

REPORT ON INFLATION

12 April 2019

Will above-target consumer price growth re-trigger inflation expectations and monetary tightening?

- In March, Romania's headline inflation climbed 0.2 percentage points higher, to 4.0% YoY, driven by more expensive tobacco and fuel (Chart 1 & 5). On month-over-month basis, the consumer price index rose 0.5%, the NIS report revealed too. March's data exceeded slightly the market consensus (Reuters survey: 3.9% YoY), however, was in line with our expectation. Underlying inflation measures were stable last month, with the NBR's preferred *Core3*¹ and our in-house *filtered inflation*² indicators staying at 2.7% YoY (Chart 3).
- Regarding the broader picture, we recall that Romania's annual inflation re-entered the NBR's tolerance band (2.5% +/- 1%) [at year-end](#). However, the relief was short-lived with the headline data broking again above the target in February. It is also worth to add that, in 2019, consumer price growth is expected to be faster than thought a few months earlier. In its February Inflation Report, the NBR had projected the headline data to end this year at 3.0% however, since then, the perspectives have started to change [raising the pressure](#) on the central bank. In our updated forecast, we estimate consumer price growth to end 2019 at the upper edge of the target range. Moreover, the risks are definitely tilted to the upside.
- March's uptick was primarily due to higher tobacco and fuel explaining 0.1 percentage point each from the acceleration (Chart 5). The latter came on the back of reviving crude oil futures on international commodity markets.
- The main components of food CPI changed mixed, with core unprocessed food inflation (raw meat, flour, and milk) slowing somewhat, while processed food inflation accelerated a bit (Chart 6 & 7). Likely, the divergence came from the gradual pass-through of last year's wheat price shock as well as the January's increase of minimum wages that fuel the CPI of processed food.
- After the increases registered in the first two month of this year (supported also by the leu's depreciation), goods' inflation softened somewhat in March (Chart 8). On the other hand, core market services' inflation continued to accelerate (Chart 12). It is important to note, that the latter group of the consumer basket is particularly sensitive for fundamental factors such as wage pressures and robust domestic demand. It is also worth mentioning, that after a similar episode of acceleration in 2017, the NBR implemented several tightening steps.
- To conclude, we reiterate that the NBR's Core3 and our filtered inflation measures were stable last month. In addition, a modest fall of the headline data is also likely (Chart 14). We expect annual inflation to end this year and next at 3.5% and 3.2% respectively. Nevertheless, the evolution of core market services inflation as well as the broader picture (e.g. strong wage pressure, rapid consumption growth, potential secondary effects of new sector level taxes, uncertainties around this year's harvest) provide a plenty of reason for concern. Inflation expectations didn't show a sharp revival yet (Chart 13), therefore, we think that the strict control over money market liquidity may be enough this year. Nonetheless, there is an important risk that another price shock will re-trigger inflation expectations. In that case, we think that the NBR will intervene by raising the policy rate too.

¹Core3 inflation excludes vegetables, fruit, eggs, fuels and products whose prices are regulated, as well as beverages and tobacco

²Filtered 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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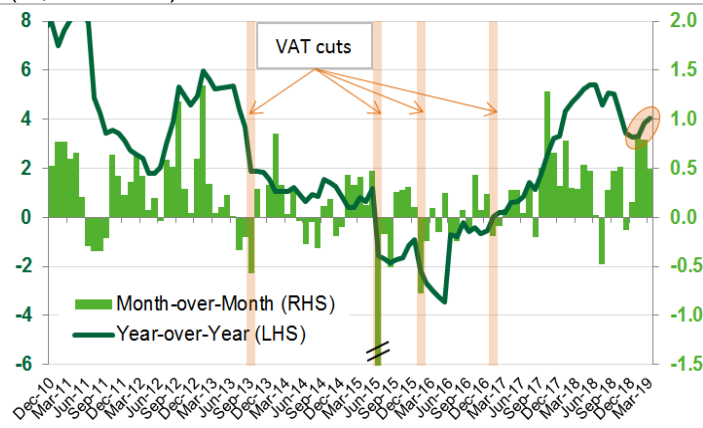
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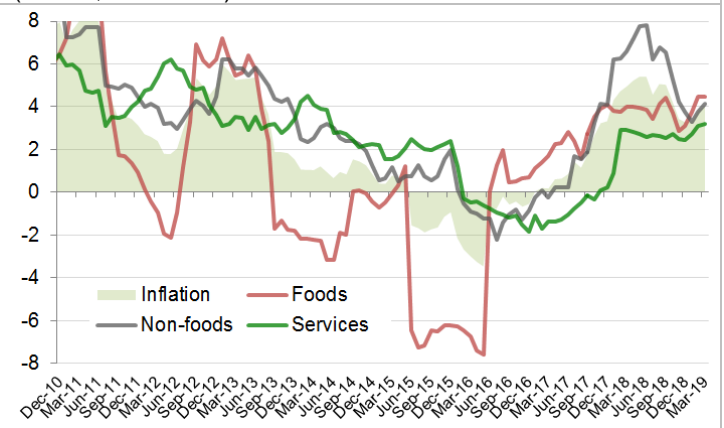
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Chart 1: Headline inflation
(%, NSA data)



Sources: NIS, OTP Research

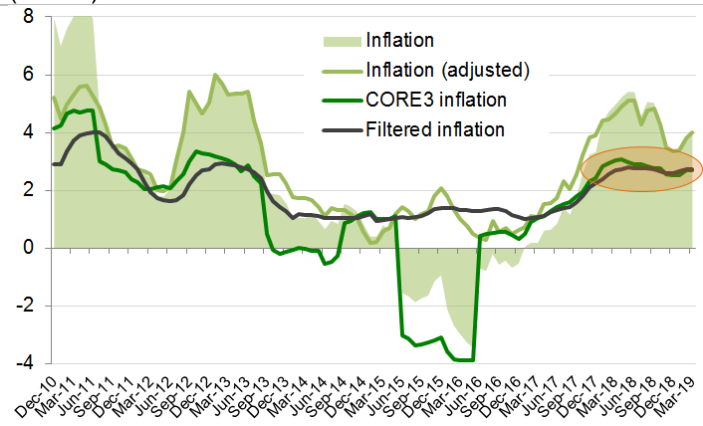
Chart 2: Inflation by its main components
(YoY%, NSA data)



Sources: NIS, OTP Research

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

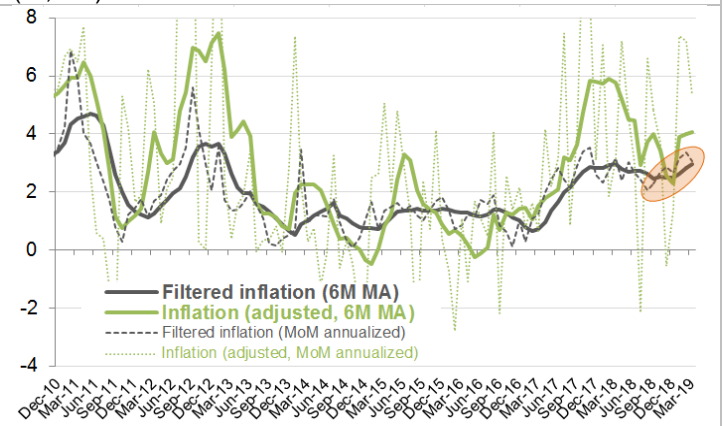
Chart 3: Inflation and underlying processes
(YoY%)



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).

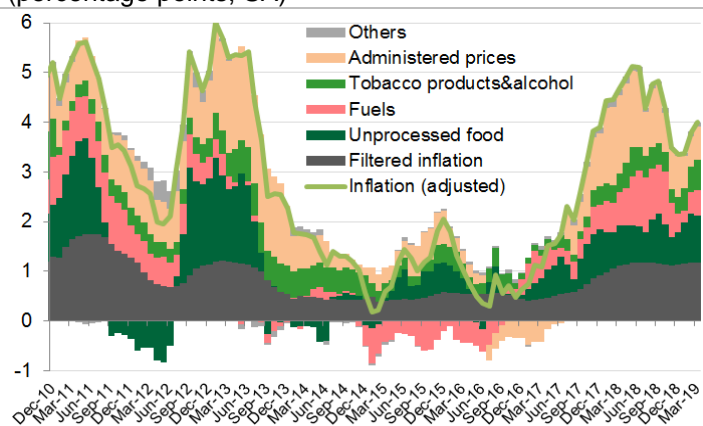
Chart 4: Inflation and filtered inflation
(%, SA)



Sources: NIS, OTP Research

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

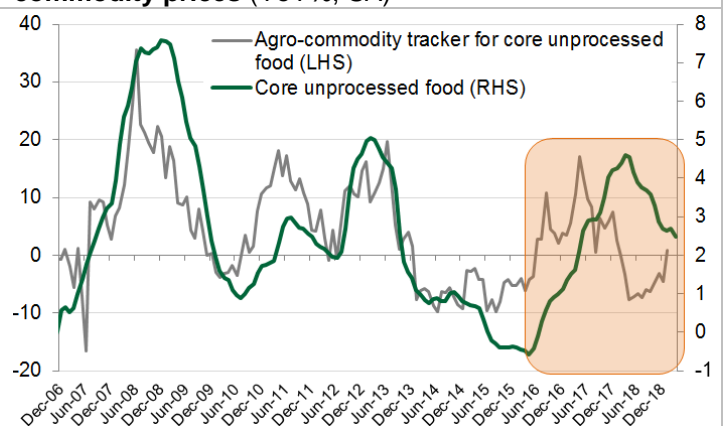
Chart 5: Decomposition of inflation
(percentage points, SA)



Sources: NIS, OTP Research

Note: adjusted by the impact of main tax changes.

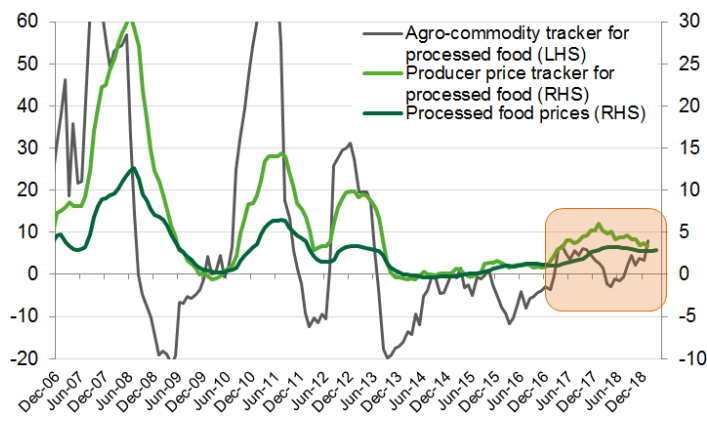
Chart 6: CPI of core unprocessed foods vs. agro-commodity prices
(YoY%, SA)



Sources: NIS, OTP Research

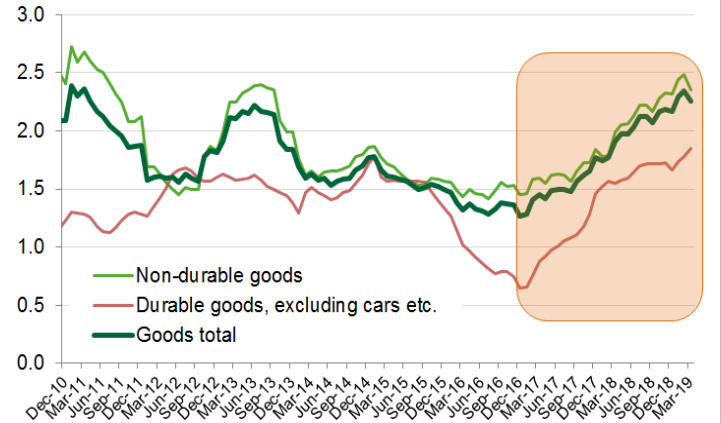
Note: adjusted by the impact of main tax changes.

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



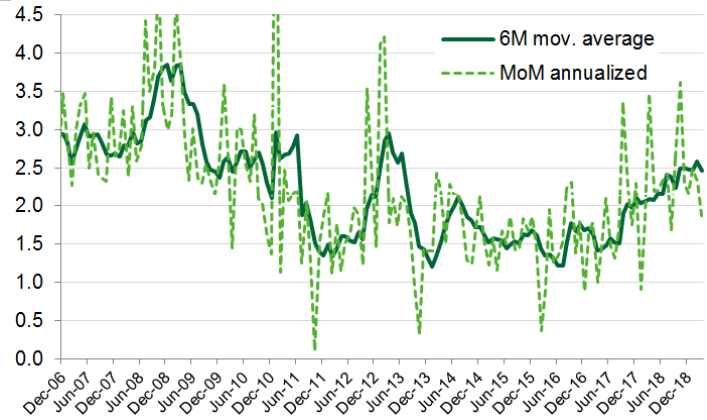
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

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



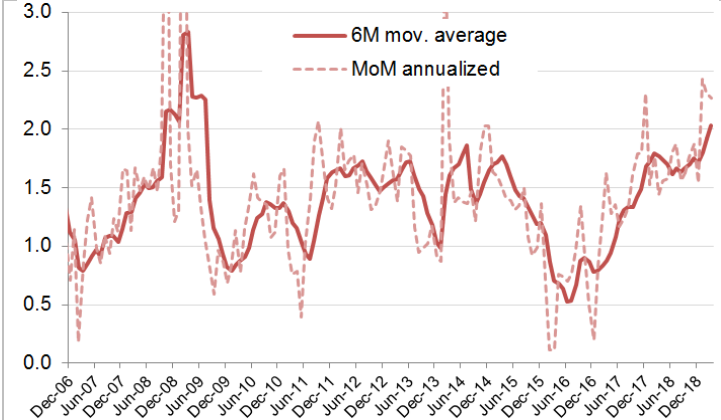
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 9: Non-durable goods (% SA)



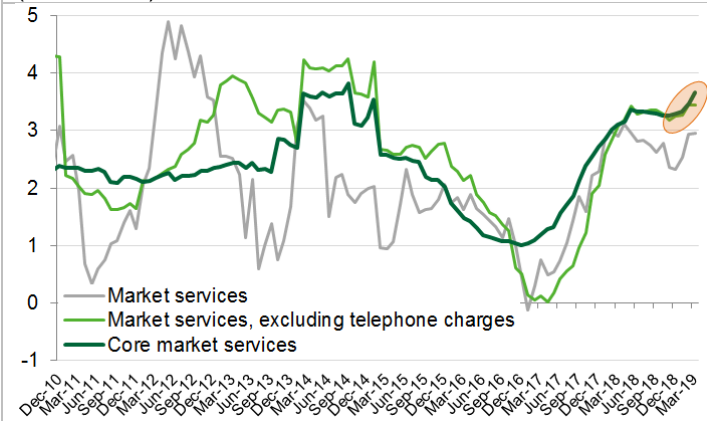
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 10: Durable goods, excluding cars etc. (% SA)



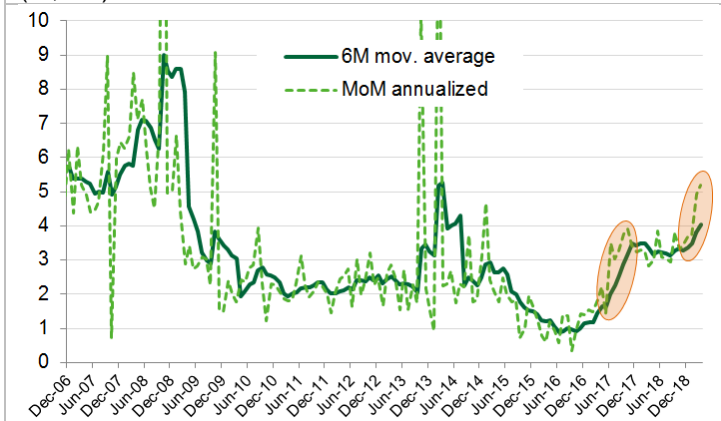
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 11: Market services (YoY%, SA)



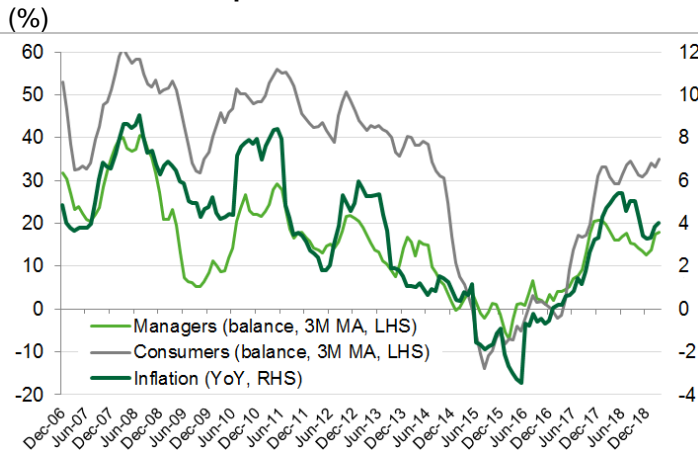
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services** excludes the EUR/RON-related telephone charges as well as insurances

Chart 12: Core market services (% SA)



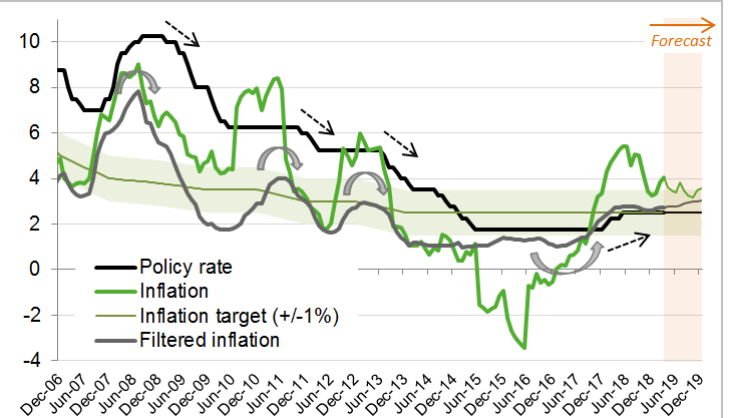
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services** excludes the EUR/RON-related telephone charges as well as insurances.

Chart 13: Price expectations vs. inflation



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

Chart 14: Inflation vs. NBR's inflation target



Sources: NIS, NBR, OTP Research
 Note: **Filtered inflation** = in-house underlying inflationary measure (SA).

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