Inflation rate

Strong disinflation in July

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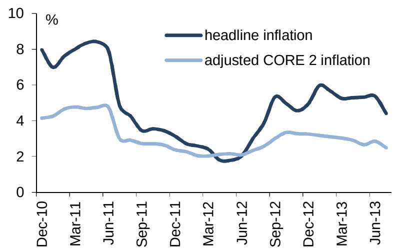
Headline and CORE inflation



Source: NIS, BCR Research

The extent of the disinflation process in July exceeded our expectation and market consensus. Monthly inflation was negative (-0.34%), while annual inflation fell strongly to 4.4%. Adjusted CORE 2 inflation, which is closely monitored by the NBR and excludes volatile prices, administered prices, tobacco and alcohol from headline inflation, fell to 2.5% y/y.

Food price shrank 1.6% m/m due to plentiful crop of fresh vegetables and fruits. Non-food items were more expensive in July as compared to June following the increase in natural gas price (+7.9%) as part of the liberalization calendar agreed with the IMF and EC. Fuels and tobacco increased by 0.6% m/m each and drove higher the price of non-food items. Services went up by 0.3% m/m as lower phone tariffs and RON monthly appreciation were offset by sharp increase in administered price of water and sewerage services (+3% m/m).

We reduced our December 2013 inflation forecast to 2.5% and see now inflation as low as 1.4% at the beginning of 2014. NBR's rate cutting cycle will continue (-2x25bp) and we estimate key rate at 4% in November. A cut in RON minimum reserves could follow in 1Q14, putting additional downward pressure on money market rates. 3M ROBOR could stay at 3.6% in December 2013 and 3.4% in December 2014, with risks skewed towards lower RON rates if the NBR delivers a bolder 50bp cut at its September meeting (we see 30% chances for that). Risks for strong RON depreciation in the context of current monetary easing cycle are contained due to government's determination to continue reforms within new agreement with the IMF and EU and NBR's comfortable FX reserves (EUR 33.4bn).