Why we're raising our inflation forecasts for Romania

Romania's October inflation rate came in at 4.67%, above consensus. There are renewed pressures from the drought in the country, and that's prompting us to revise our inflation forecasts from 4.2% to 5% this year and to 4.4% from 4.1% in 2025

The inflationary impact of Summer droughts in Romania are becoming more apparent

The impact of this year's drought seems to become more and more visible

In monthly terms, food inflation came in stronger than we had expected, printing close to a 0.8% advance for the second month in a row. Fruit and vegetable inflation rates were yet again particularly strong, coming in at 3.2% and 2.4% compared to the previous month. Here, fresh fruit stands out the most, with a monthly increase of 7.9%. The impact of this year's drought seems to be becoming increasingly visible.

Non-food inflation came up above our expectations due to a larger-than-expected increase in fuel prices, adding around 0.2pp to the headline number compared to our forecast. This could be an outcome of growing price pressures in other fuel items such as firewood and less related to petrol or diesel prices. Services inflation continues to show persistent stickiness across the board, growing 0.59% versus the previous month, in line with the wage cost component that continues to rise in double digits (13.8% as of September).

In year-on-year terms, both food and non-food inflation accelerated at 4.75% and 3.45%, respectively. Services inflation, on the other hand, despite decelerating slightly from 7.82% to 7.66%, remains at stubbornly high levels.

Most factors and other risks at play point to further upward potential for price pressures. We expect this year's drought to continue to impact food inflation this winter. Moreover, wage growth is set to continue to fuel the fixed cost component of service providers, acting as a brake for this category's disinflation process. What's more, the Constitutional Court recently ruled that a windfall tax on energy producers is unconstitutional, which could represent a risk to the government's ability to subsidise consumers' energy bills in the future. Last but not least, the uncertainty over the potential trade protectionist measures towards Europe stemming from the Republican clean sweep in the US adds further external risks. We are revising our year-end forecast from 4.2% to 5.0% and 2025 year-end forecast from 4.1% to 4.4%.

The policy implications of this release and the future inflation path add visibly to the upside risks for rates next year. What's more, at the November Inflation Report presentation, Governor Isarescu hinted that the Bank is unlikely to continue its easing cycle until a clear structure of future fiscal corrections emerges. This is also in line with our recently published note on the backloading and upside risks at play for interest rates next year.

> All told, we are not yet adjusting our call of 100bp of rate cuts next year, but we acknowledge that the risks of the National Bank of Romania delaying rate cuts until the second or even the third quarter have increased. The key factors influencing this are domestic economic growth falling below potential and our gloomy outlook for eurozone growth next year. These conditions could justify more significant rate cuts in the second half of the year, provided there is greater clarity on inflation and fiscal policies by then. The NBR will continue to fine-tune its policy through a high-uncertainty environment, where risks for rates to stay on hold for longer are skewed to the upside.

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