

## Disinflation in Romania is becoming more evident

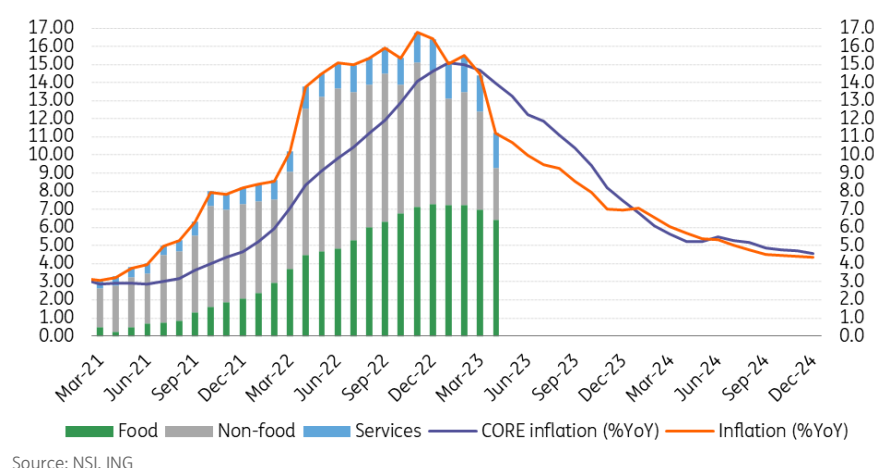
At 11.2%, April inflation surprised to the downside as both the market consensus and our expectations were 11.5%. While it was mainly due to statistical base effects and therefore largely anticipated, the sharp drop in April inflation (from 14.5% in March) should consolidate the market's confidence in Romania's downward inflation trajectory



Mugur Isarescu,  
Governor of the  
Romanian National  
Bank

We are again starting our note by blaming our forecasting error on some unexpected price movements in one category or another. This time it was electricity prices which surprised to the downside, falling by just over 2% versus March against our call for a small increase. Marginal downside surprises are also visible in the service sector, which helped to push core inflation to 14.0% in April, from 14.6% the previous month. We continue to see core inflation printing above the headline rate for the rest of 2023, with the gap between the two likely to close in the first quarter of 2024.

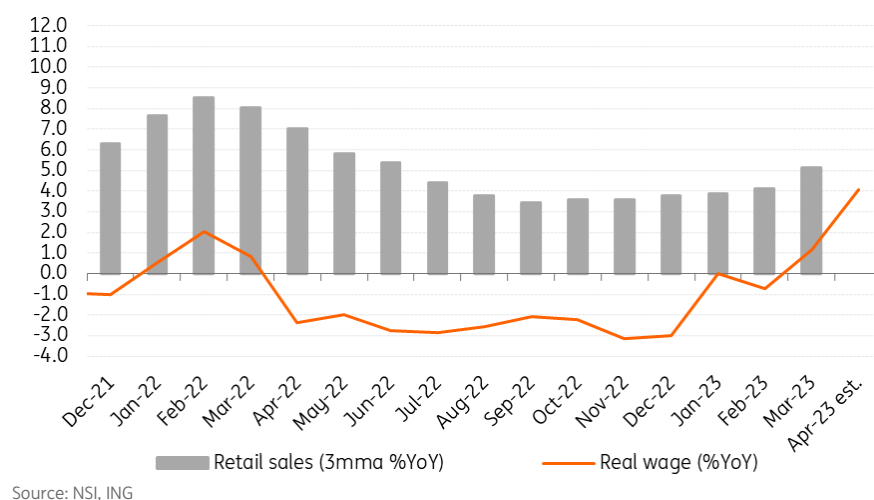
## Inflation (YoY%) and components (ppt)



We have corroborated the latest inflation data with the latest wage data, which again looks impressively strong. The average net wage advanced in March by an eye-catching 15.7%, with above-average growth visible in sectors such as agriculture, IT services, transport and construction, while public sector employees have generally seen below-average wage growth. After a year of negative prints, real wage growth turned positive in March and is likely to remain in positive territory for the foreseeable future.

All in all, the labour market seems to signal a bit of a re-tightening, considering the marginally lower unemployment rate, high labour costs growth and increasing hiring intentions. Among the few mitigations are the slower increase in the total number of employees, and reports that still show a decrease in the labour shortage. In any case, wage growth for the rest of the year looks set to remain quite strong and we revise our estimates for the average net wage advance from 12.0% to 14.5%. This might not be strong enough to exercise meaningful additional inflationary pressures by itself, but it will be propping private consumption.

## Real wage growth turns positive



## May Inflation Report reconfirms the downward inflationary trend

Today, the National Bank of Romania (NBR) Governor Mugur Isarescu presented the bank's latest Inflation Report which incorporates the newest inflation forecasts. The newer inflation profile is only marginally lower than the one from the previous report. The NBR now see the 2023 year-end inflation at 7.1% (from 7.2% initially) while the end-2024 is seen at 4.2%, still above the 1.5-3.5% target range. One of the few surprising moments of today's press conference was when Governor Isarescu said he believed the key rate has peaked at 7.00%.

The surplus liquidity situation was briefly addressed during the press conference, with explanations pointing to large EU fund inflows overlapping capital inflows (presumably accommodated via FX purchases in order to avoid RON appreciation). "Not bothered but not pleased either" seems to sum up the NBR's stance on the subject.

### What we make of it all

For the first time in about two years, the risks to the inflation profile are slightly skewed to the downside. We've had a long-standing forecast of 7.4% inflation at the end of 2023, which we revise to 7.0%, while we acknowledge that risks seem still seem to be skewed to the downside. For the end of 2024, we maintain the 4.1% estimate.

We continue to see the key rate on hold at 7.00% for the rest of 2023, with the first rate cut possible in the first quarter of 2024 once inflation prints below the key rate. In practice, the NBR has already switched to a much looser policy stance by sterilising the excess liquidity at the deposit facility and not at the key rate. From the highs of October 2022, the 3-month rate has been dropping by more than 150 basis points, while the liquidity deficit turned into a record surplus. This is real policy easing, not just fine-tuning.

As usual, the policy stance will be dependent on FX developments. Should any upside pressures on EUR/RON emerge, the NBR will likely be more than willing to provide euro liquidity to the market in order to mop up some of the local currency surplus. We still believe that EUR/RON will be allowed to shift some 2.0-2.5% higher later this year, most likely after inflation is credibly within single digits. While we maintain our view, we must also acknowledge that upside pressure on the pair has not been material and that the adjustment might take a bit longer to occur.

## ROMGBs remain an attractive option within the CEE region

The latest Romanian government bond (ROMGBs) auction confirmed that market demand remains very strong, while supply fell significantly in the second quarter as expected. According to our estimates, MinFin has secured around 60.5% of the planned ROMGBs issuance, by far the most in the Central and Eastern European region. The situation is thus more than comfortable for the rest of the year. We think that MinFin may look to avoid FX issuance of Eurobonds or bonds under local law this year and instead issue more ROMGBs, taking advantage of the frontloading from earlier in the year. However, we think this should not be a problem given current market demand and the decline in supply in recent weeks.

On the fiscal side, as across the CEE region, we see weaker state budget results in the first few months of the year, but for now the Romanian government seems to have the strongest momentum to respond to negative developments and we expect the state budget to remain under control with a targeted deficit of 4.4% of GDP. The inflation profile in Romania, along with the Czech Republic, looks the best in the region, and looking at yield spreads across CEE peers we still see ROMGBs as cheap. Thus, overall, ROMGBs remain our preferred choice within the CEE region.

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