

REPORT ON INFLATION

14 September 2017

Seasonal foods dragged down headline data in August; Demand sensitive items provided further evidence of rising underlying price pressures

- In August, Romania's annual inflation slipped to 1.15%, down from July's 1.42% (Chart 1), missing expectations by a quite wide margin, after the market consensus stood at 1.45%, according to a Reuters survey (our forecast was at 1.35%). However, it is important to add that last month's slowdown was mainly the result of a sharp setback in seasonal unprocessed food prices, a very volatile item group, which shaved of around 0.3 percentage points from the headline figure. Meanwhile, excluding the effect of important tax changes, implemented in the beginning of this year (one-percentage-point standard VAT rate cut, the elimination of the special excise duty on fuels, as well as scrapping radio&TV fees) Romania's annual inflation would have been at around 2% YoY, that is to say, inside the NBR's target range (2.5% +/- 1%). On month-over-month basis, the consumer price index slipped 0.2%.
- The CORE3 inflation, the NBR's preferred underlying measure, continued to rise, reaching 1.6% YoY, the highest level since August 2013 (Chart 3), as beside fundamental factors, the depreciation of the leu also provided support. *Filtered inflation*¹, our in-house core CPI indicator, which excludes highly exchange rate sensitive items too, increased marginally, still suggesting that underlying price pressures continued to build-up in August.
- Despite the unexpected fall of the headline figure, we believe that the general outlook of inflation remained broadly unchanged. Romania's CPI growth was dragged down, among others, by unusually low imported inflation, sluggish evolution of commodity prices and large tax cuts. Nonetheless, with the negative effect of tax reductions set to fade out as well as with the reintroduction of the special excise duty on fuels (in two equal steps in 15 September and 1 October), and on the other hand, given the rapidly rising unit labour costs and definitely strong domestic demand (Chart 13), in the following quarters, the annual inflation may increase gradually from its current, still rather subdued, level.
- Our forecast error was entirely due to the sharp fall of unprocessed food prices (for a detailed decomposition of inflation please see Chart 5), with vegetables plunging the most. A seasonal fall was quite likely in August on the back of favourable weather conditions, but the fact data pointed to a more significant drop than we had expected. Nevertheless, only one deviation doesn't make us, and probably neither the central bank, to alter remarkably longer-term inflation projections, as vegetable price evolution is frequently characterized by large swings, and accordingly, even a significant decline can be reversed relatively quickly (Chart 6). In addition, a positive base effect (in September 2016, seasonal unprocessed food prices fell sharply) may also support the annual growth rate to recover next month.
- In our opinion, a potential turnaround in the case of agro-commodity prices, which had started to take shape in the latest period (Chart 7&8), is set to cause more concern to the NBR than a drop of seasonal food CPI, as it would result in secondary impacts not only on the headline, but also on core inflation indicators. With our agro-commodity trackers, apparently, losing impetus and with timelier future prices also pointing a sluggish performance, we deem there is limited room for further significant acceleration in the case of core unprocessed (covering raw meat, milling products and milk) as well as processed food CPI. Cereal futures on financial markets came under pressure in the light of improved production prospects among exporters, particularly in the Black Sea region.
- August's statistics revealed that market services inflation, which is less exposed to global CPI developments, kept up its momentum (Chart 11&12) and durable goods' inflation also remained on an upward trajectory (Chart 9&10). In the case of goods, the following few months could be crucial, as vendors frequently make important changes in their offer prices in this period.
- Summing it up, we reiterate that the downside risks increased undoubtedly, but with the excise duty hike in the pipeline, we are still comfortable with our 2.0% year-end [inflation forecast](#). Nonetheless, given the downward shift in the outlook of core food prices, as well as the lower inflation perspective for the EZ (owing to the euro's rapid appreciation), we think that the odds for launching the policy normalisation process in Q1 2018 instead of Q4 2017 had increased (for more about the monetary policy outlook please see our latest [MPC report](#)).

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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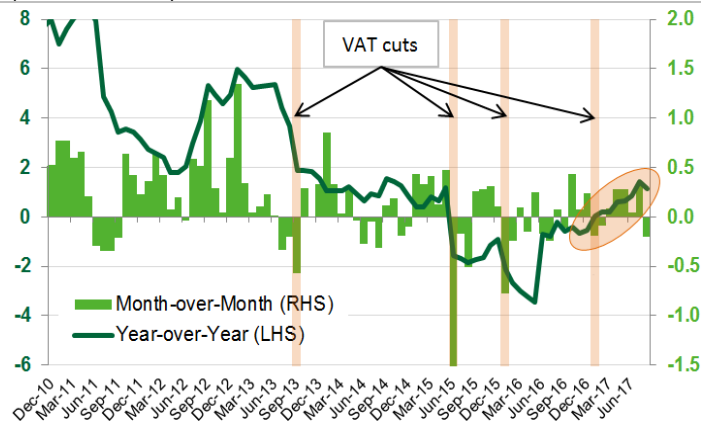
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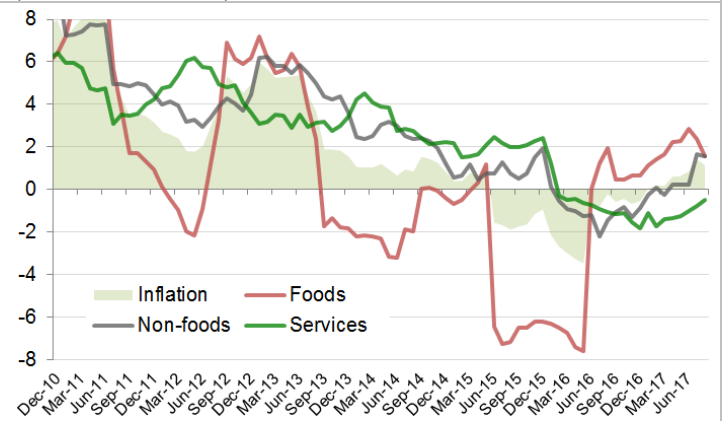
Chart set:

Chart 1: Headline inflation
(%, NSA data)



Sources: NIS, OTP Research

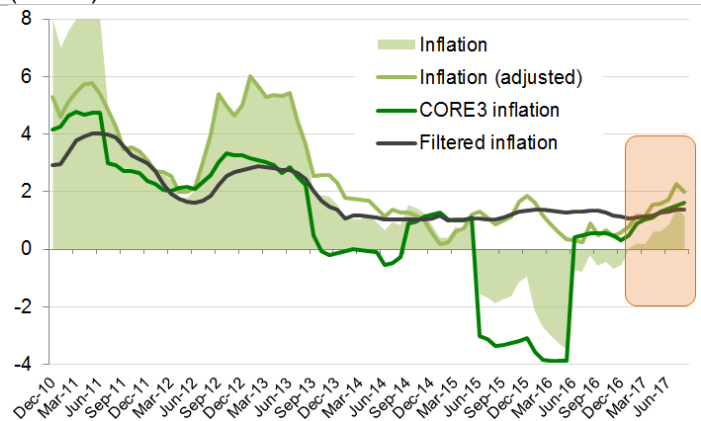
Chart 2: Inflation by its main components
(YoY%, NSA data)



Sources: NIS, OTP Research

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

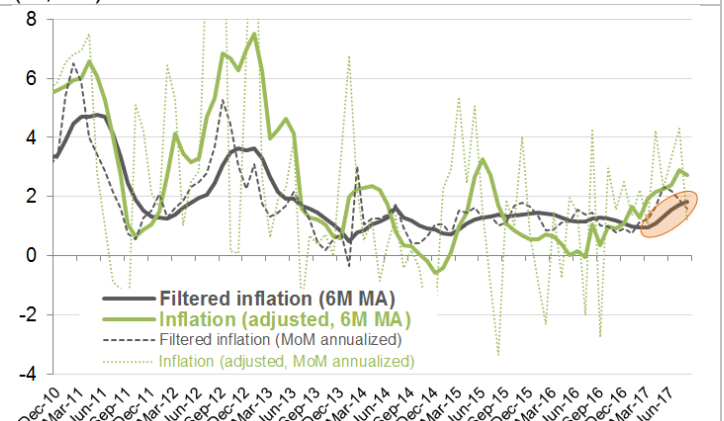
Chart 3: Inflation and underlying processes
(YoY%)



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).

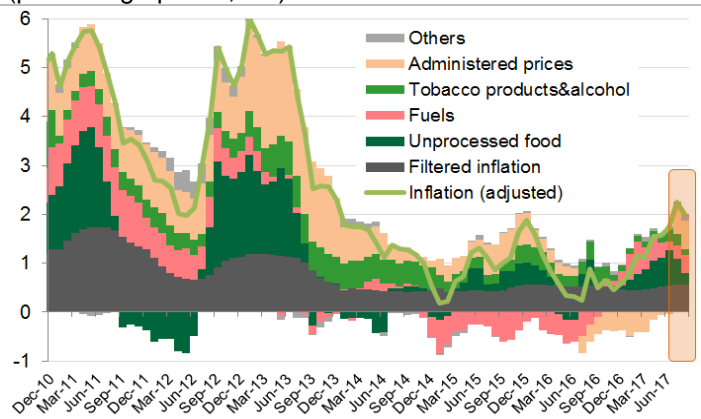
Chart 4: Inflation and filtered inflation
(%, SA)



Sources: NIS, OTP Research

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

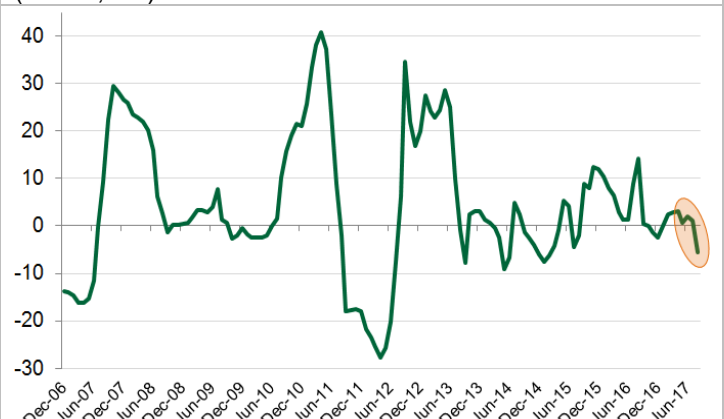
Chart 5: Decomposition of inflation
(percentage points, SA)



Sources: NIS, OTP Research

Note: adjusted by the impact of main tax changes.

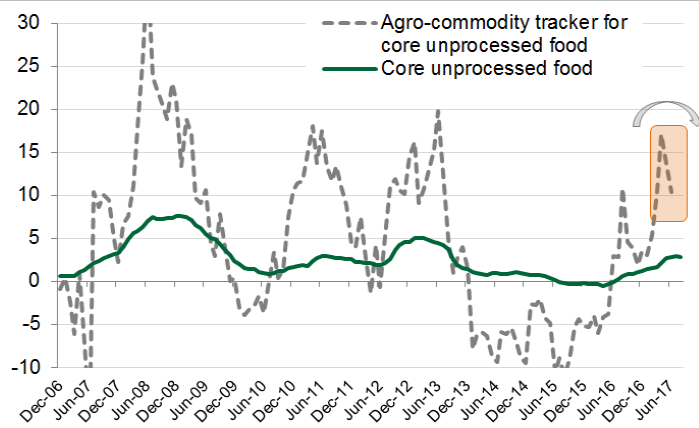
Chart 6: Vegetable's inflation
(YoY%, SA)



Sources: NIS, OTP Research

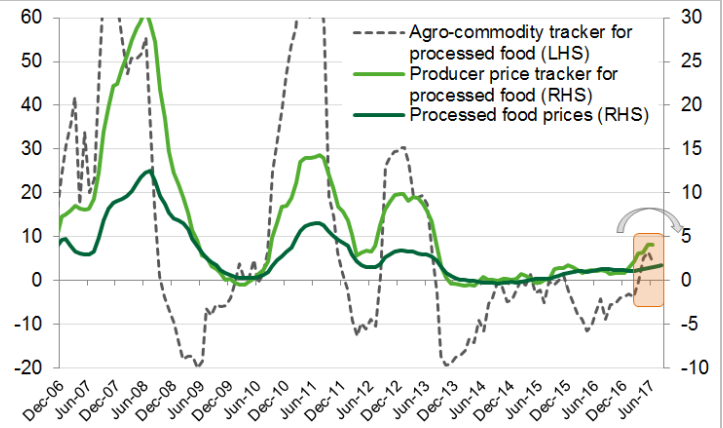
Note: adjusted by the impact of main tax changes.

Chart 7: CPI of core unprocessed foods vs. agro-commodity prices (YoY%, SA)



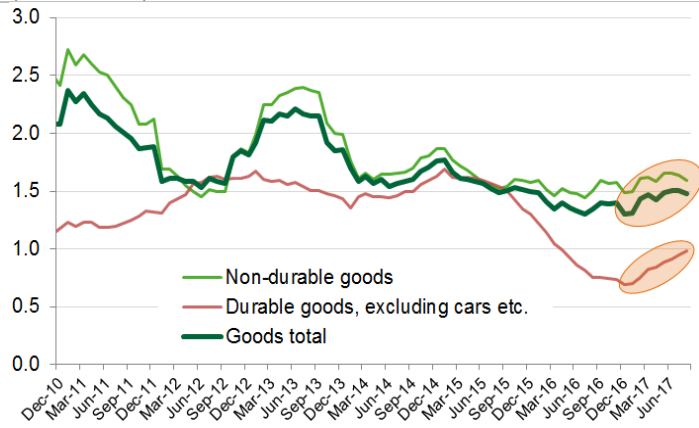
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 8: CPI and PPI of processed foods vs. agro-commodity prices (YoY%, SA)



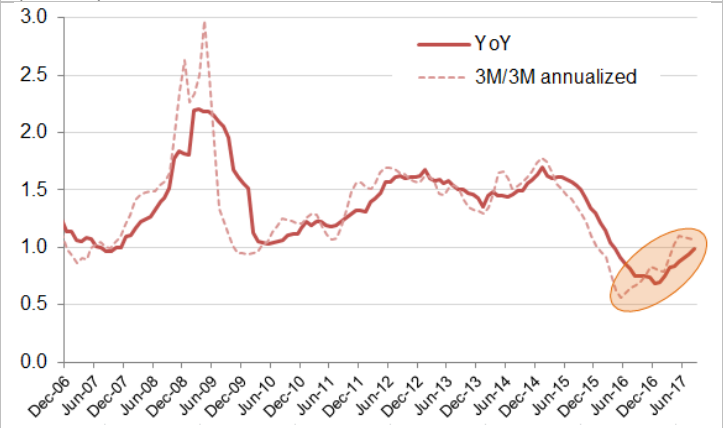
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 9: Goods' inflation (YoY%, SA)



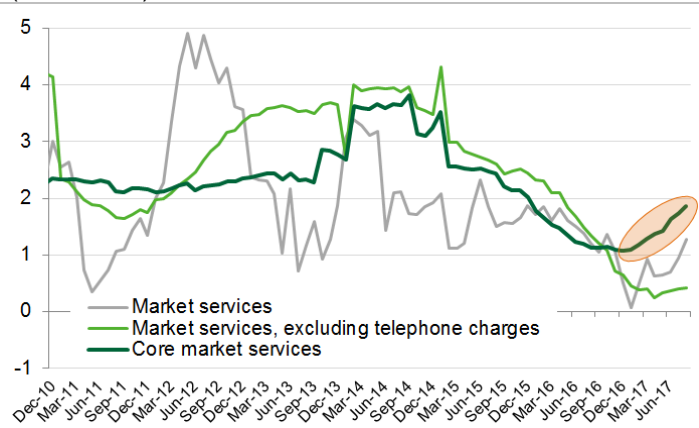
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

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



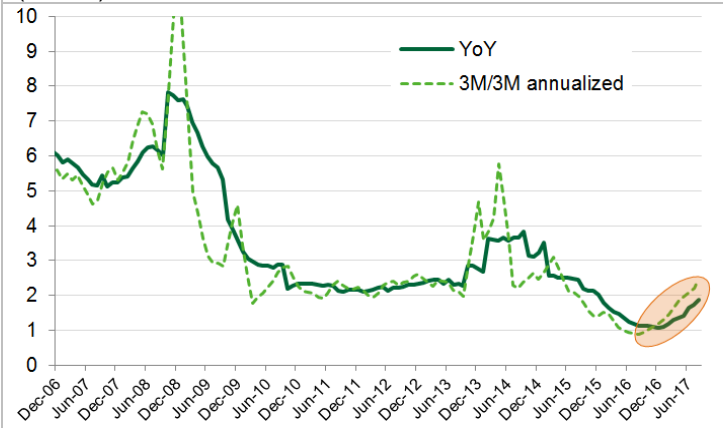
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes.

Chart 11: Market services (YoY%, SA)



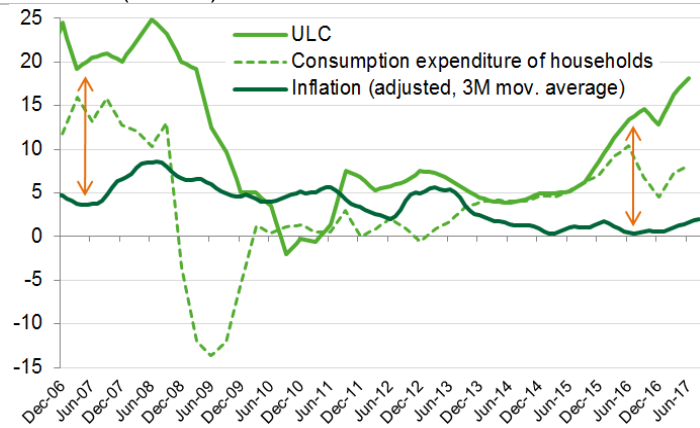
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services**, excludes the EUR/RON-related telephone charges as well as insurances.

Chart 12: Core market services (% SA)



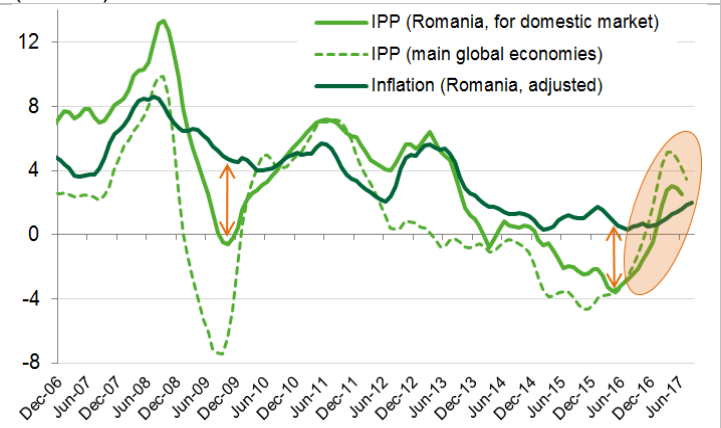
Sources: NIS, OTP Research
Note: adjusted by the impact of main tax changes; **Core market services**, excludes the EUR/RON-related telephone charges as well as insurances.

Chart 13: ULC & households' consumption vs. inflation (YoY %)



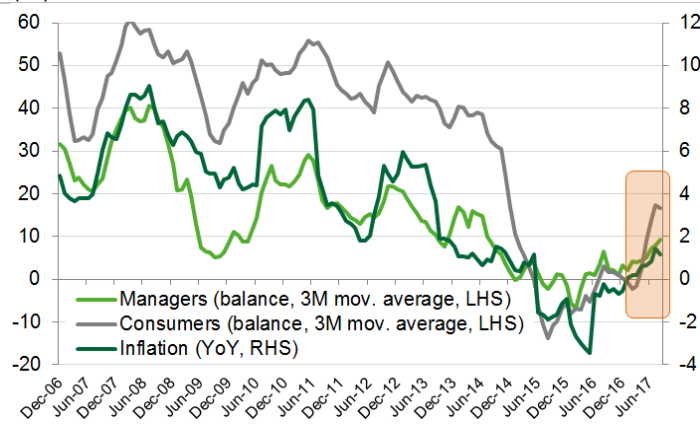
Sources: Eurostat, NIS, OTP Research
 Note: adjusted by the impact of main tax changes.

Chart 14: Industrial production prices vs. inflation (YoY %)



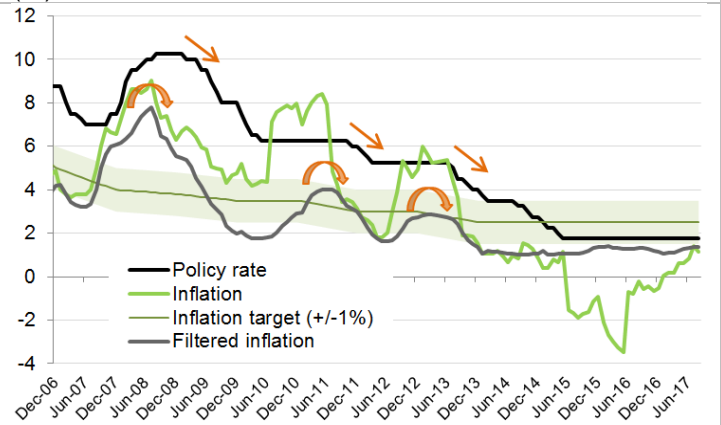
Sources: NIS, OECD, NBSC, OTP Research
 Note: adjusted by the impact of main tax changes; the IPP (main global economies) includes data from EU28, USA and China

Chart 15: Price expectations vs. inflation (%)



Sources: EC, NIS, OTP Research

Chart 16: Policy rate and inflation (%)



Sources: NBR, NIS, OTP Research

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