Romanian inflation getting serious

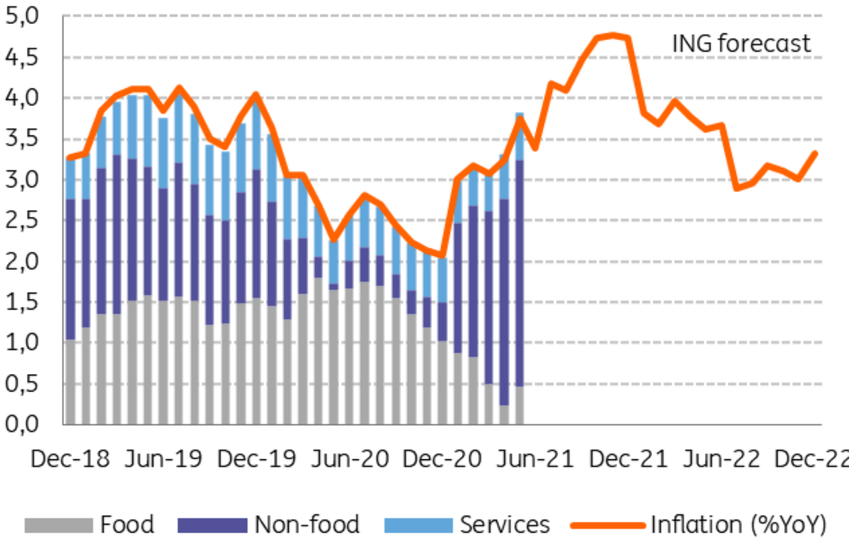
May inflation reached 3.75%, quite a bit above the ING and market call for 3.50% and 3.57%, respectively. Looking forward, inflation will settle rather comfortably above 4.0% starting in the second half of this year and might even flirt with the 5.0% level in the last quarter. We revise our year-end forecast to 4.7%

Source: Shutterstock

As we approach the second half of 2021, the Romanian inflation profile looks set to consolidate above the National Bank of Romania's 3.5% upper limit even earlier than expected. The upside surprise in May -and almost our entire forecast error- came from fresh fruit and vegetable prices, with the former advancing by almost 9% versus the previous month. Coupled with an almost 12% monthly increase in the price of potatoes, it pushed May's food inflation to 1.1% compared to April. This is pushing our year-end forecast from 4.3% to 4.7% and the annual average to 3.9%.

Looking forward, June inflation could be the last to print below 4.0% this year, as a new round of price hikes for gas and electricity is scheduled for July. We see inflation printing in the 4.0%-4.5% range in 3Q21 and 4.5-5.0% range in 4Q21. Starting with 1Q22, favourable base effects will kick in and could bring inflation slightly below 4.0% again, followed by a gradual descent towards the 3.0%-3.50% area throughout 2022.

Inflation (YoY%) and components (ppt)



Source: NSI, ING

Central bank reaction? Not yet, but it's getting tense...

It was not so long ago that we were still thinking inflation could stay within the NBR's 1.5%-3.5% target range this year. Despite the rather significant departure from those expectations, the inflation bout will still be mainly driven by supply-side factors and this should help the NBR to stay on hold for the rest of the year, taking advantage of the relatively high interest rate differential versus its peers. Yes, today's inflation increases the chance of seeing a rate hike in 2021, but we're not there yet and might just get away without one.

We maintain our view for a gradually firmer liquidity stance as we move ahead into 2021, with rate hikes more likely in the first half of 2022. The end of 2022 should see the key rate at 1.75% with risks skewed to the upside. Our main issue with this rationale is that liquidity management is probably a blunter tool in anchoring inflation expectations compared to a "classical" rate hike. Hence, if the NBR determines that expectations are starting to drive the inflation rate higher, we might see straight rate hikes as soon as 4Q21.

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