Romania: CPI surprises to the upside, again and again

Inflation declined less than expected in October and our forecast error came almost exclusively from fuel prices. For the end of 2018, we see inflation at 3.7% with risk balance tilted to the upside. Over the next twelve months, we expect another three key rate hikes of 25bps and see EUR/RON as the main trigger

The National Bank of Romania building in Bucharest

Source: Shutterstock

4.3%

October CPI % YoY

Above ING forecast on fuel prices

Higher than expected

CPI surprise: Supply side factors

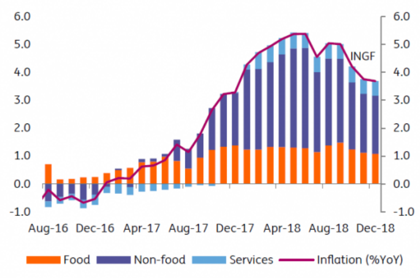
Inflation declined less than expected to 4.3% in October versus our consensus of 4.0% and Bloomberg consensus of 4.1%. Our forecast error came almost exclusively from fuel prices.

However, core inflation remained flat near 2.7%, in line with our expectation.

Food CPI declined by 0.7 percentage points in October to 3.7% year on year on strong base effects. Non-food prices came 1.3ppt down to 5.3% YoY, as the second step in excise duty hike, and the increase in regulated energy prices from October 2017 dropped out of the base.

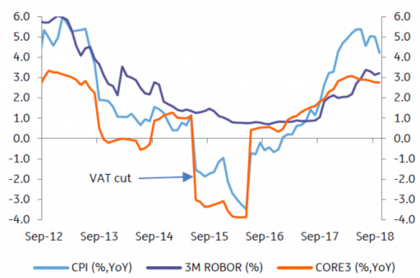
Prices of non-oil fuels such as firewood are likely to have increased by a lot to actually more than offset the decline in gasoline prices. Services CPI inched 0.2ppt higher to 2.7%, with half of the increase coming from phone bills which are linked to the EUR/RON exchange rate. Hence, reflecting the mildly weaker RON.

Fig 1 Large base effect coming in October



Source: NIS, ING

Fig 2 Core inflation tamed, for now



Source: NIS, NBR, ING

Implications for central bank policy: Core inflation feedings doves

Core inflation came in virtually unchanged at 2.7%, which should give some comfort to the central bank in its dovish assessments of the CPI outlook. Both ours and NBR latest forecast see core CPI bottoming in 4Q18.

With core inflation forecast closer to the upper bound of the central bank target band over the policy horizon, we think that more hikes are needed to accommodate supply shocks within the target band limits. However, if the central bank is happy to target the interval and is flexible to overshooting driven by non-core factors, fewer hikes could be needed, but this could risk anchor inflation expectations at a higher level (at the upper bound) and lead to lower policy credibility.

By the end of 2018, we see inflation at 3.7% and at 3.4% by the end of 2019 with the risk balance tilted to the upside. We expect another three key rate hikes of 25bps each by the central bank over the next twelve months and see the EUR/RON as the main trigger.

Without RON depreciation pressures, the central bank is likely to delay rate increases. This is not our base case scenario as we believe that carry would not be enough to offset the weak and deteriorating fundamentals. We view the latest NBR assessment and outlook for the twin deficits as too complacent.