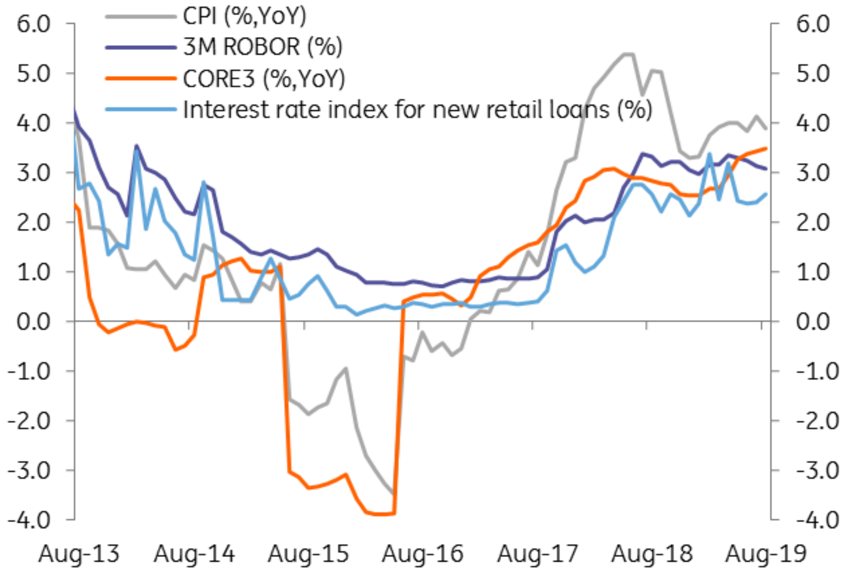
Romania: August inflation inches lower

CPI came in at 3.9% year-on-year in August, falling 0.2 percentage points from the previous month, but 0.1ppt higher than our forecast and the Bloomberg median

The 0.1ppt error on our side came almost exclusively from volatile food prices. Core inflation inched up 0.1ppt to 3.4% year-on-year, near the upper band of the central bank's target interval. Food inflation inched down 0.2ppt to 5.0% YoY in August, while non-food prices dropped 0.4ppt to 3.0% YoY. Services, which are non-tradable, inched 0.1ppt higher to 4.2% YoY. These prices better reflect domestic price pressures and partially the telecom tax applied from the start of the year.

Softer monetary conditions from new rate index for retail loans origination, despite elevated inflation



Source: NBR, NIS, ING

A significant interest rate differential has already attracted hefty capital inflows, prompting central bank interventions of c.EUR1 billion in July to stop the Romanian leu from firming below 4.72/EUR, likely acknowledging that fundamentals require a weaker real effective exchange rate. In fact, NBR Governor Mugur Isarescu mentioned in the Annual Report presentation that "a controlled depreciation", "reasonable, below 5%" is one option to avoid a "rapid deterioration" in the current account.

3.9%

August CPI (YoY)

vs. 3.8% ING forecast

Higher than expected

We see headline inflation at 3.8% by year-end with the risk profile to the forecast skewed to the upside. We expect the NBR to hold rates unchanged in the coming quarters to keep inflation expectations in check, despite the lower global rate environment. If interest rate differentials widen further, prompting significant capital inflows, we could see the NBR loosening liquidity controls to push market rates lower, while keeping the key rate unchanged to retain flexibility if things change rapidly.

The NBR has plenty of room to ease if the economic outlook worsens, but it is constrained by the fiscal stance. Fiscal consolidation is overdue. Markets have given some extra time for this because of the negative rate environment in the eurozone but it is now likely to be delayed by the electoral backdrop.

Assuming some fiscal consolidation post-elections, the NBR could ease its policy stance. First steps are likely to be a loosening in liquidity controls and lower reserve requirements ratios.

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