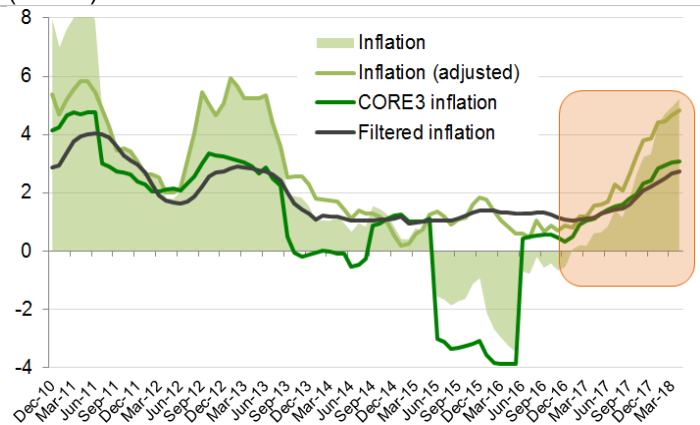
Chart 2: Inflation by its main components
(YoY%, NSA data)



Sources: NIS, OTP Research

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

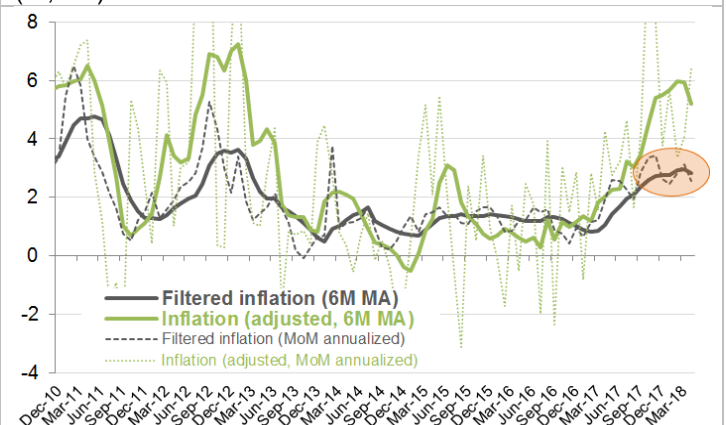
Chart 3: Inflation and underlying processes
(YoY%)



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).

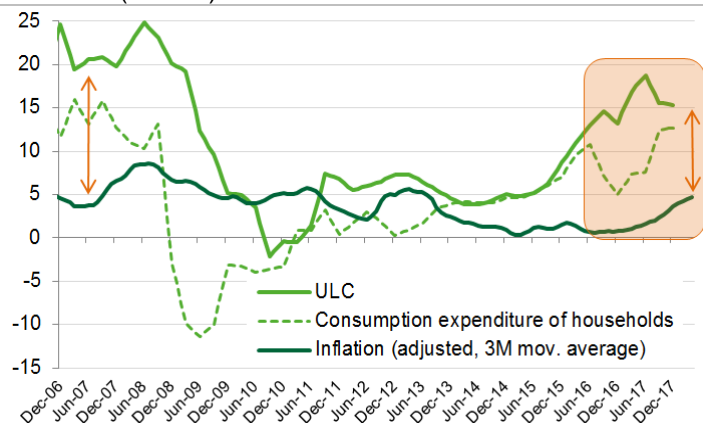
Chart 4: Inflation and filtered inflation
(%, SA)



Sources: NIS, OTP Research

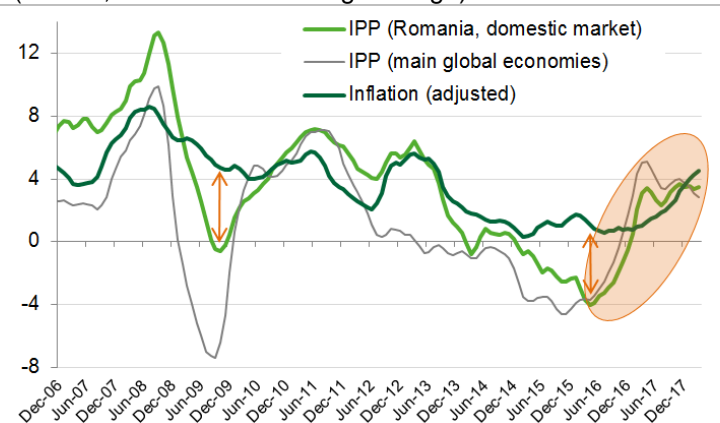
Note: adjusted by the impact of main tax changes; 6M MA = six-month moving average.

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



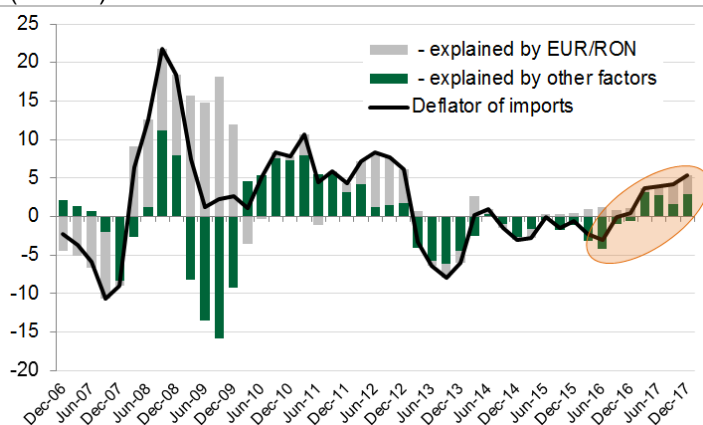
Sources: Eurostat, NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

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



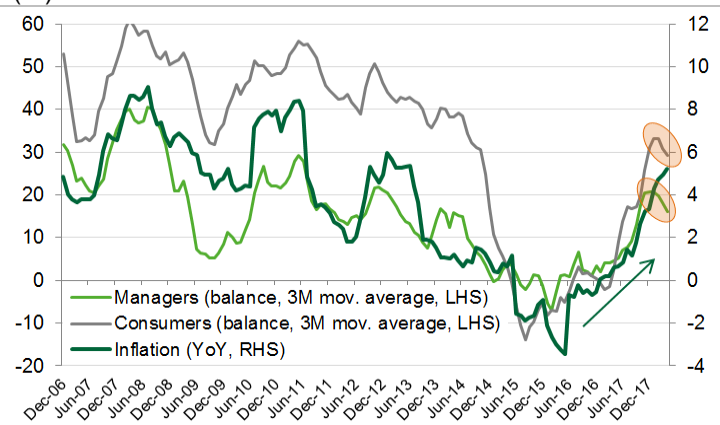
Sources: NIS, OECD, NBSC, OTP Research
 Note: adjusted by the impact of main tax changes; the IPP (main global economies) includes data from EU28, USA and China

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



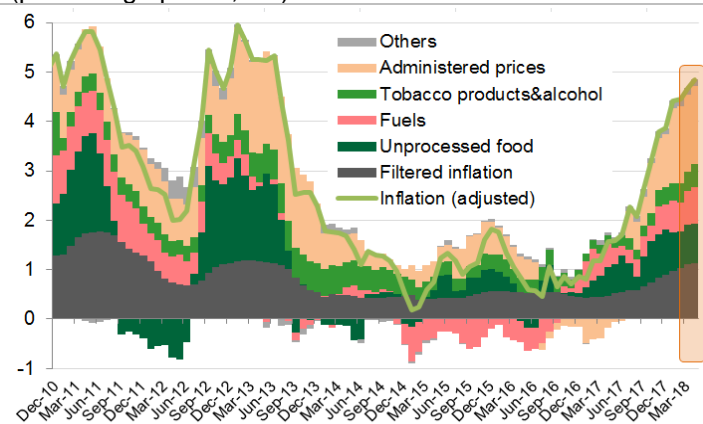
Sources: NBR, NIS, OTP Research

Chart 8: Price expectations vs. inflation (%)



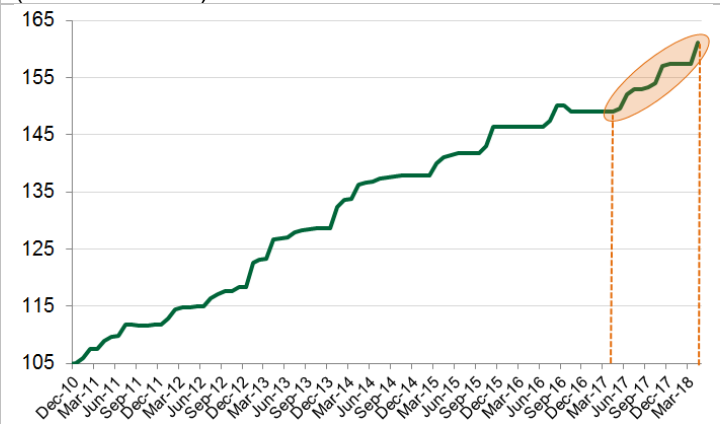
Sources: EC, NIS, OTP Research

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



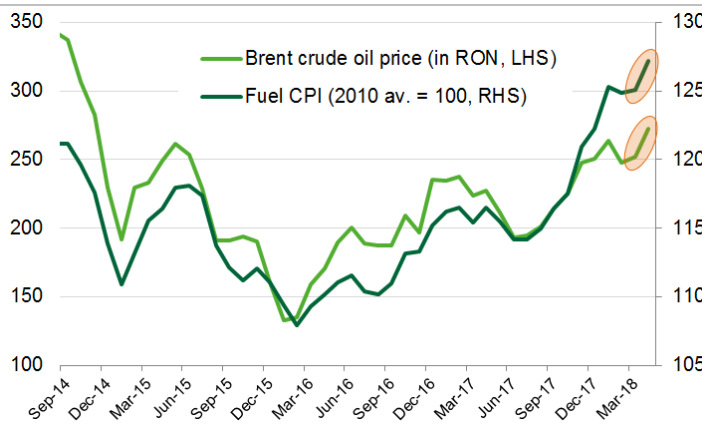
Sources: NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

Chart 10: CPI of tobacco and cigarettes (2010 av. = 100)



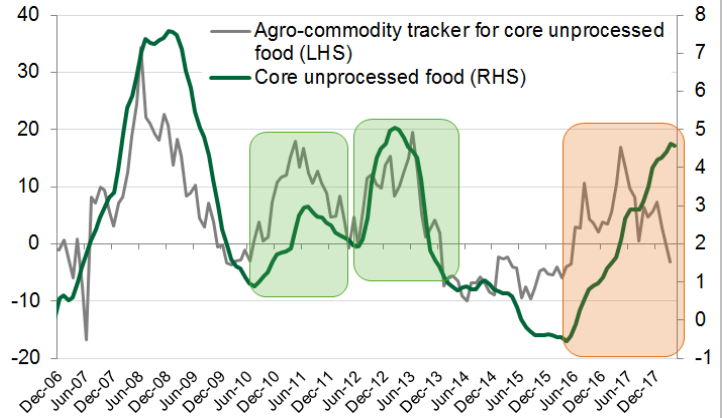
Sources: NIS, OTP Research

Chart 11: CPI of fuels vs. Brent oil prices



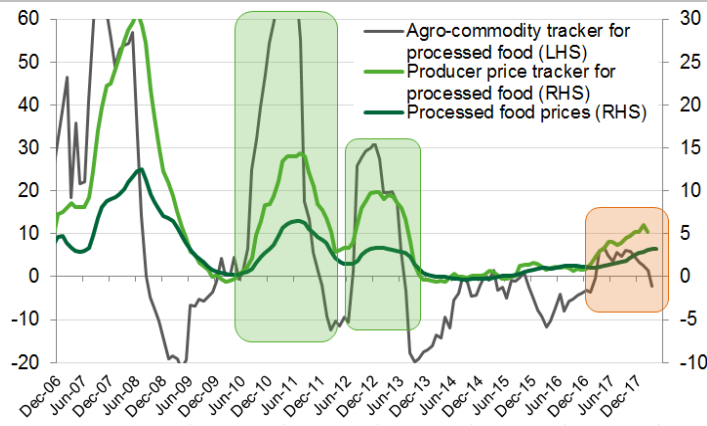
Sources: NIS, Reuters, OTP Research
 Note: Fuel CPI is adjusted by the impact of main tax changes.

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



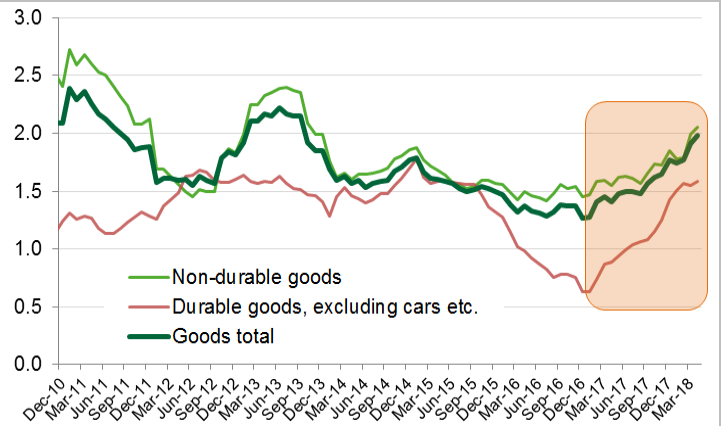
Sources: NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

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



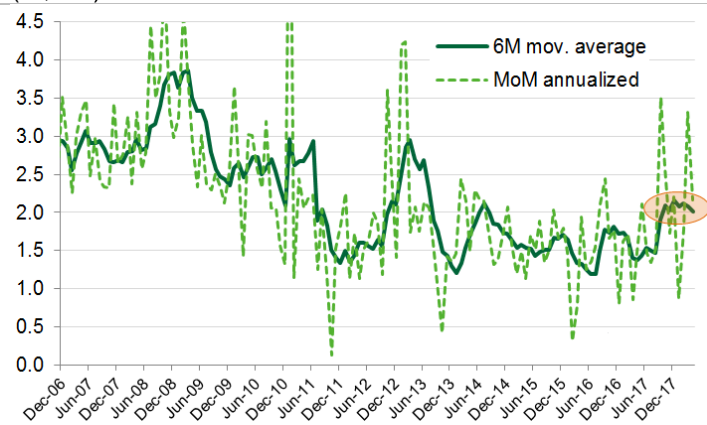
Sources: NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

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



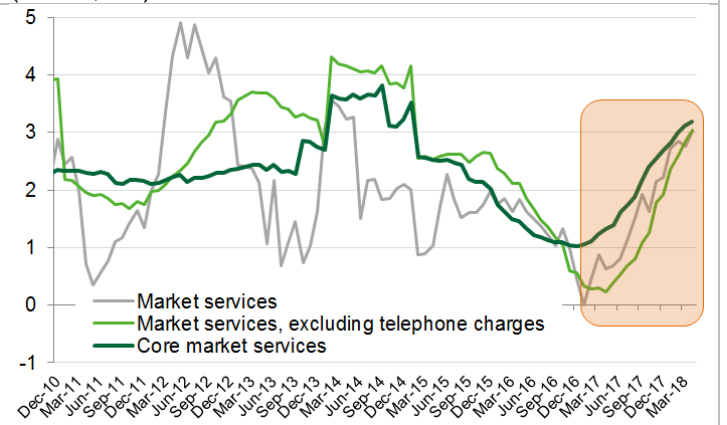
Sources: NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

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



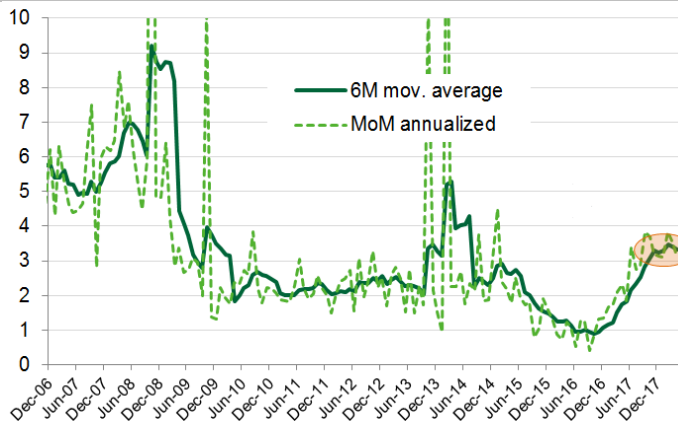
Sources: NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

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

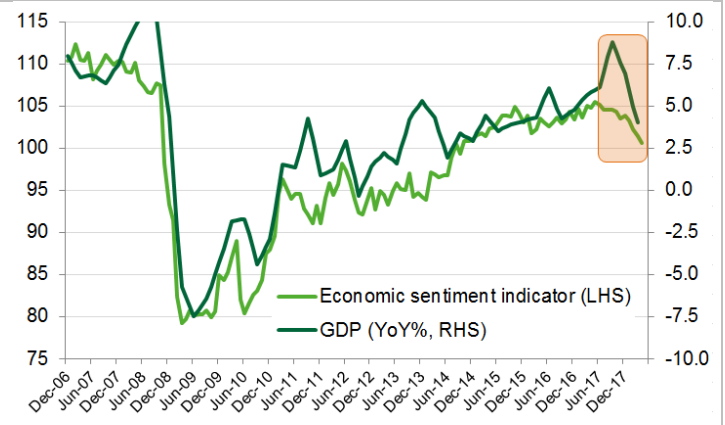
Chart 17: Core market services
(%, SA)



Sources: NIS, OTP Research

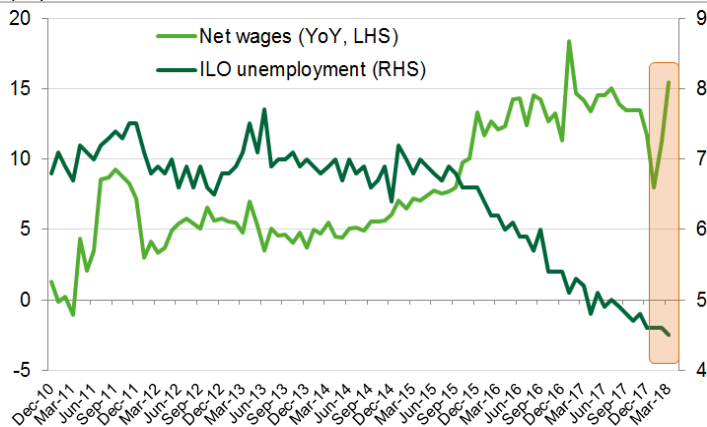
Note: adjusted by the impact of main tax changes; **Core market services** excludes the EUR/RON-related telephone charges as well as insurances.

Chart 18: GDP growth vs. economic sentiment indicator



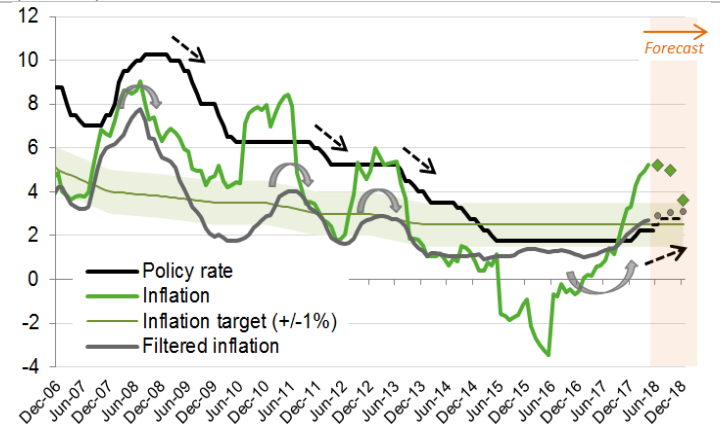
Sources: NIS, EC, OTP Research

Chart 19: Labour market indicators
(%)



Sources: NIS, OTP Research

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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