

# REPORT ON INFLATION

13 December 2018

## ***Inflation re-entered the NBR's tolerance band earlier than previously thought; this provides temporary relief for the central bank***

- Romania's consumer price growth was at 3.4% YoY in November, down from 4.3% YoY a month earlier (Chart 1), primarily because of lower fuel and unprocessed food inflation. This outturn means that consumer price growth entered the NBR's tolerance band (2.5% +/- 1%) for the first time this year. November's data undershot the market expectation (3.7% YoY; Reuters poll) and even our low-end call of 3.5% YoY. In month-over-month comparison, the consumer price index fell by 0.1%, the NIS's report also showed. Meanwhile, Core3 inflation, the NBR's preferred underlying indicator, decreased from 2.8% YoY to 2.6% YoY, and our in-house *filtered inflation*<sup>1</sup> measure softened from 2.7% YoY to 2.6% YoY (Chart 3).
- We [reiterate](#) that Romanian consumer prices had marked multi-year highs earlier in 2018, driven primarily by administered price hikes, soaring Brent, and the weaker leu. Meanwhile, underlying inflation indicators also increased. Because of the changing environment, the NBR had launched the policy normalisation earlier than most of its peers. However, as inflation reached a turning point at mid-year, the central bank also entered wait-and-see mode.
- November's sharp deceleration was mainly due to lower fuel prices (Chart 10). This explains around 0.4 percentage points of the fall of the headline data (Chart 9). Beside fuels, unprocessed food inflation also had an important contribution (0.3 ppts) to the easing consumer price growth, primarily as the egg price shock caused by the fipronil scandal dropped out from the base (Chart 11). Core unprocessed food inflation (raw meat, flour, and milk) fell too (Chart 12), even though the effect of higher wheat prices had appeared in the case of flour. To a lesser extent, base effects in the case of tobacco as well as exchange-rate-sensitive items (telephone charges and cars) also helped.
- Amid the components of our filtered inflation measure, the growth rate of processed food CPI continued its downward trend (Chart 13). However, November's fall was a bit softer than we had expected, as bread inflation picked up. As we wrote in our [previous report](#), we think that the downward trend of processed food inflation may come to an end soon, as the effect of higher wheat prices (Chart 14), coupled with another minimum wage hike in January, will increase the production cost of companies in food industry.
- Goods' inflation marched slightly higher in November, driven mainly by clothing and footwear. We reiterate that goods' inflation has been increasing for almost two years (Chart 15), signalling higher underlying cost-push and demand-pull pressures. On the other hand, market services inflation (Chart 17) came in a bit softer than we had expected, while high-frequency indicators provided further signs of stabilisation near the 3% threshold (Chart 18). It is worth mentioning that the stabilisation was rather broad-based. Nonetheless, as we noted earlier too, there is a risk that higher wages and robust domestic demand may re-ignite services inflation.
- Looking forward, we are more confident that in the following period headline inflation will stay inside the NBR's tolerance band (Chart 19). More precisely, we expect consumer price inflation to finish this year and next at 3.3% and 3.1%. Nonetheless, the mildly decreasing trend of core CPI measures may be reversed next year.
- With more confidence that headline and core inflation indicators will stay inside the target band, the central bank could keep the policy rate unchanged for longer. Early signs that the Fed and the ECB may tighten monetary policy more slowly than previously thought are expected to lower the pressure on the NBR as well. We think that the central bank will continue to follow a data-dependent approach, while also keeping an eye on external conditions.

<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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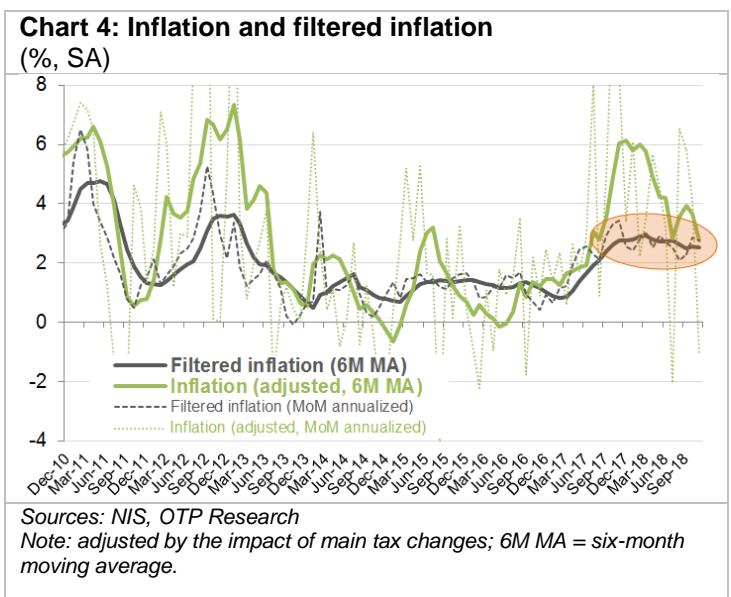
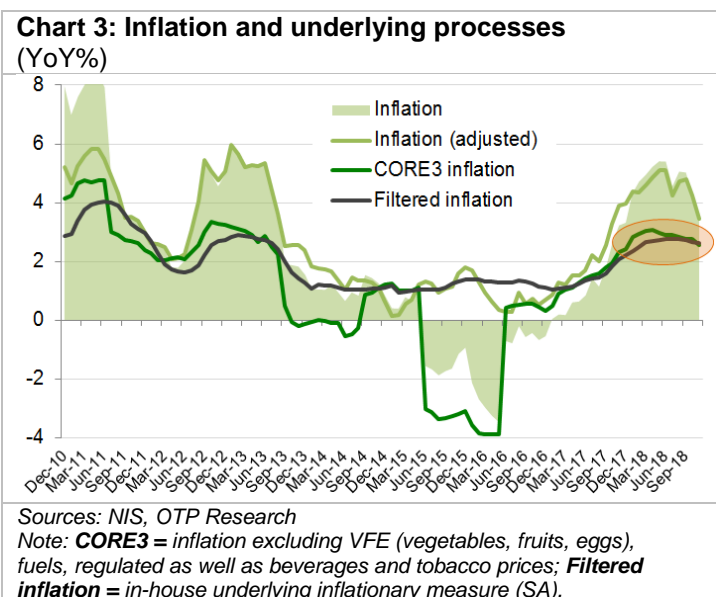
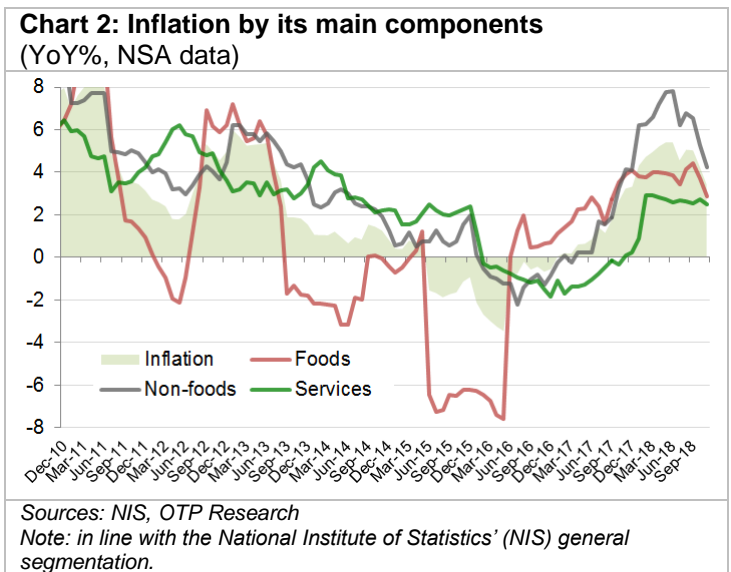
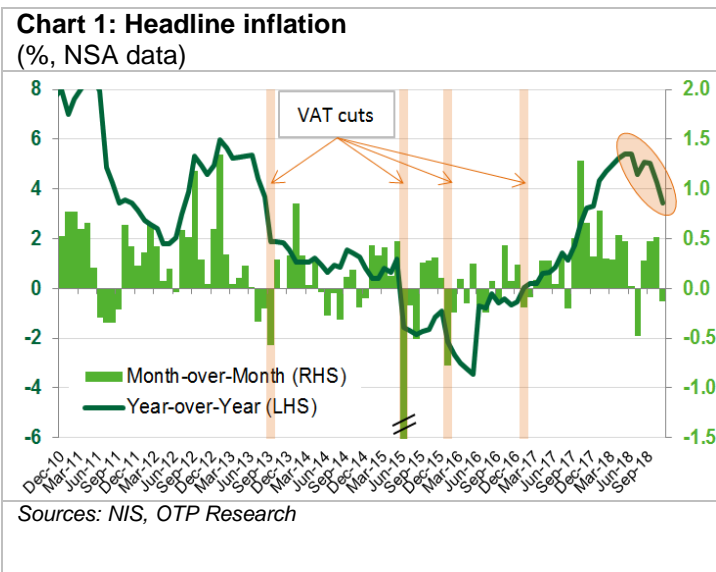
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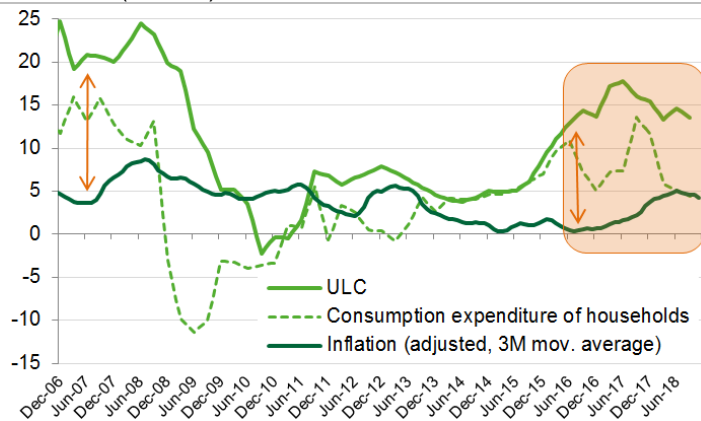
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- In our updated base scenario, we do not expect the NBR to raise the policy rate before H2 2019 (Chart 19). Nevertheless, more restrictive lending conditions are set to translate into a sort of tightening earlier. We recall that the new DSTI (debt-service-to-income) rule for households will enter into force starting from January 2019. Tighter liquidity management could be also used to adjust monetary conditions, if needed.
- In case of a broad-based but mild economic slowdown on the external front, coupled with supportive financial conditions, we think that the NBR may keep rates unchanged throughout next year.
- Among the key risks, we underscore the tight labour market as well as the uncertainties about the health of the global economy. As we noted in our latest [GDP report](#), Romania is much more resilient than it was before the 2008 financial crisis, but it seems to be more exposed to external shocks than several other countries in the CEE region. Therefore, a deeper global downturn with weakening pressure on the leu would urge the central bank to tighten policy more rapidly.

## Chart set:

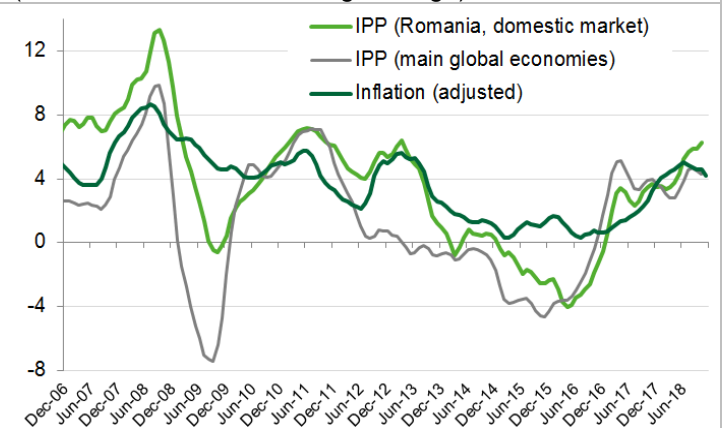


**Chart 5: ULC and households' consumption vs. inflation (YoY %)**



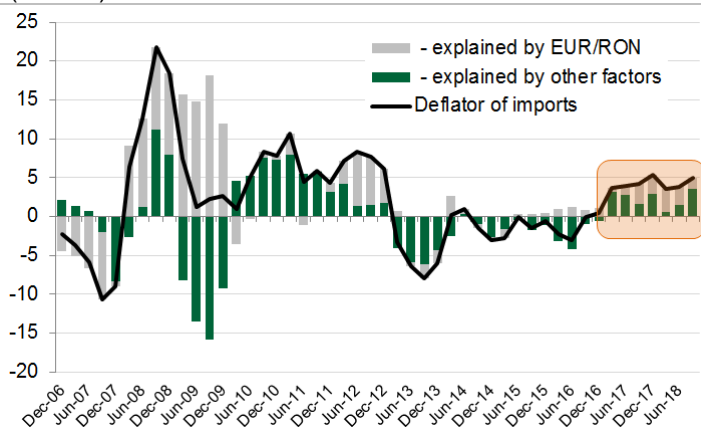
Sources: Eurostat, NIS, OTP Research  
Note: inflation data adjusted by the impact of main tax changes.

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



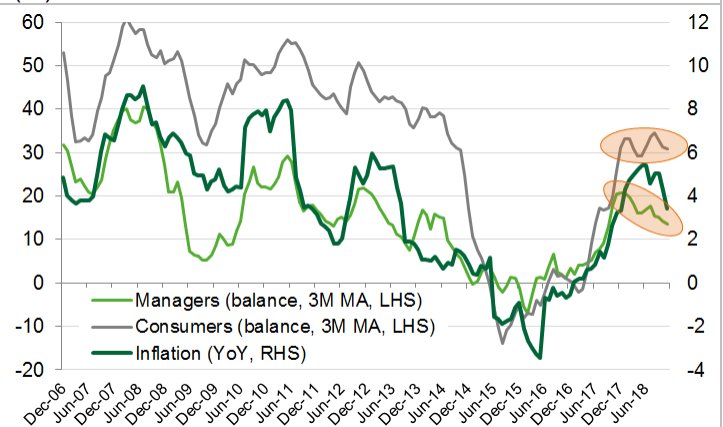
Sources: NIS, OECD, NBSC, OTP Research  
Note: inflation data adjusted by the impact of main tax changes; the IPP (main global economies) includes data from EU28, USA and China

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



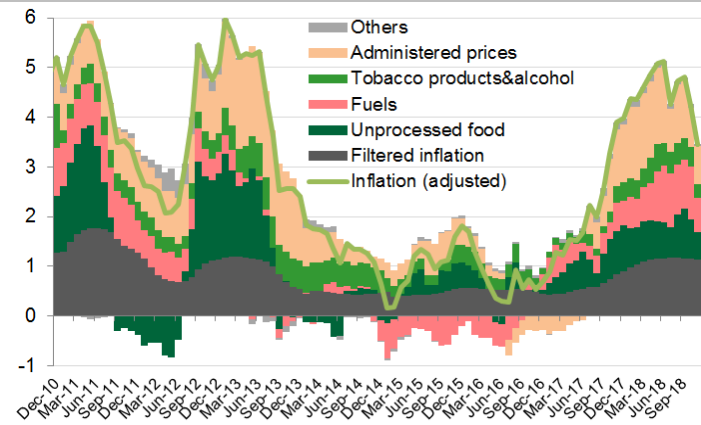
Sources: NBR, NIS, OTP Research

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



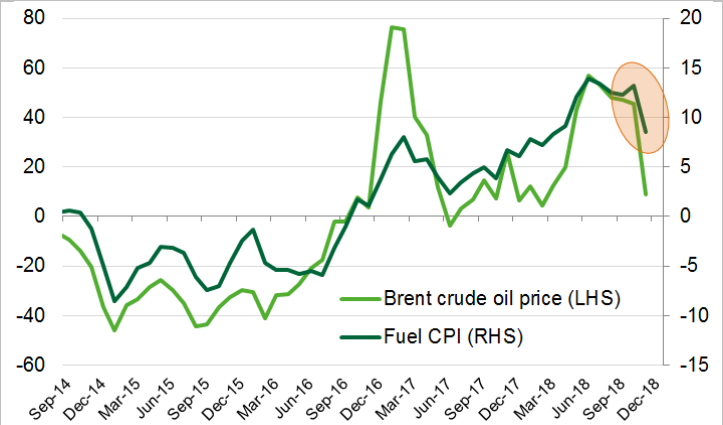
Sources: EC, NIS, OTP Research  
Note: 3M MA = three-month moving average.

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



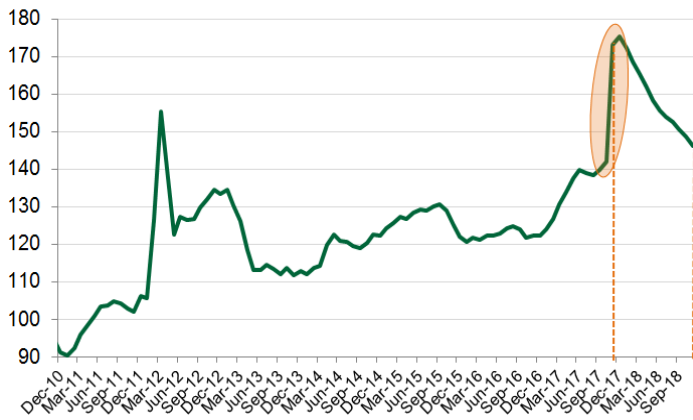
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 10: CPI of fuels vs. Brent oil prices (YoY %)**



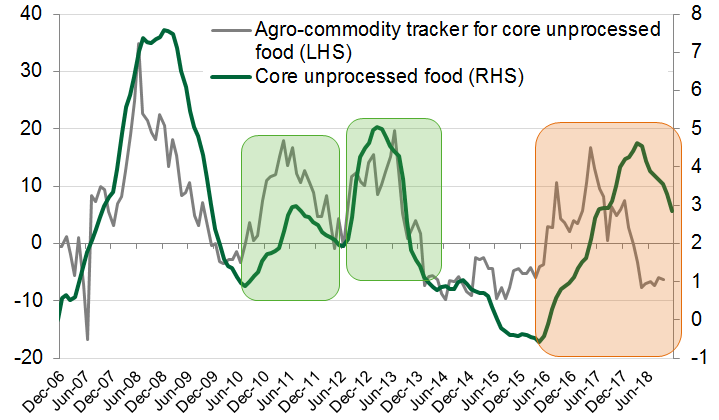
Sources: NIS, Reuters, OTP Research  
Note: Fuel CPI is adjusted by the impact of main tax changes.

**Chart 11: CPI of eggs**  
(2010 av.= 100, SA)



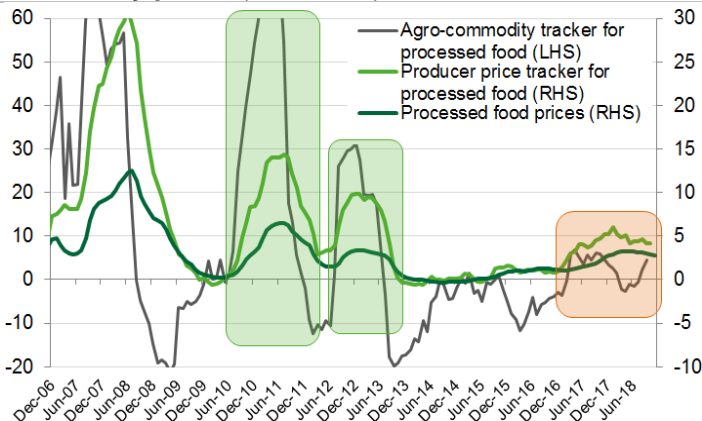
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



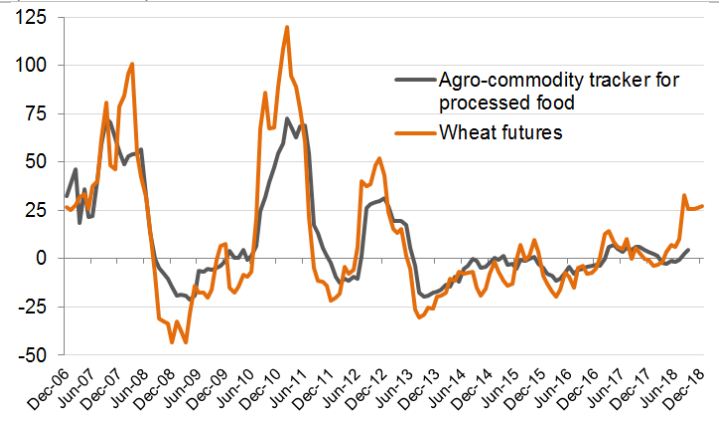
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

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



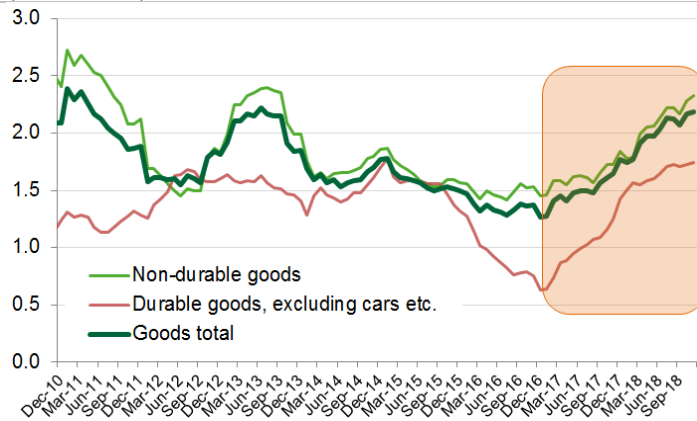
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 14: Agro-commodity prices vs. wheat futures** (YoY%, SA)



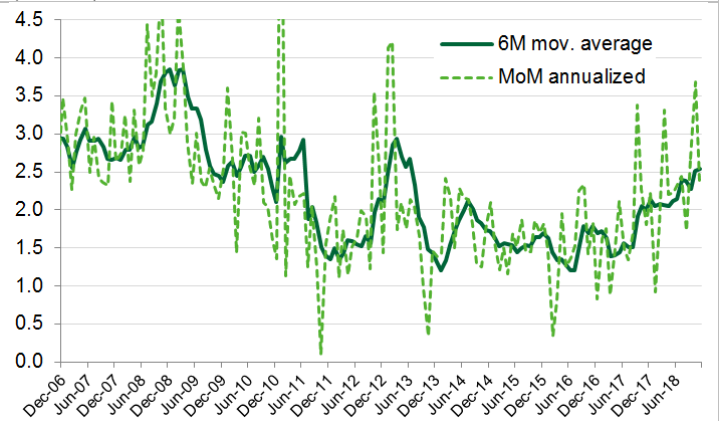
Sources: NIS, Reuters, OTP Research  
Note: December data for wheat futures is the average of 1-12 December

**Chart 15: Goods' inflation**  
(YoY%, SA)



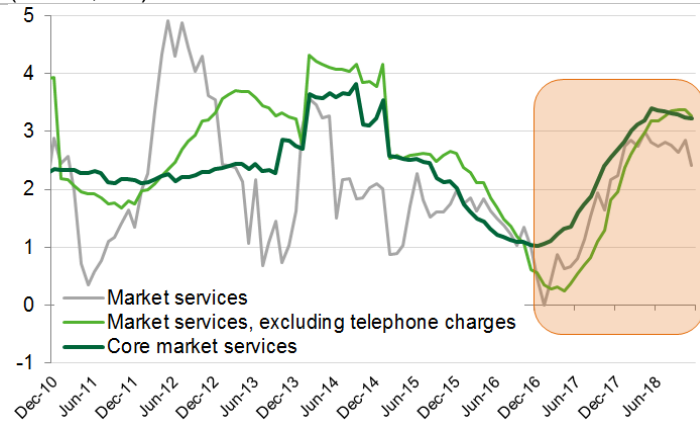
Sources: NIS, OTP Research  
Note: adjusted by the impact of main tax changes.

**Chart 16: Non-durable goods**  
(%, SA)



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

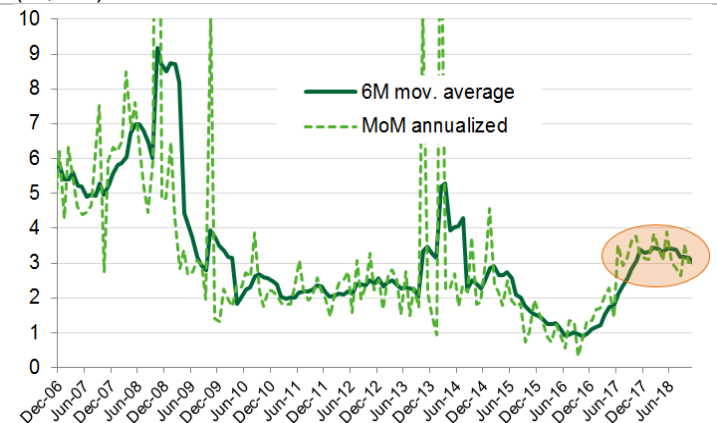
**Chart 17: Market services**  
(YoY%, SA)



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

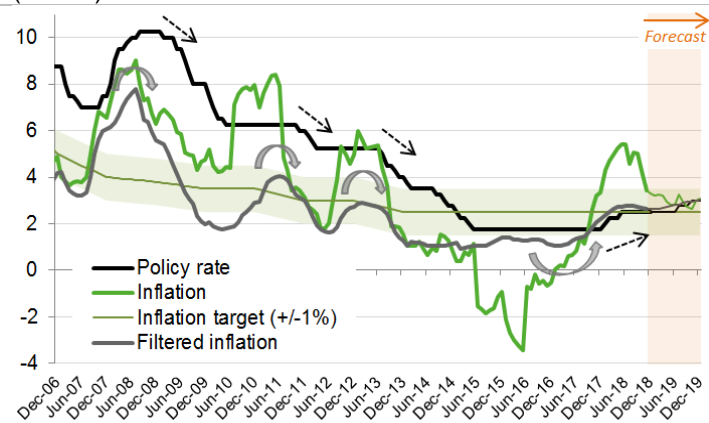
**Chart 18: Core market services**  
(%, SA)



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



Sources: NIS, NBR, OTP Research

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



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