

Romanian inflation overshoots expectations in January

Through-the-roof electricity prices (+18.4% vs the previous month) have pushed annual inflation back to 3.0%. More important, in 2021 energy prices will be included in the core inflation rate, which just reached 4.3% last month



Source: Shutterstock

3.0% January inflation

Higher than expected

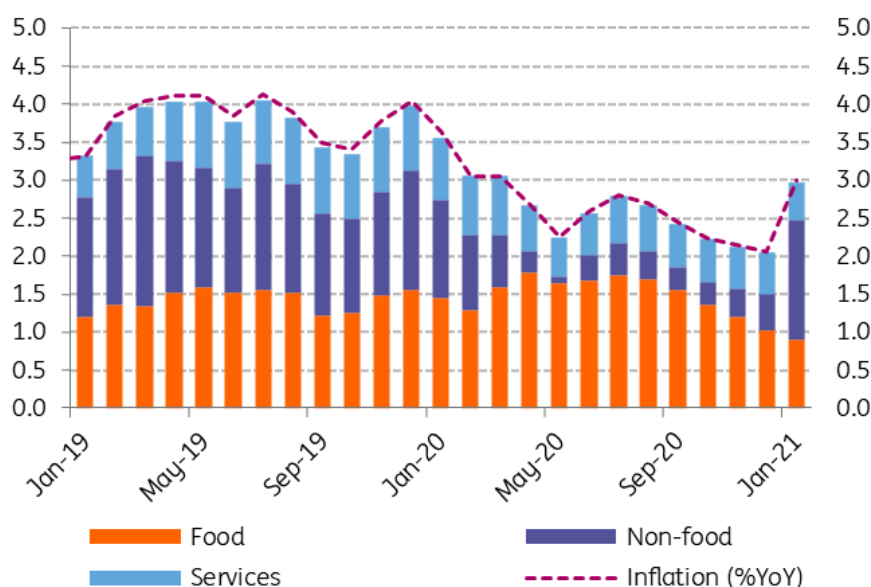
Romanian inflation has reached a 10-month high, surprising the consensus and a whopping 0.5ppt more than we expected. The entire forecast error on our side came from electrical energy prices, the 18.4% month-on-month increase coming way above our estimate.

The increase in electrical energy prices is a result of retail market liberalisation which occurred on 1

January 2021. Households have the option to sign new contracts with other energy distributors but so far it seems that not many have bothered to look for alternatives on the competitive market. While last month's volatility should not occur again in the following months, the energy price dynamic will be a key factor of volatility in inflation for some months or even quarters to come.

Besides its significant impact on headline inflation, the full liberalisation of the energy market means that going forward, electrical energy prices will be included in the CORE inflation calculation. And what a difference this can make to the core inflation profile! Instead of a gradual shift towards the 2.0-2.5% area, as in the central bank's latest Inflation Report forecast, we now see the core inflation rate printing between 3.0% and 3.5% for most of the year, with possible overshoots in the next couple of months.

CPI (YoY%) and its main components (ppt)



Source: NIS, ING

Policy impact? Not really

We don't expect the National Bank of Romania to react to this inflation spike as it has a clear one-off driver. However, our view that the easing cycle has found a bottom is now reinforced. We renew our call for the key rate to remain at 1.25% at least through the first half of next year.

In the FX space, the already limited room for some leu depreciation has probably got even more limited after today's inflation print, due to the still significant effect that the FX rate has for Romanian inflation. Hence, while we maintain our 4.92 year-end forecast (which is already below most estimates), we do admit that the chances of seeing another year of rock-solid FX stability are on the rise. Liquidity conditions are likely to be adjusted depending on the FX pressures, as maintaining the leu's stability might require some hefty FX intervention.

While some of January increase in electricity prices will be reversed in the coming months, the impact on this year's inflation is clearly on the upside. For now we maintain our year-

end inflation forecast at 2.7% but acknowledge that the risks are for a higher print.

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