

Romania: inflation forecast update

We revise down year-end inflation forecast amid declining soft commodity futures prices and lower energy prices. Inflationary pressures should ease after the first quarter, due to favourable energy-related statistical base effect. We see NBR holding key rate steady at 7.00% throughout 2023. Persistent and broad-based features of the current high inflation suggests that it should not decline quickly and hence upside risks to inflation trajectory remain.

Above target inflation over the policy horizon

Analysts:

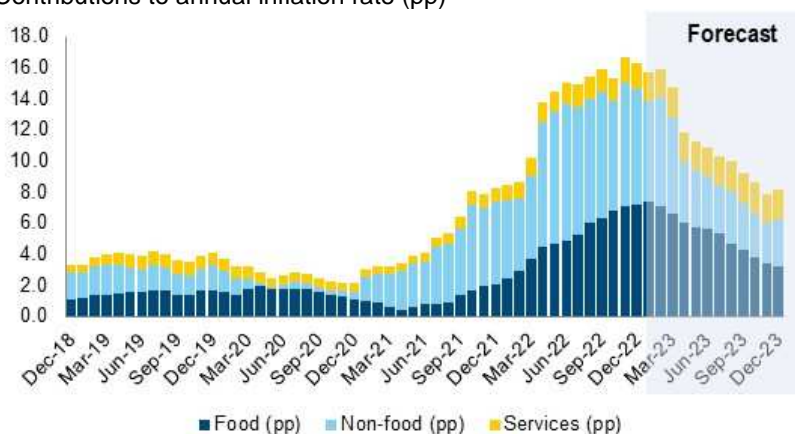
Dorina Ilasco
dorina.ilasco@bcr.ro

Ciprian Dascalu
ciprian.dascalu@bcr.ro

Inflation has been the main macro topic for the past year around the world and it is likely to remain in 2023. Therefore, we decided to release an updated view on Romania consumer prices, due to some changes in forecast assumptions. We see inflation at 8.0% by year-end vs. the 8.7% previously, after peaking at 16.8% in November 2022, the fastest pace in almost 20 years. We expect core inflation to peak-out in February 2023 at 15.4% and remain above headline inflation over the entire projection horizon. Headline inflation is projected to decline to around 5.0% by end- 2024, still above the upper bound of the NBR’s target range of 2.5%±1pp over the medium term. Uncertainties around our inflation outlook remain elevated over the short term and depend on domestic and EU growth profiles, while the war in Ukraine and re-opening of China could potentially have meaningful impact on world commodity prices.

The downward revision of the 2023 inflation outlook is particularly related to lower energy prices, given the price caps on electricity and natural gas prices over the next couple of years and the assumed decline in soft commodity prices, in line with their futures prices.

Fig. 1: Food and non-food prices behind disinflation process in 2023
 Contributions to annual inflation rate (pp)



Source: NIS, BCR Research

Romania Macro & FI Research

Ciprian Dascalu (Chief Economist)

Dorina Ilasco (Senior Economist)

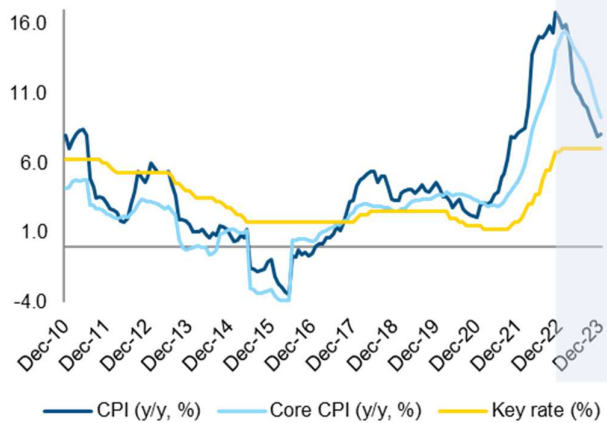
Eugen Sinca (Senior Economist)

Vlad Ionita (Quantitative analyst)

Note: Past performance is not necessarily indicative of future results.

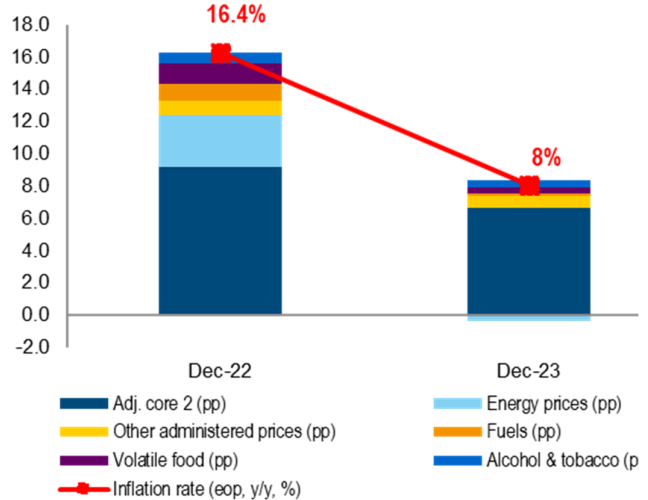
With potentially slowing inflation, we believe that the central bank will keep the key rate on hold at 7.00% throughout 2023. Meanwhile, liquidity management, the NBR’s favourite policy tool, is likely to be actively used in the following quarters, depending on the EUR/RON and upcoming inflation readings.

Fig. 2: Double-digit core inflation for most of 2023
 CPI inflation (core and headline) vs. NBR key rate



Source: NIS, NBR, BCR Research

Fig. 3: Large contribution from core inflation
 Contribution to year-end inflation rate (pp)



Source: NIS, NBR, BCR Research

Headline inflation is likely to remain elevated in the short term (near or above the 15.0% y/y), before falling sharply (-3pp) at the beginning of the second quarter, due to a strong energy-related statistical base effect, and ending the year at 8.0% y/y, 0.7pp lower than to our previous forecast update released in August 2022.

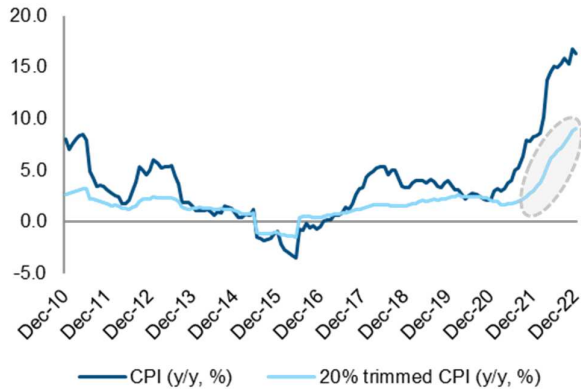
Core inflation (CPI less administered, volatile food and fuels, tobacco, and alcohol), the central bank's preferred gauge for tracking underlying inflation pressures, is projected to peak just above the 15.0% in February this year, remain in double-digit territory until the last quarter of this year and stay above headline inflation at least over the following couple of years. We think that potentially cooling core inflation should give the central bank some breathing room on rates, especially as other CEE central banks already signalled the end of their hiking cycles.

Before offering more details on the current assumptions behind the forecasted path for headline inflation, we took a different look at the historical CPI data to see how broad-based the recent high inflation is. For this, we calculate a 20% trimmed-mean inflation, which is basically an alternative approach of measuring inflation by eliminating 10% of the most volatile m/m consumer price changes from both ends of the distribution. After removing the outliers, the trimmed inflation reveals that the current high inflation is not only a result of a sharp increase in the prices of a few items, and it is broad-based (see fig. 4). The broad-based nature indicates that the current high inflation should not go away so quickly, thus potentially making it harder for the central bank to bring inflation under control over the medium term.

In our view, the uncertainties surrounding our inflation projection remain elevated over the short term and depend on domestic and EU economic growth profiles. The war in Ukraine is still playing a major role and the re-opening of China's economy should certainly influence the global economy, with both factors potentially having a meaningful impact on world commodity prices.

Fig. 4: Trimmed inflation signals persistent and broad-based price growth

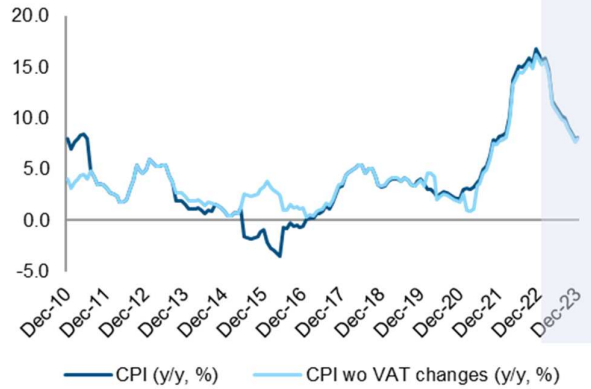
CPI inflation vs. trimmed inflation rate



Source: NIS, BCR Research

Fig. 5: Recent VAT hikes add just 0.1pp to year-end inflation

CPI inflation vs. CPI without VAT changes

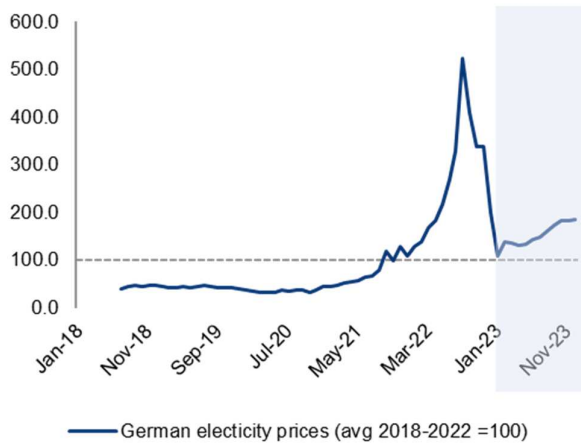


Source: NIS, BCR Research

After hitting all-time highs in 2022, the global energy market is likely to be more stable this year, with a mild winter and calmer energy prices. Futures prices indicate that electricity and natural gas prices should moderate in 2023, though stay significantly above the five-year average for some time (see fig. 6 and 7).

Fig. 6: Electricity futures prices 50% higher vs. 5Y average

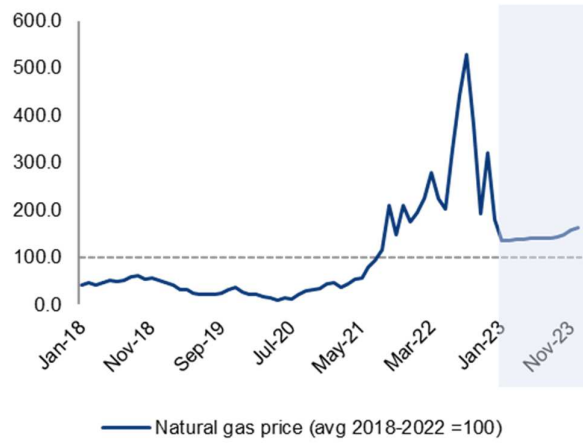
Electricity price vs. 5Y average, futures curve



Source: Bloomberg, BCR Research

Fig. 7: Natural gas futures prices 40% higher vs. 5Y average

Natural gas price vs. 5Y average, futures curve



Source: Bloomberg, BCR Research

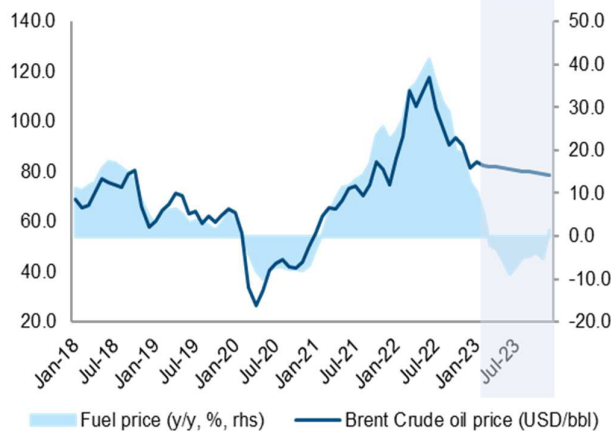
Turning back to our newest projection, we reiterate that the downward revision for 2023 is particularly related to exogenous factors such as volatile commodity prices and government measures to tackle them.

The new fiscal measures, those designed to keep price caps on electricity and natural gas prices until March 2025 and establishing electricity tariffs based on actual consumption, not on the average consumption of 2021, explain nearly half of our forecast revision. On the other hand, the short-term inflation outlook is likely to be only slightly affected by the recently

introduced VAT rate hike from 9% to 19% for non-alcoholic drinks that contain added sugar and from 5% to 9% for hotel accommodation, restaurant and catering services starting January 1. Assuming a full and immediate pass-through into final prices, these could have an impact of 0.1pp on the annual figure, all other things equal (see fig. 5). Prices for mandatory car insurance is also expected to go higher following the rise in the contribution to the Insurance Guarantee Fund (from 2.5% to 4%). According to our estimates, the measure may have an upward impact of less than 0.1pp in 2023, assuming low double-digit price growth for mandatory car insurance. In the case of a much sharper surge (closer to a mid-double-digit advance), it would have a sizable impact on the CPI rate. Supply-side pressures related to the new hike in excise duties for tobacco as of April are already visible, as the most important producers partially increased in advance cigarette prices starting with late December or mid-January.

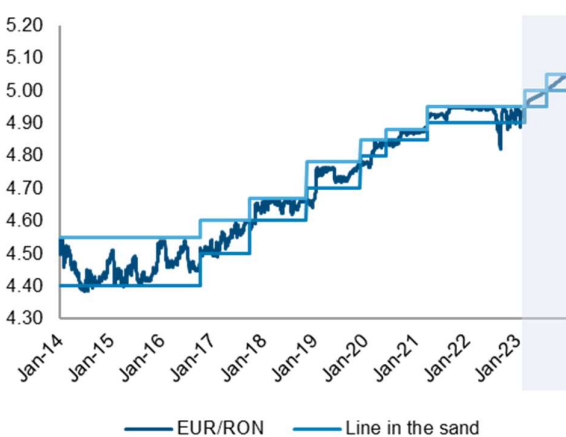
Fuel prices should decline marginally this year, due to the recent removal of the compensation for car fuel of 50 bani/litre as of January limited to some extent by the cuts in excise duties for gasoline and diesel, and firewood prices which are capped until the end of March. On top of these, Brent Crude oil futures prices are averaging 81 USD per barrel this year, down 18% relative to 2022 (see fig. 8). According to our estimates, a 10% drop in oil price should push overall inflation down by about 0.4pp within one-year time, due to both first- and second-round effects (*ceteris paribus*).

Fig. 8: Lower oil prices on weaker global demand
 Fuel price vs. Brent crude oil price, futures curve



Source: NBR, Bloomberg, BCR Research

Fig. 9: Gradual depreciation of the local currency
 EURRON rate and forecast



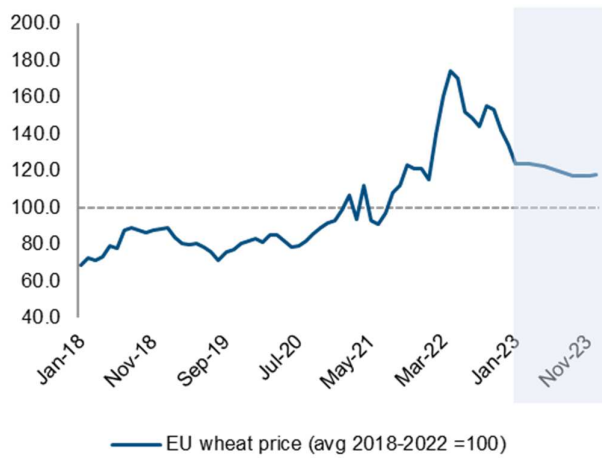
Source: NBR, BCR Research

Our year-end EURRON estimate stands at 5.05. Hence, we expect the depreciation to be gradual (about 2% on average), in line with past years, as fundamentals should ultimately prevail, and the RON should start to weaken once the offshore inflows into local currency sovereign debt fend-away. Furthermore, our estimates show that EURRON dynamics have an asymmetric effect on consumer prices and that a 1% depreciation of the leu against the euro should push consumer prices higher by about 0.25-0.3% over the following twelve months.

Inflationary pressures coming from food items are likely to ease. Food prices should increase slower in 2023 compared to the previous year, as prices of some global soft commodities like wheat, milk, pork meat, sunflower seed oil

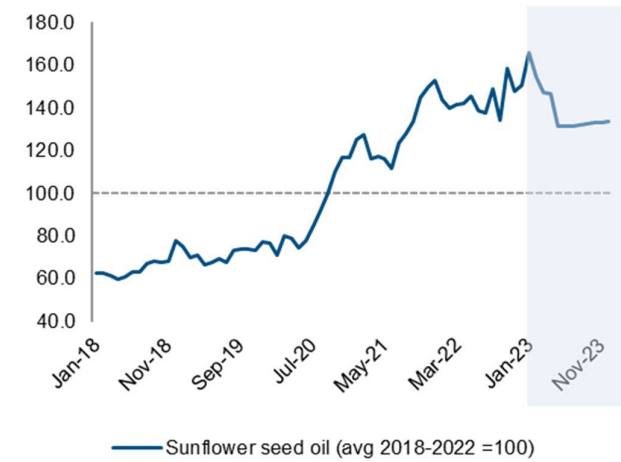
and sugar are seen to decline based on their future contracts (see fig. 10-15).

Fig. 10: Wheat futures fall sharply into the summer
 EU wheat price vs. 5Y average, future curve



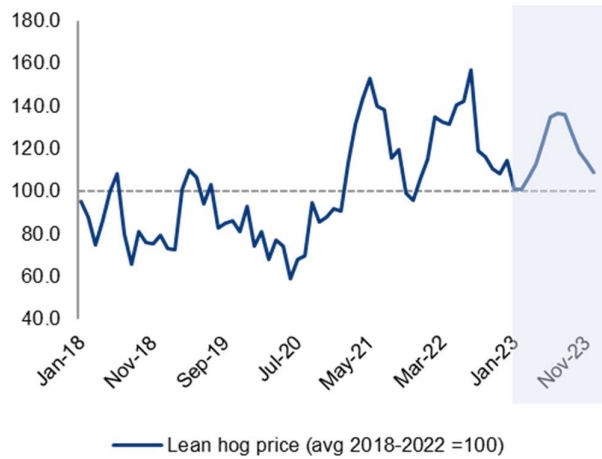
Source: Bloomberg, BCR Research

Fig. 11: Sunflower seed oil futures decline marginally
 Sunflower seed oil price vs. 5Y average, future curve



Source: Bloomberg, BCR Research

Fig. 12: Cooling pork meat futures
 Lean hog price vs. 5Y average, future curve



Source: Bloomberg, BCR Research

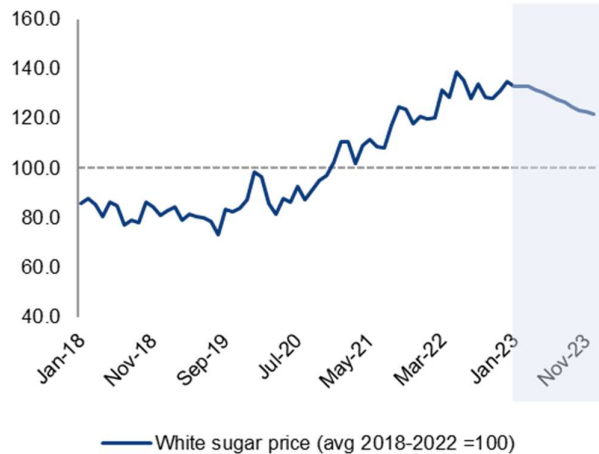
Fig. 13: Milk futures drop significantly
 Milk price vs. 5Y average, future curve



Source: Bloomberg, BCR Research

Fig. 14: White sugar futures decline gradually

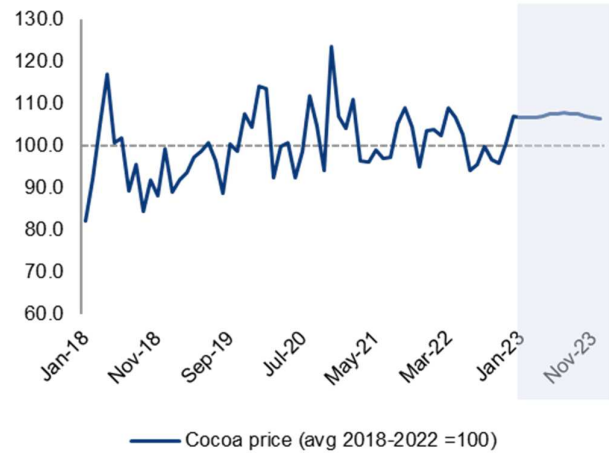
White sugar price vs. 5Y average, future curve



Source: Bloomberg, BCR Research

Fig. 15: Cocoa futures inch higher

Cocoa price vs. 5Y average, future curve



Source: Bloomberg, BCR Research

Market impact

Next NBR rate setting meeting is scheduled for 9 February. We expect no change in monetary policy conditions after January dovish hike which combined with the drop in commitment to tight liquidity management from press release actually led to an easing in monetary conditions afterwards.

Updated inflation forecast is due for release after the meeting with the new *Inflation Report*. In the communique after the previous meeting, the NBR was expecting inflation 'to reach one-digit levels in 2023 Q3 already'. Furthermore, central bank's spokesman Dan Suciuc said that price growth in Romania will probably ease to about 7% by the end of this year.

Lower inflation outlook is mostly priced into ROMGBs, in our view. At the same time, a significant deceleration in inflation should imply higher 'two-way flexibility' on FX. The NBR already signalled its discomfort with RON strengthening by loosening money market liquidity management.

Erste Group Research
Special Report | Romania | Economy
6. February 2023

Group Research

Head of Group Research Friedrich Mostböck, CEFA®, CESGA®	+43 (0)5 0100 11902
CEE Macro/Fixed Income Research Head: Juraj Kotian (Macro/FI) Katarzyna Rzentarzewska (Fixed income) Jakub Cery (Fixed income)	+43 (0)5 0100 17357 +43 (0)5 0100 17356 +43 (0)5 0100 17384
Croatia/Serbia Alen Kovac (Head) Mate Jelić Ivana Rogic	+385 72 37 1383 +385 72 37 1443 +385 72 37 2419
Czech Republic David Navratil (Head) Jiri Polansky Michal Skorepa	+420 956 765 439 +420 956 765 192 +420 956 765 172
Hungary Orsolya Nyeste János Nagy	+361 268 4428 +361 272 5115
Romania Ciprian Dascalu (Head) Eugen Sinca Dorina Ilasco Vlad Nicolae Ionita	+40 3735 10108 +40 3735 10435 +40 3735 10436 +40 7867 15618
Slovakia Maria Valachyova (Head) Matej Hornak	+421 2 4862 4185 +421 902 213 591
Major Markets & Credit Research Head: Gudrun Egger, CEFA® Ralf Burchert, CEFA® (Sub-Sovereigns & Agencies) Hans Engel (Global Equities) Margarita Grushanina (Austria, Quant Analyst) Peter Kaufmann, CFA® (Corporate Bonds) Heiko Langer (Financials & Covered Bonds) Stephan Lingnau (Global Equities) Carmen Riefler-Kowarsch (Financials & Covered Bonds) Rainer Singer (Euro, US) Bernadett Povazsai-Römhild, CEFA®, CESGA® (Corporate Bonds) Elena Stalov, CIAA® (Corporate Bonds) Gerald Walek, CFA® (Euro, CHF)	+43 (0)5 0100 11909 +43 (0)5 0100 16314 +43 (0)5 0100 19835 +43 (0)5 0100 11957 +43 (0)5 0100 11183 +43 (0)5 0100 85509 +43 (0)5 0100 16574 +43 (0)5 0100 19632 +43 (0)5 0100 17331 +43 (0)5 0100 17203 +43 (0)5 0100 19641 +43 (0)5 0100 16360
CEE Equity Research Head: Henning Erikuchen Daniel Lion, CIAA® (Technology, Ind. Goods & Services) Michael Marschallinger, CFA® Nora Nagy (Telecom) Christoph Schultes, MBA, CIAA® (Real Estate) Thomas Unger, CFA® (Banks, Insurance) Vladimira Urbankova, MBA (Pharma) Martina Valenta, MBA	+43 (0)5 0100 19634 +43 (0)5 0100 17420 +43 (0)5 0100 17906 +43 (0)5 0100 17416 +43 (0)5 0100 11523 +43 (0)5 0100 17344 +43 (0)5 0100 17343 +43 (0)5 0100 11913
Croatia/Serbia Mladen Dodig (Head) Boris Pavalek, CFA® Marko Plastic Matej Pretkovic Iva Tomic Bruno Barbic Davor Spoljar, CFA®	+381 11 22 09178 +385 99 237 2201 +385 99 237 5191 +385 99 237 7519 +385 99 237 1662 +385 99 237 1041 +385 72 37 2825
Czech Republic Petr Bartek (Head) Jan Safranek	+420 956 765 227 +420 956 765 218
Hungary József Miró (Head) András Nagy Tamás Pleiser, CFA®	+361 235 5131 +361 235 5132 +361 235 5135
Poland Cezary Bernatek (Head) Piotr Bogusz Lukasz Jarczak Krzysztof Kawa Jakub Szkopek	+48 22 257 5751 +48 22 257 5755 +48 22 257 5754 +48 22 257 5752 +48 22 257 5753
Romania Caius Rapanu	+40 3735 10441
Group Markets	
Head of Group Markets Oswald Huber	+43 (0)5 0100 84901
Group Markets Retail and Agency Business Head: Christian Reiss	+43 (0)5 0100 84012
Markets Retail Sales AT Head: Markus Kaller	+43 (0)5 0100 84239
Group Markets Execution Head: Kurt Gerhold	+43 (0)5 0100 84232
Retail & Sparkassen Sales Head: Uwe Kolar	+43 (0)5 0100 83214
Markets Retail Sales CZ Head: Roman Choc	+420 956 765 374
Markets Retail Sales HUN Head: Peter Kishazi	+36 1 23 55 853

GM Retail Products & Business Development

Head: Martin Langer	+43 (0)50100 11313
Corporate Treasury Product Distribution AT Head: Martina Kranzl-Carvell	+43 (0)5 0100 84147
Group Securities Markets Head: Thomas Einramhof	+43 (0)50100 84432
Institutional Distribution Core Head: Jürgen Niemeier	+49 (0)30 8105800 5503
Institutional Distribution DACH+ Head: Marc Frieberthäuser	+49 (0)711 810400 5540
Bernd Bollhof	+49 (0)30 8105800 5525
Andreas Goll	+49 (0)711 810400 5561
Mathias Gindele	+49 (0)711 810400 5562
Ulrich Inhofner	+43 (0)5 0100 85544
Sven Kienzle	+49 (0)711 810400 5541
Rene Klasen	+49 (0)30 8105800 5521
Christopher Lampe-Traupe	+49 (0)30 8105800 5523
Danijel Popovic	+49 1704144713
Michael Schmotz	+43 (0)5 0100 85542
Klaus Vosseler	+49 (0)711 810400 5560
Slovakia Sarlota Sipulová Monika Smělková	+421 2 4862 5619 +421 2 4862 5629
Institutional Distribution CEE & Insti AM CZ Head: Antun Burić Jaromir Malak	+385 (0)7237 2439 +43 (0)5 0100 84254
Czech Republic Head: Ondřej Čech Milan Bartoš Jan Porvich	+420 2 2499 5577 +420 2 2499 5562 +420 2 2499 5566
Institutional Asset Management Czech Republic Head: Petr Holeček Petra Maderová Martin Peřina David Petráček Blanka Weinerová Petr Valenta	+420 956 765 453 +420 956 765 178 +420 956 765 106 +420 956 765 809 +420 956 765 317 +420 956 765 140
Croatia Head: Antun Burić Zvonimir Tukač Natalija Zujic	+385 (0)7237 2439 +385 (0)7237 1787 +385 (0)7237 1638
Hungary Head: Peter Cszizmadia Gábor Bálint Ádám Szőnyi	+36 1 237 8211 +36 1 237 8205 +36 1 237 8213
Romania and Bulgaria Head: Octavian Florin Munteanu	+40 746128914
Group Institutional Equity Sales Head: Brigitte Zeitlberger-Schmid Werner Fürst Viktoria Kubalcova Thomas Schneidhofer Oliver Schuster	+43 (0)50100 83123 +43 (0)50100 83121 +43 (0)5 0100 83124 +43 (0)5 0100 83120 +43 (0)5 0100 83119
Czech Republic Head: Michal Řízek Jifi Feres Martin Havlan Pavel Krabicka	+420 224 995 537 +420 224 995 554 +420 224 995 551 +420 224 995 411
Poland Head: Jacek Jakub Langer Tomasz Galanciak Wojciech Wysocki Przemyslaw Nowosad Grzegorz Stepień	+48 22 257 5711 +48 22 257 5715 +48 22 257 5714 +48 22 257 5712 +48 22 257 5713
Croatia Matija Tkalicanac	+385 72 37 21 14
Hungary Nandori Levente Krisztian Kandik Balasz Zankay	+ 36 1 23 55 141 + 36 1 23 55 162 + 36 1 23 55 156
Romania Liviu Avram	+40 3735 16569
Group Fixed Income Securities Markets Head: Goran Hoblaj	+43 (0)50100 84403
Fixed Income Flow Sales Head: Gorjan Hoblaj Margit Hraschek Christian Kienesberger Ciprian Mitu Bernrd Thaler Zsuzsanna Toth	+43 (0)5 0100 84403 +43 (0)5 0100 84117 +43 (0)5 0100 84323 +43 (0)5 0100 85612 +43 (0)5 0100 84119 +36-1-237 6209
Poland: Pawel Kielek Michal Jarmakowicz	+48 22 538 6223 +43 50100 85611
Fixed Income Flow Trading Head: Gorjan Hoblaj	+43 (0)5 0100 84403
Group Fixed Income Securities Trading Head: Goran Hoblaj	+43 (0)50100 84403
Group Equity Trading & Structuring Head: Ronald Nemeč	+43 (0)50100 83011
Business Support Bettina Mahoric	+43 (0)50100 86441

Disclaimer

This publication was prepared by Erste Group Bank AG or any of its consolidated subsidiaries (together with consolidated subsidiaries "Erste Group") independently and objectively as other information pursuant to the Circular of the Austrian Financial Market Authority regarding information including marketing communication pursuant to the Austrian Securities Supervision Act. This publication serves interested investors as additional source of information and provides general information, information about product features or macroeconomic information without emphasizing product selling marketing statements. This publication does not constitute marketing communication pursuant to Art. 36 (2) Austrian Securities Supervision Act as no direct buying incentives were included in this publication, which is of information character. This publication does not constitute investment research pursuant to § 36 (1) Austrian Securities Supervision Act. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and it is not subject to the prohibition on dealing ahead of the dissemination of investment research. The information only serves as non-binding and additional information and is based on the level of knowledge of the person in charge of drawing up the information on the respective date of its preparation. The content of the publication can be changed at any time without notice. This publication does not constitute or form part of, and should not be construed as, an offer, recommendation or invitation to subscribe for or purchase any securities, and neither this publication nor anything contained herein shall form the basis of or be relied on in connection with or act as an inducement to enter into any contract or inclusion of a security or financial product in a trading strategy. Information provided in this publication are based on publicly available sources which Erste Group considers as reliable, however, without verifying any such information by independent third persons. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forecasts, opinions and expectations contained herein are fair and reasonable, Erste Group (including its representatives and employees) neither expressly nor tacitly makes any guarantee as to or assumes any liability for the up-to-dateness, completeness and correctness of the content of this publication. Erste Group may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Erste Group endorses, recommends or approves any material on the linked page or accessible from it. Neither a company of Erste Group nor any of its respective managing directors, supervisory board members, executive board members, directors, officers of other employees shall be in any way liable for any costs, losses or damages (including subsequent damages, indirect damages and loss of profit) howsoever arising from the use of or reliance on this publication. Any opinion, estimate or projection expressed in this publication reflects the current judgment of the author(s) on the date of publication of this document and do not necessarily reflect the opinions of Erste Group. They are subject to change without prior notice. Erste Group has no obligation to update, modify or amend this publication or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. The past performance of securities or financial instruments is not indicative for future results. No assurance can be given that any financial instrument or issuer described herein would yield favorable investment results or that particular price levels may be reached. Forecasts in this publication are based on assumptions which are supported by objective data. However, the used forecasts are not indicative for future performance of securities or financial instrument. Erste Group, its affiliates, principals or employees may have a long or short position or may transact in the financial instrument(s) referred to herein or may trade in such financial instruments with other customers on a principal basis. Erste Group may act as a market maker in the financial instruments or companies discussed herein and may also perform or seek to perform investment services for those companies. Erste Group may act upon or use the information or conclusion contained in this publication before it is distributed to other persons. This publication is subject to the copyright of Erste Group and may not be copied, distributed or partially or in total provided or transmitted to unauthorized recipients. By accepting this publication, a recipient hereof agrees to be bound by the foregoing limitations. This document is only made to or directed at investment professionals (as that term is defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial promotion) Order 2005 ("FPO")) or to persons for whom it would otherwise be lawful to distribute it. Accordingly, persons who do not have professional experience in matters relating to investments should not rely on this document.

© Erste Group Bank AG 2023. All rights reserved.

Published by:

Erste Group Bank AG
Group Research
1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna

Erste Group Homepage www.erstegroup.com