National Bank of Romania

Inflation Report

August 2021

Year XVII, No. 65

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NOTES

Some of the data are still provisional and will be updated as appropriate in the subsequent issues.

The source of statistical data used in charts and tables was mentioned only when they were provided by other institutions.

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Foreword

The primary objective of the National Bank of Romania is to ensure and maintain price stability, with monetary policy being implemented under inflation targeting starting August 2005. In this context, active communication of the monetary authority to the public at large plays a key role, and the major tool that the central bank uses to this end is the *Inflation Report*.

Apart from analysing the most recent economic, monetary and financial developments and explaining the rationale and the manner of implementing monetary policy in the previous period, the *Report* provides the National Bank of Romania's quarterly projection on inflation over an eight-quarter horizon, including the associated uncertainties and risks, and an assessment of the recent and future macroeconomic context from the perspective of the monetary policy decision.

By drafting and publishing the *Inflation Report* on a quarterly basis, in accordance with the frequency of the forecasting cycle, the National Bank of Romania aims to provide all those interested with the opportunity of best comprehending its analytical framework and hence the reasons underlying the monetary policy decisions. Securing a transparent and predictable monetary policy is meant to strengthen monetary policy credibility and thus help achieve an effective anchoring of inflation expectations and lower the costs associated with ensuring and maintaining price stability.

The analysis in the *Inflation Report* is based upon the most recent statistical data available at the date of drafting the *Report*, so that the reference periods of indicators herein may vary.

The *Inflation Report* was approved by the NBR Board in its meeting of 6 August 2021 and the cut-off date for the data underlying the macroeconomic projection was 4 August 2021.

All issues of this publication are available in hard copy, as well as on the NBR's website at http://www.bnr.ro.

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Summary

Developments in inflation and its determinants

The annual CPI inflation rate continued to advance in 2021 Q2, exceeding the upper bound of the variation band of the flat target starting with May and reaching 3.94 percent in June (+0.89 percentage points against March 2021). The faster momentum was mainly driven by the rise in international commodity prices, which quickly passed through into volatile prices, mainly for fuels. In turn, the annual adjusted CORE2 inflation saw its downward path come to a halt in 2021 Q2, moving slightly up in April to 2.9 percent (against 2.8 percent in March) and hovering around this value afterwards. In June, both the annual CPI inflation rate and the adjusted CORE2 inflation rate stood above the forecast in the previous *Inflation Report* by 0.4 percentage points and 0.2 percentage points, respectively. The average annual CPI inflation rate also followed an uptrend to reach 2.9 percent in June. The average annual inflation rate calculated based on the Harmonised Index of Consumer Prices (HICP) edged to 2.4 percent in June, up by 0.3 percentage points against March. Given that price increases were larger at the European level, Romania marginally reduced the gap with respect to the EU average.

In the period under review, the adjusted CORE2 inflation rate reflected relatively high underlying inflationary pressures. Thus, significant influences on production costs were triggered by the broad-based rise in commodity prices, although pressures from labour costs have meanwhile moderated, as labour market tightness has not yet reached the pre-pandemic level. At the same time, aggregate demand in the economy continued its fast-paced recovery amid improvements in consumer confidence, easing the transmission of production cost increases into the final prices. In addition, short-term inflation expectations increased considerably in 2021 Q2 to values above the long-term average, with the contribution of all economic sectors, including services, which had previously been strongly affected by mobility restrictions. The upward trend in prices was visible for all core inflation components, with Q2 facing larger price hikes than usual for this time of the year.

The annual growth rate of unit labour costs posted a notable slowdown in 2021 Q1, especially as a result of the methodological changes on the labour market, which aimed at excluding households (largely workers in agriculture) producing goods exclusively or mostly for self-consumption from employed persons. By contrast, the annual pace of increase of ULC, excluding agriculture, remained in positive territory, decelerating however to 3.6 percent from 8.7 percent at the end of the previous year. At the same time, the ULC in industry saw its quarterly dynamics worsen somewhat in April-May 2021 compared with January-March 2021 (2.1 percent), signalling the deterioration of competitiveness in some industrial sectors, especially consumer goods industries.

Monetary policy since the release of the previous *Inflation Report*

In its meeting of 12 May 2021, the NBR Board decided to keep the monetary policy rate at 1.25 percent per annum and leave unchanged the deposit facility rate and the lending facility rate at 0.75 percent and 1.75 percent per annum, respectively. The annual CPI inflation rate dropped in March 2021 somewhat less than expected to 3.05 percent from 3.16 percent in February. Behind this evolution stood the decelerations reported by VFE and tobacco product components and the slowdown in core inflation, which were largely offset, in terms of impact, by the higher-than-expected increase in fuel prices. In line with expectations, the annual adjusted CORE2 inflation rate continued to decrease in 2021 Q1, falling to 2.8 percent in March from 3.3 percent in December 2020. The main contribution to this came from the disinflationary base effects associated with the developments in some processed food prices, to which added the modest influences of the aggregate demand deficit and of the slower annual depreciation of the leu against the euro. Nevertheless, the dynamics of this component continued to be marked by underlying inflationary pressures, namely the upside trend of short-term inflation expectations, along with influences from a rebound in consumption on certain segments, as well as from supply-side disruptions.

The latest forecast showed the annual inflation rate following a relatively higher path over the next two years, as it had been again revised significantly upwards in the short term and, to a smaller extent, over the latter part of the projection horizon.

The main uncertainties and risks to the inflation outlook came from the evolution of the pandemic and of the associated restrictive measures, depending especially on the extent and effectiveness of the vaccination process. Major sources of uncertainties and two-way risks were also the fiscal policy stance, in the context of the budget consolidation presumed to be carried out gradually over the medium term, as well as the absorption of European funds, especially those under the Next Generation EU programme. The synchronised uptrends in many international commodity prices also continued to be relevant.

Subsequently, the statistical data showed the pick-up in the annual CPI inflation rate in May to 3.75 percent from 3.05 percent in March, slightly above the forecast and, at the same time, above the upper bound of the variation band of the target. The increase owed almost entirely to the exogenous CPI components, particularly the hike in fuel prices amid higher oil prices. The annual adjusted CORE2 inflation rate stayed below 3 percent, moving up to 2.9 percent in May from 2.8 percent in March 2021. Statistical data on economic growth in 2021 Q1 indicated its further recovery at a considerably faster pace than anticipated, thus recovering almost entirely the loss incurred in 2020 Q2. Specifically, the economy declined, in annual terms, at a slower rate of only -0.2 percent compared to -1.4 percent in 2020 Q4. Private consumption was the major driver of the recovery, under the impact of the strong revival of purchases of goods and services. In turn, gross fixed capital formation had a larger positive contribution to annual GDP dynamics, which came even to prevail in this quarter, amid the leap taken by investment in equipment. Conversely, the negative contribution of net exports widened substantially, following a swifter advance in the growth rate of imports of goods and services than in that of exports thereof. Against this backdrop, but also in the wake of the notable worsening of the primary and secondary income balances, the current account deficit recorded the largest widening in annual terms in the last 14 quarters.

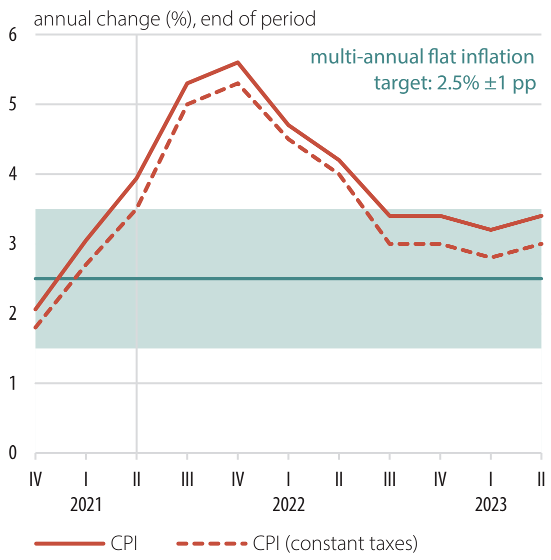
In the NBR Board meeting of 7 July 2021, the latest assessments indicated the outlook for the annual inflation rate to rise over the short time horizon to higher values than those in the latest medium-term forecast, published in the May 2021 *Inflation Report,* under the stronger transitory impact of supply-side factors. Determining factors were the larger hikes in energy prices, particularly of natural gas and electricity. The uncertainty factors identified previously remained relevant, with those arising from the dynamics of international commodity prices becoming relatively stronger. Noteworthy was also the marked slowdown in the pace of vaccination on the domestic front amid the more contagious (Delta) coronavirus variant tending to spread in some European countries.

Based on the data available at that time and in the context of the identified risks and uncertainties, the NBR Board decided to keep the monetary policy rate at 1.25 percent per annum; moreover, it decided to leave unchanged the deposit facility rate at 0.75 percent per annum and the lending facility rate at 1.75 percent per annum. At the same time, the NBR Board underlined that it aimed to preserve price stability over the medium term in line with the 2.5 percent ±1 percentage point flat inflation target, in a manner conducive to achieving sustainable economic growth in the context of fiscal consolidation, while safeguarding financial stability. Furthermore, the NBR stated that it stood ready to use its available instruments in order to achieve the overriding objective regarding medium-term price stability.

Inflation outlook

Subsequent to the release of the May 2021 *Inflation Report*, a number of risks of significant magnitude have materialised, with an impact on the configuration of the new baseline scenario. Nevertheless, the updated scenario continues to be subject to a string of interlinked sources of uncertainty, of which those associated with the public health have been gaining momentum recently. Following the pandemic shock, the recovery of economic activity in Romania started in 2020 Q3, with a notable rebound persisting also in 2020 Q4 and 2021 Q1, respectively. Under these circumstances, available data suggest that nearly all of the economic activity losses recorded in 2020 Q2 have been recovered by end-March. The high-frequency indicators point to a further expansion of the economy in 2021 Q2 and Q3, even though signs of a relative slowdown have been building up. Against this background, the recent onset of a relatively accelerated transmission of the Delta virus strain in some EU Member States raises new questions regarding the persistence of the economic recovery, especially as the cold season approaches. Should a resurgence of the pandemic occur, the magnitude of the economic impact will be mainly conditional on the progress of the vaccination campaign as a whole, as well as on that addressing the vulnerable groups. These medical parameters will determine the severity of mobility restrictions imposed by the authorities or, as the case may be, the voluntary restrictions adopted by the population. For this reason, the downside risks to the outlook for economic activity

Inflation forecast



Source: NIS, NBR projection

in the baseline scenario are seen prevailing further, particularly in the short run, until the medical situation returns to normality.

According to the baseline scenario, GDP growth for 2021 is projected at a significant positive value. This follows the considerably stronger-than-expected performance in 2021 Q1, combined with the swift recovery of economic activity in Romania's foreign trading partners in Q2 (Eurostat flash estimates at end-July 2021) and also expected to extend into the second part of the year, as the authorities gradually lift some mobility restrictions. Positive influences also relate to the emerging signs of a normal agricultural year, as well as to the assumption that EU funds under the Next Generation EU programme will be disbursed starting this year. For 2021, given that the National Recovery and Resilience Plan will probably be operational only towards the end of the year, the amount of EU funds received under this programme is assumed to be slightly below the working hypothesis in the previous *Report*. However, these inflows are foreseen to become significant as of next year, given that Romania benefits from one of the largest allocations in terms of grants, i.e. 6.4 percent of the 2019 GDP (cumulative figure for the 2021-2026 period).

Despite the third wave of the pandemic, household consumption remained strong at the beginning of this year, probably fuelled also by the large volume of savings accumulated in the recent period. As mobility restrictions have eased, which has restored consumption opportunities in the hardest-hit sectors, and real monetary conditions continue to exert stimulative effects, consumption is foreseen to contribute most to the expected high GDP growth for 2021. Along with the relative decline in economic agents' uncertainty regarding the evolution of the medical and, implicitly, economic situation, private sector's investment flows are anticipated to rebound. The government programmes aimed at supporting corporate financing, the large amount of public investment expenditure as well as the absorption of EU funds under the Next Generation EU programme will also make a substantial contribution to the dynamics of gross fixed capital formation. Against this backdrop, investment in the economy will further receive a strong boost both this year and in the period ahead.

Having resumed at a fast pace the recovery of losses induced by the first pandemic wave, Romania's exports lost some momentum in early 2021, also due to the developments in foreign demand. At the same time, imports of goods and services further saw significant dynamics, higher than those of exports, prompting a wider trade deficit than in the same period of the previous year. Under these circumstances, given also the less favourable developments in primary and secondary income balances, the current account deficit in 2021 will widen against its 2020 level. Over the medium term, although its evolution will benefit from the envisaged start of fiscal correction this year, the pace of economic recovery in Romania's foreign partners and addressing several structural problems in the economy as soon as possible will remain, however, the drivers of the current account dynamics.

The faster-than-expected recovery of the economy in 2021 Q1 also entailed a notable correction of the cyclical component of economic activity. In the previous *Inflation Report*, the negative output gap was forecasted to move into positive territory starting 2021 H2, yet the most recent assessment hints that it may have closed fully as early as at the start of this year. Coupled with the anticipated fast-paced investment, which also exerts an impact on potential GDP dynamics, the output gap will remain – despite expectations of a swift recovery of the economy – only on a moderately uptrend over the medium term, albeit revised upwards from the levels in the previous *Inflation Report*. The projected brisker dynamics of Romania's economy with respect to those of the EU trading partners, point to a slight acceleration over the medium term in the real convergence of our economy.

After the release of the May 2021 *Inflation Report*, a number of upward risks to inflation have materialised, mostly related to CPI basket components whose prices are beyond the scope of monetary policy, in particular energy prices (higher electricity, natural gas and fuel prices). Upward pressures emerged, and are projected to linger, also for the adjusted annual CORE2 inflation rate, which is seen reaching 3.4 percent in both December 2021 and December 2022. Persistent underlying inflationary influences are ascribable to the quicker recovery of economic activity and its impact on the output gap. On the other hand, inflationary pressures that at the current juncture are expected to be only of a temporary nature and therefore to fade away in the course of next year, stem from imported goods prices, as well as from the steeper rise in short-term inflation expectations, fuelled by the recent energy price hikes. In this context, the annual CPI inflation rate is anticipated to enter a sharply upward path during the months ahead and reach 5.6 percent in December, 1.4 percentage points above the value forecasted in the previous *Inflation Report*. The contribution of exogenous components to projected inflation at end-2021 is 3.5 percentage points, 1.1 percentage points higher than previously envisaged. The temporary nature of most of the recent shocks will induce favourable base effects in 2022, as the annual CPI inflation rate is foreseen to re-enter the variation band of the target in 2022 Q3 (3.4 percent) and reach the same value at end-2022. At this horizon, the updated projection is merely 0.3 percentage points above that in the prior baseline scenario, of which the contribution of components beyond the scope of monetary policy is only 0.1 percentage points higher than the previously forecasted figure.

In the particular context of the persisting health crisis, the central bank's monetary policy stance was tailored in a prudent manner to preserve price stability over the medium term, in an approach conducive to achieving sustainable economic growth amid the fiscal consolidation process, while safeguarding financial stability.

The risks that have materialised since the latest *Inflation Report* show that economic developments are uncertain in the context of the still pending resolution of the public health crisis. The various indicators measuring the degree of uncertainty associated with the economy's performance, albeit improving somewhat, are still relatively elevated compared to historical values. For this reason, in the current round, several sources of risk from the domestic and external environment remain relevant; based on the available information at the cut-off date of this *Report*, the balance of risks to the annual inflation rate projection is assessed to be on the upside with respect to the values of the baseline scenario, especially in the short run.

Both domestically and externally, the main uncertainty relates to the evolution of the public health crisis, given the rapid spread of the Delta variant, which has already become a dominant strain in a number of countries. The resurgence of the public health crisis has the potential to bring about new trade barriers, but also to reduce the technology transfer to less developed economies. Moreover, the economic policy mix, given the sought-for economic recovery, would remain more stimulative for a longer period of time, potentially exacerbating certain macroeconomic imbalances.

On the domestic front, the fiscal and income policy stance remains one of the significant risk sources in terms of the design of fiscal consolidation measures. In the near run, against the background of the swift, higher-than-expected recovery of the economy, it remains to be seen to what extent the August budget revision will feature a lower full-year government deficit. Over the medium term, as Romania remains constrained by the excessive deficit procedure initiated in 2020, the configuration of the set of measures that will be adopted with a view to reaching the 3 percent-of-GDP headline deficit limit by 2024 is of the essence. In this vein, as requested by the European Commission, more on the detailed plan concerning the Romanian authorities' consolidation strategy is to be disclosed in mid-October 2021. The magnitude, schedule and content of these measures are crucial in terms of the optimal design of the macroeconomic policy mix in Romania, implicitly as regards the potential risks to the baseline scenario.

As for inflation, major risks continue to be associated, over the short to medium term, with developments in international commodity prices as well as domestic energy prices. On the external front, despite recent synchronised hikes in commodity prices, the trigger mechanisms were extremely diverse, complicating the accurate identification of future trends in prices: disruptions in global production and distribution chains (in the case of building materials), speculative behaviour on global stock markets, extreme weather conditions (in the case of agri-food commodities), etc. Domestically, although sizeable risks of higher electricity and natural gas prices have already materialised compared to the baseline scenario in May, the persistence of such pressures in the period ahead should not be overlooked.

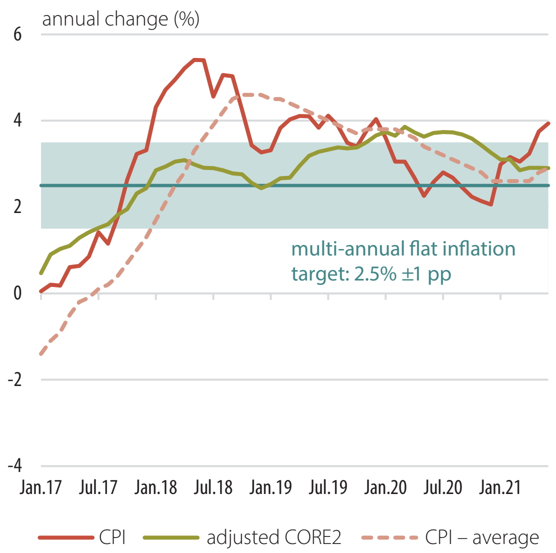
Monetary policy decision

Given the features of the new inflation outlook, but also the heightened uncertainties and risks associated herewith, stemming from the coronavirus pandemic, as well as the fiscal policy stance and the absorption of European funds, the NBR Board decided in its meeting of 6 August 2021 to keep the monetary policy rate at 1.25 percent, while preserving tight control over money market liquidity. Moreover, it decided to leave unchanged the deposit facility rate at 0.75 percent and the lending (Lombard) facility rate at 1.75 percent. At the same time, the NBR Board decided to maintain the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions.

1. Inflation developments

The annual CPI inflation rate continued to advance in 2021 Q2, exceeding the upper bound of the variation band of the flat target and reaching 3.94 percent at the end of the period under review (+0.89 percentage points against March 2021). This was mainly attributable to the rise in international commodity prices, which quickly passed through into volatile prices. Thus, pressures on production costs remain significant and the pass-through into prices is facilitated by the rebound in demand, amid the improvement in the medical situation and the restoration of consumer confidence. Against this background, the annual adjusted CORE2 inflation rate halted its downward trend, hovering around 2.9 percent in the period under analysis (Chart 1.1).

Chart 1.1. Inflation developments



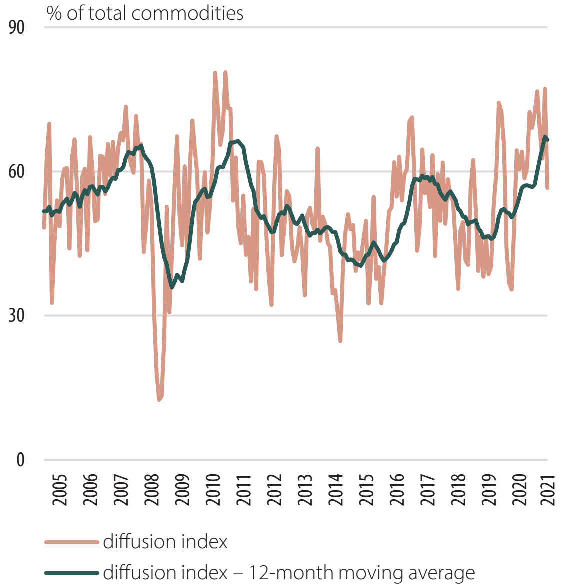
Source: NIS, NBR

The progress made since the beginning of the year in the global vaccination process led to a better epidemiological situation and allowed for the easing of mobility restrictions, enabling economic activity to recover at a pace that exceeded expectations. As a result, several commodity prices embarked on a steep uptrend, accentuated by supply-side bottlenecks (Chart 1.2). The Brent oil price further followed the upward path embarked ever since the beginning of 2021, albeit at a slightly slower pace than in the first months of the year, standing at approximately USD 75/barrel at end-June versus approximately USD 65/barrel at end-2021 Q1. The impact on fuel consumer prices was compounded by the statistical effect associated with the plummeting oil prices in first months of the COVID-19 pandemic dropping out from the calculation of the annual inflation rate. Specifically, fuel prices made the largest contribution to the increase in annual CPI dynamics in 2021 Q2 (+0.57 percentage points) (Chart 1.3).

Remaining in the area of exogenous components of the consumption basket, the annual decline in VFE prices slowed down throughout Q2, with all the items recording higher price changes than the seasonal averages. The gradual re-opening of the hospitality industry led to increased demand for food items, which has also reflected in retail prices, including VFE prices. Thus, after their monthly change had stood constantly below the seasonal average for eight months, starting with May 2021, they witnessed a trend reversal, in spite of the plentiful supply.

In 2021 Q2, tobacco products also had an inflation-boosting contribution, with their annual inflation rate climbing to 7.1 percent in June (against 4.9 percent in March), following the incorporation of the excise duty hike in the final price of a packet of cigarettes based on a slightly different calendar compared to the previous year.

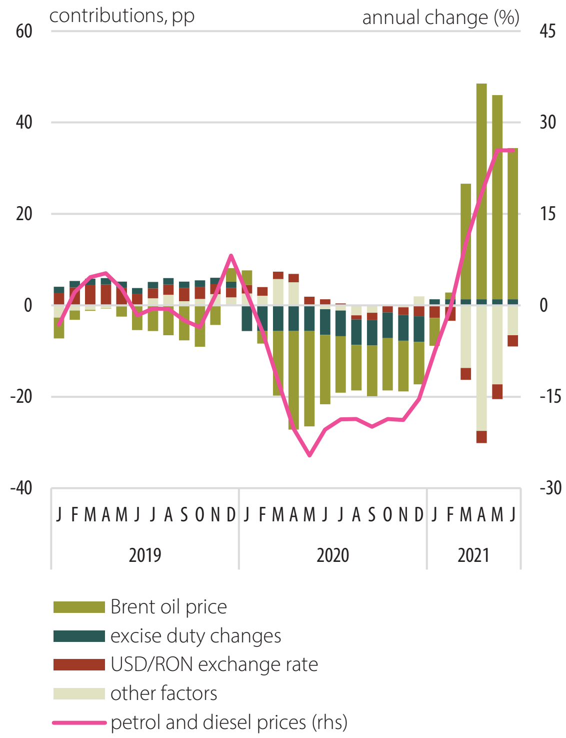
Chart 1.2. Commodities on international markets



Note: The diffusion index measures the percentage of commodities whose prices record positive monthly changes, out of a maximum of 185 agri-food, metal, energy and other commodities.

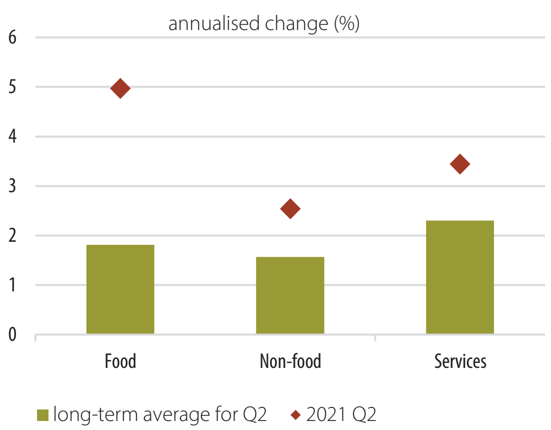
Source: World Bank, FAO, Bloomberg, European Commission

Chart 1.3. Motor fuel prices



Source: Bloomberg, NIS, NBR calculations and estimates

Chart 1.4. Adjusted CORE2 inflation components



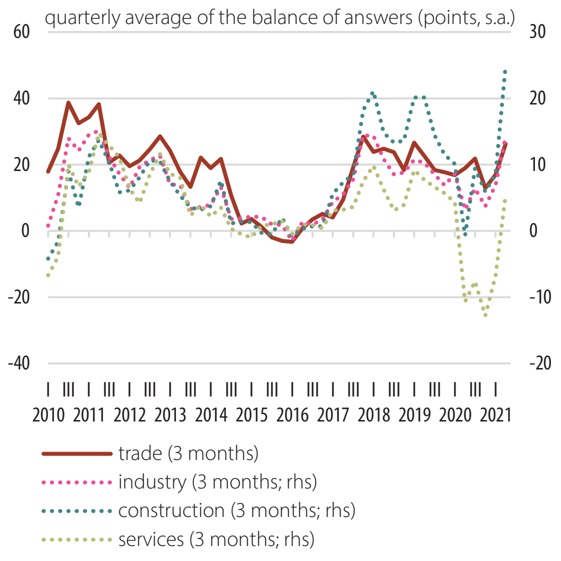
Note: The columns show the average annualised change in prices in Q2, calculated for 2011-2020. All values exclude the first-round effects of VAT rate changes.

Source: NIS, NBR calculations

The annual adjusted CORE2 inflation rate saw its downward path come to a halt in 2021 Q2, moving slightly up in April to 2.9 percent (from 2.8 percent in March) and hovering around this value afterwards. Pressures on production costs remained significant in this period, amid an across-the-board increase in commodity prices and other input costs, the value chains being under strain in an effort to keep up with demand; these influences were partly offset by lower pressures on labour costs, at least in the short term, as the labour market has still been loose. At the same time, the pass-through to final prices is facilitated by the rebound in demand, amid the restoration of consumer confidence, as well as the substantial savings accumulated throughout the past year, given the fewer opportunities for income spending and the higher level of precaution usually manifest at times of crisis.

Looking at current developments, the upward trend in prices was visible for all core inflation components, with Q2 facing larger price hikes than usual for this time of the year (Chart 1.4). On the goods segment, however, this influence on the annual inflation rate was offset by statistical effects associated with the dropping out from the calculation of the first months of the pandemic, when some essential goods had seen sharp price hikes, driven by soaring demand at that moment. With regard to services, the recovery of activity in the sub-sectors most affected by containment measures had an impact on prices. In 2021 Q2, relatively significant contributions to faster annual dynamics of the prices of services included in adjusted CORE2 index came from cultural and catering services. As consumers regain their confidence, they become more willing to use services that they previously had to give up for health reasons; by contrast, companies adjust prices upwards in an attempt to recover the losses incurred over the last year, especially given that uncertainty persists, with the increasingly probable emergence of a fourth wave of infections this autumn being likely to bring about new restrictions for the sector.

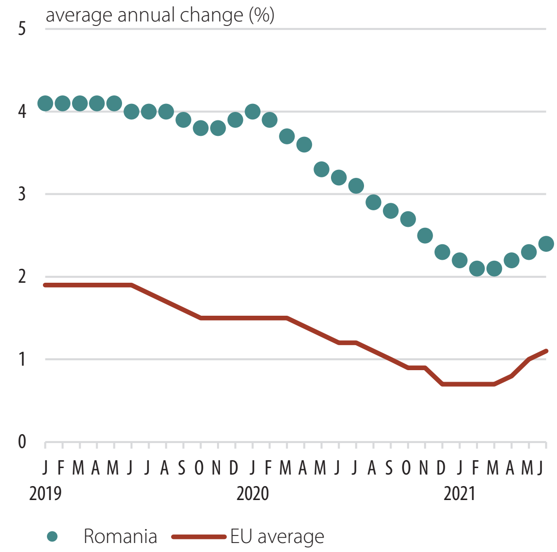
Chart 1.5. Expectations on price developments



Source: EC-DG ECFIN

Short-term inflation expectations went up significantly in 2021 Q2, to values exceeding the long-term average for all categories of economic agents. This is the first time since the pandemic outbreak that even the services sector expects price hikes on a three-month horizon (Chart 1.5). Financial analysts' expectations on price developments also increased, yet remained in the upper half of the variation band of the target, both on the one-year and two-year horizons.

Chart 1.6. Average annual HICP



Source: Eurostat

The average annual inflation rate also followed an upward path. Specifically, based on the national methodology, the average annual inflation rate increased to 2.9 percent in June 2021, while the rate calculated in accordance with the harmonised structure reached 2.4 percent (+0.3 percentage points versus end-2021 Q1 in both cases). As the rise was larger at EU level, Romania marginally narrowed the gap to the EU average, yet remains among the Member States with the highest average HICP inflation, behind Czechia, Hungary and Poland (Chart 1.6).

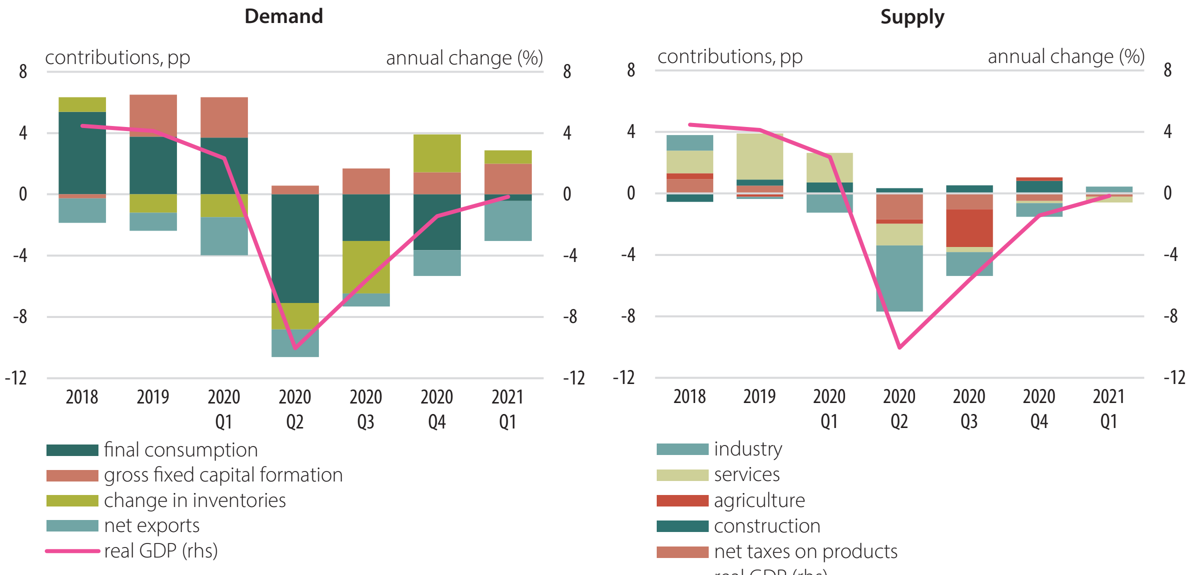
The annual CPI inflation rate in June 2021 stood 0.4 percentage points above the level projected in the May 2021 *Inflation Report*, i.e. 3.9 percent compared to a 3.5 percent forecast. Most of the forecasting error came from volatile prices, especially for fuels, given the higher-than-expected rise in crude oil prices. In addition, at end-2021 Q2, the annual adjusted CORE2 inflation rate exceeded the previously-anticipated value (2.9 percent compared to a 2.7 percent forecast), the influences from fundamentals leading to marginally larger-than-expected price increases, yet broadly spread across all three main segments.

2. Economic developments

1. Demand and supply

> In 2021 Q1, GDP continued to recover the loss generated by the pandemic crisis management, standing only 0.2 percent below the level posted in the same year-earlier period (Chart 2.1). Current developments show, however, a slower pace of economic rebound, with gross value added reporting slacker dynamics, i.e. down to 0.5 percent in quarterly terms, particularly due to the weaker performance of industry, in line with the slowdown seen on the external front. The swifter increase in domestic absorption helped maintain imports on a robust growth path, which had an erosion effect on real GDP dynamics (Chart 2.2).

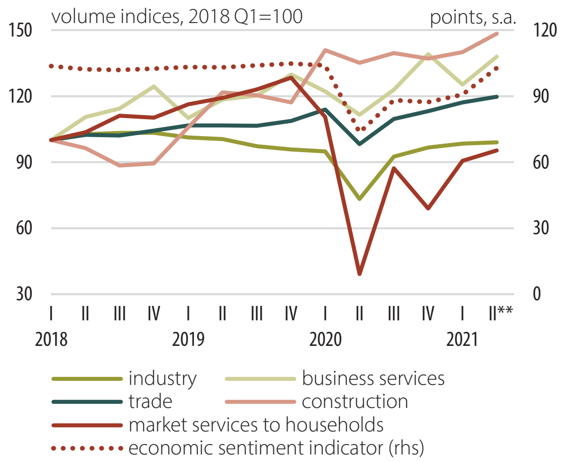
Chart 2.1. Contributions to economic growth



Source: NIS, NBR calculations

Consumer demand continued to rise in 2021 Q1, but the upsurge in the first months was depressed by the third wave of infections, which brought about the reintroduction of restrictions, with an impact on market services to households, in particular. Nevertheless, this segment reports a swift rate of increase, i.e. 31 percent, in Q1 as a whole versus the previous period. Purchases of goods expanded further (up by approximately 1.2 percent, quarterly change), albeit at a slightly slower pace than in the prior quarter, especially as a result of the modest performance of trade in food items (quarterly decline of about 2 percent). Conversely, purchases of durables stepped up to 9.6 percent, with a decisive contribution from motor vehicle sales, as the economic recovery and favourable prospects most likely prompted companies to

Chart 2.2. Economic sectors*

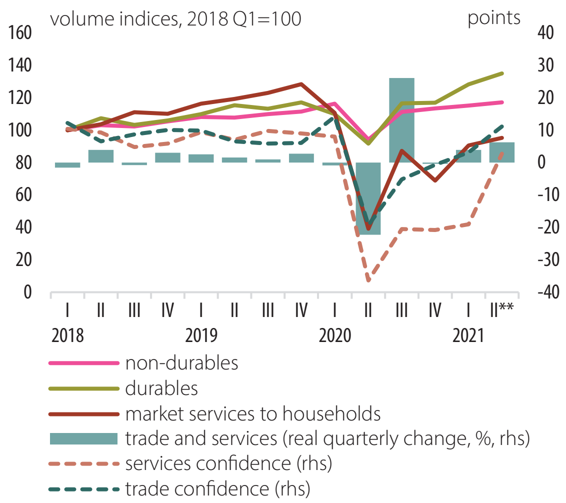


*) seasonally adjusted data series

**) April-May for economic sectors, except for business services (April)

Source: NIS, Eurostat, EC-DG ECFIN

Chart 2.3. Trade and services to households*



*) seasonally adjusted data series

**) Apr.-May, except for confidence indicators

Source: NIS, EC-DG ECFIN, NBR calculations

resume the car fleet renewal process that had been discontinued at the pandemic onset (Chart 2.3).

The easing of restrictions in the latter part of Q2, amid the improvement of the health situation, favoured the rise in economic sentiment (the DG ECFIN confidence indicator added approximately 12 points to 102.7 points in Q2 versus the previous quarter). Alongside the favourable evolution of household income and the growing interest in bank loans, this has led to a faster advance in consumer demand. Specifically, trade turnover saw a pick-up in its quarterly rate of increase in April-May to around 6.4 percent, mainly on account of purchases of food items and motor vehicles. In the first case, the volume of sales exceeded the pre-pandemic level, the demand being fostered also by the extension of loyalty programmes and promotional campaigns launched by major retail networks, actions that were also facilitated by the substantial progress towards the digitalisation of operations. As for the automotive market, apart from companies' purchases, households also accounted for rising sales, an important role having the car fleet renewal programme launched at the end of April and supplemented in June with funds for the "Rabla Plus" component, on the back of the keener interest in purchases of green (electric or plug-in hybrid) vehicles. Moreover, the easing of physical distancing restrictions fostered demand for market services, the volume of receipts growing by 5.3 percent in April-May as compared with the first quarter average.

In 2021 Q1, the general government budget execution led to a deficit of lei 14.6 billion, i.e. 1.3 percent of GDP, well below that posted in the same year-ago period (lei 18.1 billion or 1.7 percent of GDP). At the same time, the narrowing of the deficit against 2020 Q4[1] – in line with the budget execution pattern – was more pronounced than in recent years. Behind this improvement stood both the relatively sharper decline in total budget expenditure – whose annual pace of increase continued to decelerate[2], mainly owing to the dynamics of spending on subsidies[3], on projects financed from non-repayable

1 Deficit of lei 34.6 billion (the equivalent of 3.3 percent of GDP)

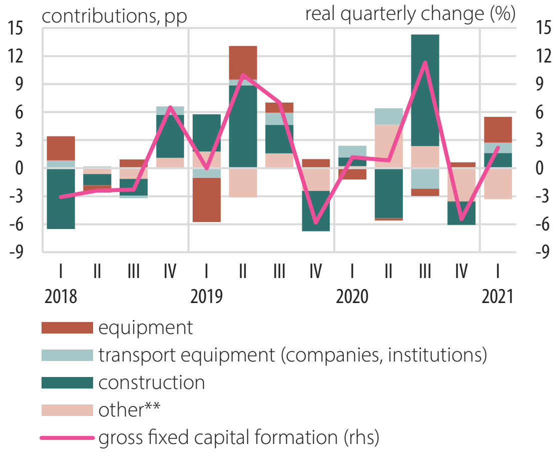
2 To 7.9 percent in real terms, from 11.2 percent in the previous quarter.

3 Possibly owing to a base effect as well, most likely reflecting the impact of a different distribution calendar for some agricultural subsidies.

external funds, as well as of staff costs[4] –, and the more obvious slowdown in the contraction of total budget revenues, which translated into significantly swifter annual dynamics[5]. Along with a favourable base effect[6] and the collection of deferred fees and taxes following tax relief measures in the context of the pandemic[7], the latter evolution reflected the stronger-than-expected recovery of economic activity starting with 2020 Q4; this was largely on account of tax revenues (mainly receipts from VAT[8], property taxes and corporate income taxes) and, to a smaller extent, due to non-tax revenues and social security contributions as well.

In 2021 Q2, the general government budget deficit widened to lei 19.2 billion (1.7 percent of GDP), as a result of a sharper rise in budget expenditures compared to that of revenues. However, the increase was weaker than in 2020 Q2 and the negative balance diminished considerably in relation to the same year-ago period[9]. Therefore, at end-2021 H1, the budget deficit amounted to lei 33.8 billion (3.0 percent of GDP), significantly lower than in 2020 H1 (lei 45.2 billion, i.e. 4.3 percent of GDP).

Chart 2.4. Investment*



*) according to ESA 2010, seasonally adjusted data series

**) investment in agriculture (plantations, livestock), ownership transfer services, R&D, IT software, geological works, other intellectual property rights

Source: Eurostat, NBR calculations

After the outstanding performance seen in 2020, gross fixed capital formation increased further in the first quarter of 2021 (11.7 percent in annual terms), Chart 2.4. The upward trend may continue in the following months, given that equipment purchases witness a hefty recovery, amid the restoring of investor confidence, while the expansion of construction works seems to persist in the short run. In the latter case however, investment growth will probably lose momentum over a longer time horizon. This prospect, which becomes visible internationally, is determined by the hike in the prices of building materials, the global economic rebound leading to strong rises in commodity prices (*inter alia* due to scarce inventories) and in transportation costs. The difficulties in cost recovery will thus add to the already existing shortage of skilled labour at local level, hindering the activity of construction companies (as shown by the successive worsening in May and June of the confidence indicator in this sector).

4 An opposite influence was exerted by the return to positive territory of the real annual dynamics of capital expenditure and spending on goods and services (albeit amid significant reduction in their volume compared to the previous quarter), as well as by the marginally faster growth of social security spending (*inter alia* on the back of state allowance for children being raised at the beginning of the year).

5 To 15.2 percent in real terms, from 0.4 percent in the previous quarter.

6 Generated by the sharp contraction in budget receipts in March 2020 owing to the outbreak of the COVID-19 pandemic and to the tax relief measures to delay the payment of fiscal obligations in this context.

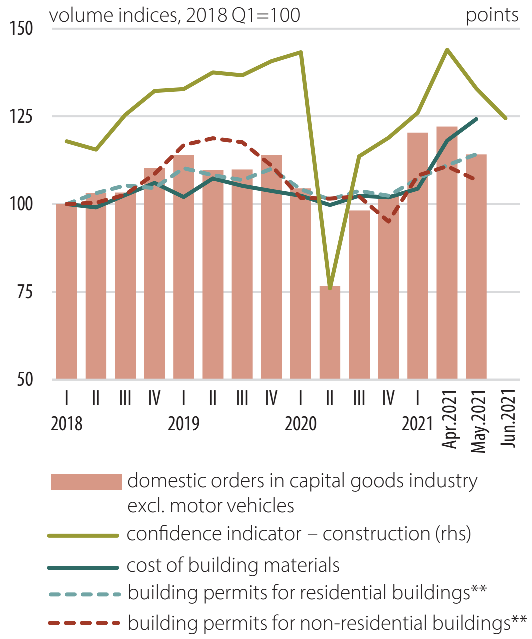
7 Towards end-2021 Q1, however, it was decided that certain tax relief measures be extended temporarily (the submission deadline for the request to reschedule the payment of budgetary obligations in simplified form was thus extended until end-2021 Q3).

8 But also on account of a drop in tax refunds compared to the same year-ago period.

9 Lei 27.1 billion (2.6 percent of GDP).

In Q1, the increase in construction investment (up 15 percent in annual terms[10]) was further ascribed to residential building works and infrastructure works. In the former case, demand remained robust, being also fostered by the pandemic context.

Chart 2.5. Signals on short-term prospects for investment*



*) seasonally adjusted data series

**) 12-month average

Source: NIS, EC-DG ECFIN, Eurostat, NBR calculations

Specifically, the support granted by the authorities since the beginning of 2020 and the changes in households' behaviour and style of life (the delay in big-ticket purchases, the expansion of teleworking and online education) reflected in the preservation of the purchasing power, the persistence of low interest rates, the increase in saving and the shift in demand (to dwellings with gardens in the periurban areas). As a result, investment in house building advanced by another 11 percent in annual terms in Q1, the number of lands in the built-up area sold in the same period grew by approximately 21 percent year on year, while the intention to start new projects was stronger (in May 2021, the floor area related to building permits was 13.4 percent higher, annual change). Public investment increased by 30 percent January through May 2021 (nominal change), with non-repayable EU funds making a prevalent contribution, i.e. 52 percent in the said period. Non-residential construction continued, however, to report a modest performance, the volume of works in the first five months of 2021 standing 3.7 percent, on average, below the figure seen in 2020 Q4. A recovery is little likely, given that the further upbeat outlook for the industrial, logistic and retail segments is eroded by developers' protracted wait-and-see approach of new office projects (Chart 2.5).

To the upward trend in construction added the step-up to 11.5 percent (quarterly change[11]) in equipment purchases in Q1, amid the improvement in business activity and in investor sentiment at international level. Investor interest in the domestic economy is also shown by the results of *EY Romania Attractiveness Survey* (June 2021), according to which two thirds of respondents consider the Romanian economy is an option for starting or expanding investment in 2021 (figure above the European average by around 25 points), as well as by the pick-up in mergers and acquisitions during 2021 H1, particularly in areas such as information technology, renewable energy, real estate transactions[12]. In terms of funding sources, this favourable context is reflected in both FDI flows (equity, including the reinvestment of earnings, cumulating in January-May 2021 a net value well above that recorded in the same period of pre-pandemic years) and domestic bank loans (Chart 2.6). The increasing resort to the latter form of financing as of mid-2020 is further backed by low interest

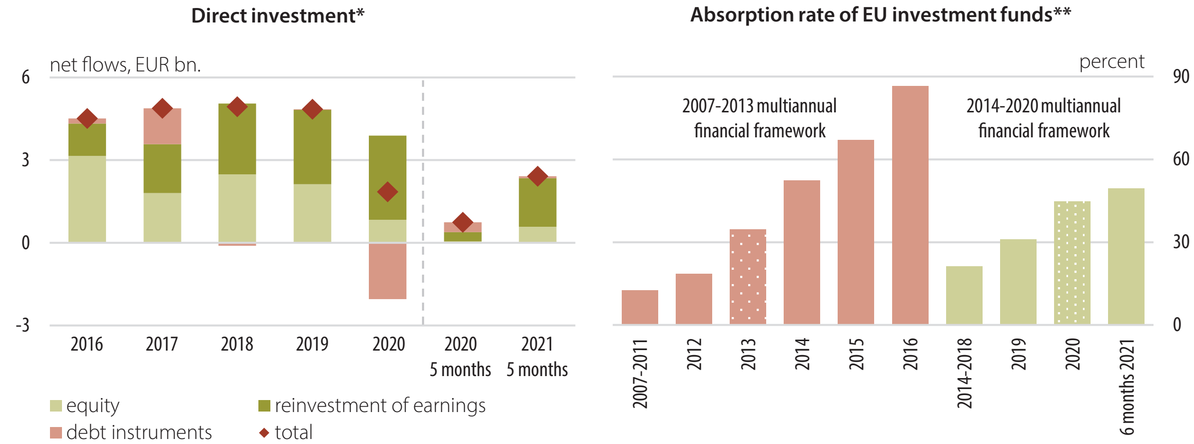
10 According to data on gross fixed capital formation (ESA 2010).

11 According to data on gross fixed capital formation (ESA 2010).

12 Source: Deloitte.

rates and the extension by end-2021 of the government support in the form of State guarantees for corporate investment loans (via the "IMM Invest Romania" programme, including the "Agro IMM Invest" sub-programme, and the "IMM Leasing for equipment and machinery" programme). Alongside investing in the expansion of production facilities or commissioning of new ones, firms have been increasingly interested in enhancing automation and cutting the energy consumption of technological processes, as well as in increasing the production capacity of renewable energy, the potential of the Romanian economy in this area enabling, in the opinion of some major international companies, the establishment of a European wind and photovoltaic hub.

Chart 2.6. Direct investment and absorption of EU investment funds



*) the positive values point to net incurrence of liabilities higher than net asset purchases

**) cumulative indicator since the beginning of the financial framework; the periods marked are the end years of each financial framework; funds from the Cohesion Fund (CF), European Regional Development Fund (ERDF), European Social Fund (ESF) – 10%, European Agricultural Fund for Rural Development (EAFRD) – 50% and European Maritime and Fisheries Fund (EMFF) – 50%

Source: MF, NBR

Chart 2.7. Exports*

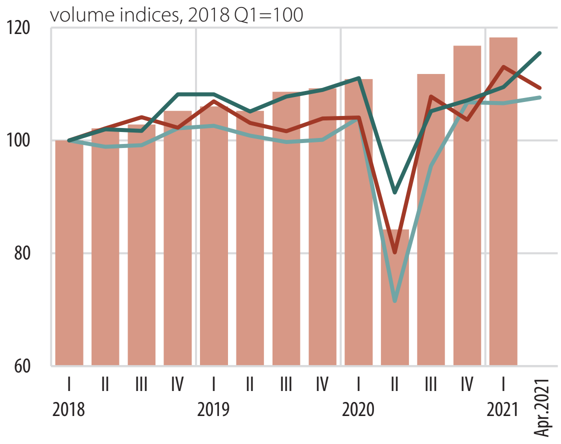
*) seasonally adjusted data series

**) April-May for the latest period

Source: NIS, EC-DG ECFIN, NBR calculations

The recovery trend in exports was slower in the first months of 2021 (down to 0.4 percent, quarterly change), due to the broader disruptions in international production and supply chains. On the domestic front, the hardest hit was the automotive industry, the global shortage in semiconductors started in February calling for the temporary halt in production. Although international trade will be further affected by such negative supply-side influences, which may even grow stronger, owing to the aggravation of the epidemiological situation, the expectations on the recovery of global aggregate demand remain bright. In this context, Romania's exports will probably continue to post positive dynamics, a prospect that is also supported by the favourable estimates on this year's agricultural production (Chart 2.7). Conversely, imports continued to increase at a faster rate than

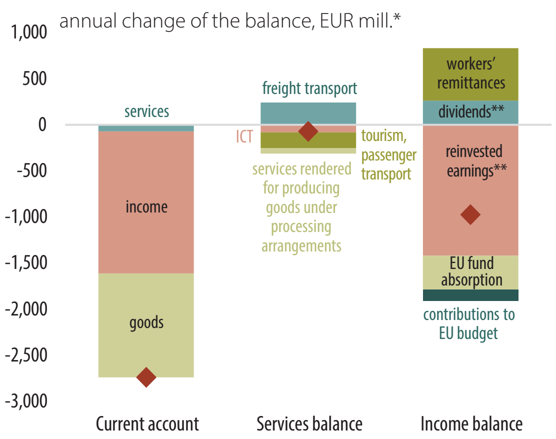
Chart 2.8. Imports*



*) seasonally adjusted data series

Source: NIS, Eurostat

Chart 2.9. Current account and key structural changes (5 months 2021)



*) the positive change points to an increase in surplus or a decrease in deficit

**) FDI companies

Source: NBR

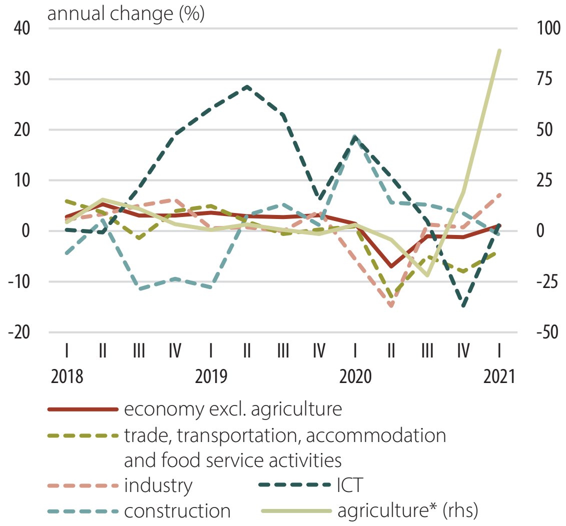
exports (by 2.8 percent in quarterly terms), a trend that is seen persisting, amid the rise in domestic absorption and in the demand for intermediate goods used to manufacture products targeting external markets (Chart 2.8). The widening of trade imbalance eroded further the current account balance, whose deficit amounted to EUR 5.9 billion in January-May 2021 (up EUR 2.7 billion from the year before). An important contribution came also from the rise by EUR 1.4 billion in payments in the form of reinvested earnings of foreign firms in Romania, particularly in the non-financial sector; even though the evolution is unfavourable in terms of the method of registration in the current account, its economic significance is positive. It indicates the swift recovery of economic activity and investor confidence, a trend that is possible due to the characteristics of the pandemic crisis, whose trigger was not related to economic or financial imbalances and, hence, it has not led to massive and long-lasting reversals in investor sentiment and capital flows (Chart 2.9).

Labour productivity

In 2021 Q1, labour productivity economy-wide rose at a faster annual pace. Even though the effect stems largely from the agricultural sector, where the methodological change in the definition of employment translated into a notable statistical increase in labour productivity, the annual dynamics of the indicator remained positive also after this segment was excluded, i.e. +1.0 percent versus 2020 Q1[13] (Chart 2.10). The step-up in digitalisation, triggered by firms' need to adapt their activity to the stringent health security measures, probably played some part in this regard. This process gradually penetrates, albeit at different paces, most economic sectors; the implications for productivity indicators are to emerge progressively, over the longer term. Effects are visible in trade, where supply chains and logistic flows have been rendered more fluid and flexible, once e-commerce became more important. At the same time, agriculture shows greater openness to digital solutions that help increase crop yields, such as technologies for measuring air and soil quality or optimising irrigation and soil fertilisation. In addition, financial or medical services are increasingly accessed via online platforms.

[13] In comparison with 2020 Q4, in 2021 Q1 the increase in productivity stood at 13.5 percent economy-wide and at 0.7 percent after excluding agriculture (the calculations were based on seasonally adjusted data series).

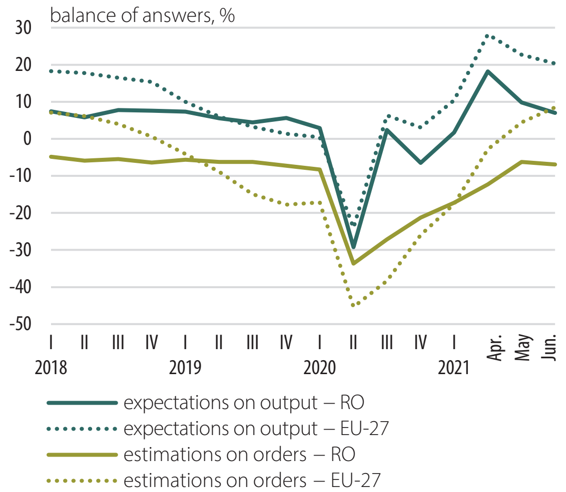
Chart 2.10. Labour productivity



*) methodological change starting in 2021 Q1

Source: NIS, NBR calculations

Chart 2.11. Signals on prospects for manufacturing*



*) seasonally adjusted data series

Source: EC-DG ECFIN

The domestic industry has recently faced some supply-side issues, yet mainly of a transitory nature. This situation is similar to that noticed at the European level and may be ascribed to the problems encountered by manufacturers with respect to the supply of raw materials and the high international transportation costs, global supply chains finding it hard to keep up with the upturn in new orders in manufacturing. The latest available data for industry point to a slight decline in indicators of labour productivity and manufacturing confidence after their reaching a historical high and a 13-year high (seasonally adjusted data) respectively in April (Chart 2.11). However, from a broader perspective, the significant improvement in demand conditions spurs a flurry of investment activity in numerous manufacturing sub-sectors, which will impact labour productivity as well, as investment in new production capacities usually embodies higher technologies. Among the said sub-sectors, the manufacture of electrical equipment, the manufacture of building materials, the chemical industry, other transport means or metallurgy are worth mentioning.

The energy sector stands out through a massive wave of investment in solar and wind power projects, fuelled by the prospect of government support schemes to help meet the renewable energy targets[14], as well as by the growing return on operations, amid the increase in selling prices. Investments subject to approval in 2021 Q1 would suggest a doubling of the installed renewable energy capacity in the medium term, bringing to mind the investment boom in 2009-2014, when Romania ranked among the most attractive countries in the world for this type of projects.

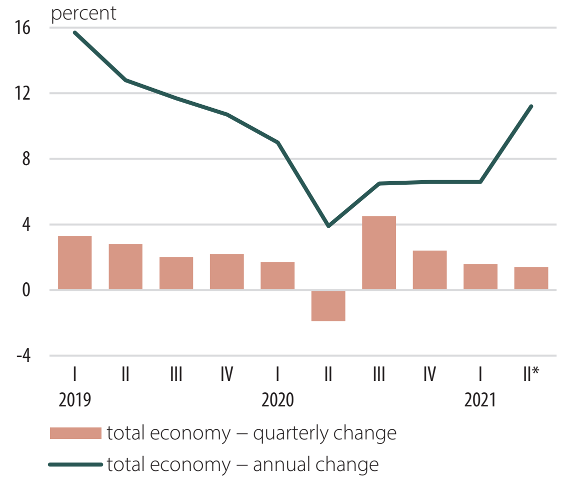
Labour market developments

Labour market conditions improved in April-May 2021 as compared with the beginning of the year, on the background of firms' optimism about the future economic activity, generated by the prospects of a better health situation and the easing of restrictions. Even though the labour market continues to be loose for now, the fast economic recovery paves the way for its becoming tight (again)

[14] According to the Integrated National Energy and Climate Plan, Romania would increase its wind and solar energy production capacity to 5,250 MW and 5,000 MW respectively in 2030 from 3,000 MW and 1,350 MW respectively at present. At the same time, under the National Recovery and Resilience Plan, Romania pledges to phase out coal from the energy mix by 2032.

starting in 2021 H2, some uncertainties lingering however with regard to the future epidemiological developments.

Chart 2.12. Nominal gross wage earnings

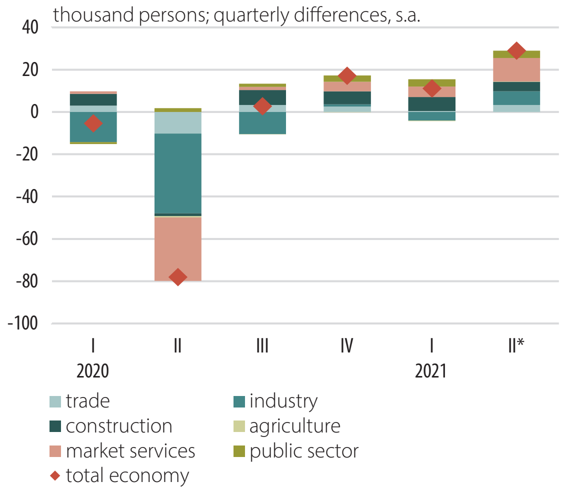


*) April-May

Note: Data are seasonally adjusted.

Source: NIS, NBR calculations and estimates

Chart 2.13. Number of employees economy-wide



*) April-May

Source: NIS, NBR calculations and estimates

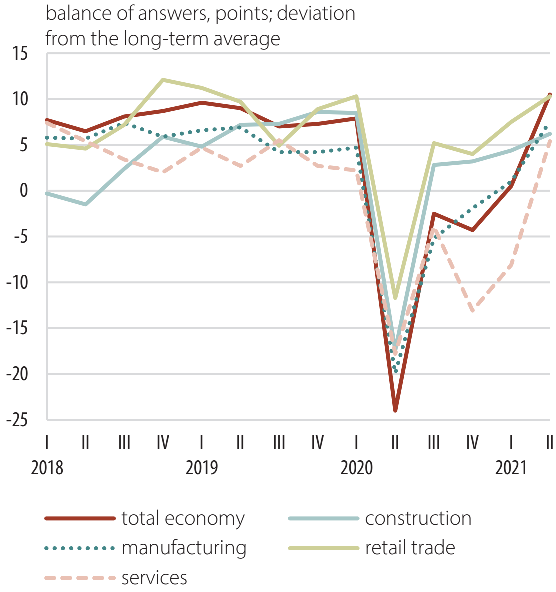
The annual growth rate of average gross wage earnings economy-wide surged by approximately 4.5 percentage points in April-May 2021 versus Q1, to 10.7 percent (Chart 2.12). This evolution largely mirrors a base effect associated with a significant number of employees being furloughed a year ago, at the outbreak of the COVID-19 pandemic, and receiving at most 75 percent of the average gross wage economy-wide. The analysis based on seasonally adjusted data shows, for the period under review, a quarterly pace of increase relatively similar to that in Q1 (around 1.4 percent), the rate of change versus 2019 Q4[15] standing at 9.8 percent. Construction, trade and services posted faster wage dynamics and some market signals suggest that employees/job candidates may gain bargaining power relative to employers again and hence private sector wages may increase in the coming period. The pent-up demand (given the economic environment characterised by elevated uncertainty and consumers' limited or lack of access to certain recreational services in the previous months) has recently been unwinding, which is likely to lead to a renewed step-up in competition for labour among companies. In fact, more and more information released by online recruitment agencies shows that 2021 H2 would again bring to the fore a shortage of skilled labour in Romania, and this problem, coupled with the bottlenecks in the supply of raw materials, could hinder a faster rebound in activity.

Turning to the number of employees, the annual dynamics returned to positive territory in April-May 2021, climbing to 1.2 percent (against -1 percent in January-March). Apart from a base effect becoming manifest, the current developments are also positive. Specifically, in the period from 2020 Q3 to May 2021, approximately 60,000 (over two thirds) of the jobs lost at the onset of the pandemic were recovered, of which about half in April-May 2021 (Chart 2.13). Increases in payrolls were observed in all the major economic sectors, mirroring firms' growing optimism about the economic activity, triggered by the signals on a better health situation in the period under review. The areas stimulated by the pandemic context (healthcare, IT, courier services) or construction witnessed swifter paces of hiring.

15 2019 Q4 was used as a reference for the pre-pandemic level.

The registered unemployment rate was stuck at 3.3 percent in January-May 2021, while the ILO unemployment rate has embarked on a downward trend since the beginning of 2021, declining from 6 percent in Q1 to 5.6 percent in April-May 2021, according to the latest monthly data. In the latter case, it is worth mentioning that the indicator is further affected by the methodological changes implemented at the EU level with a view to harmonising data series across Member States, so that the readings for 2021 are not comparable with those available for previous years. As far as Romania is concerned, the change implied the exclusion of households producing agricultural goods exclusively or mostly for self-consumption from employed persons and, hence, from labour force, which declined by over 700,000 persons.

Chart 2.14. Companies' expectations on the number of employees in the next 3 months*



*) seasonally adjusted data series

Note: The long-term average refers to the period from June 2002 to June 2021.

Source: NIS, EC-DG ECFIN, NBR calculations

January through May 2021, companies' recourse to government financial relief measures for job retention was relatively low, with disbursements accounting for only half of the almost lei 2 billion budgeted until end-June 2021, when the said programmes were removed. The limited impact of the third wave of infections in spring 2021 on labour market developments signals that businesses have increasingly adapted to the social distancing restrictions imposed by the pandemic, also in the services sector requiring human interaction, with companies resorting to solutions such as e-commerce, catering services or courier services.

Even though the job vacancy rate remained relatively unchanged in the first quarter of 2021, the latest surveys point to a larger demand for labour in the major economic sectors, a recovery of confidence being noticeable also in services. The average of results of the EC-DG ECFIN survey for April-June 2021 shows a substantial improvement in the balance of answers, to values higher than both the pre-pandemic levels and the long-term average[16] in the main economic sectors (Chart 2.14). The Manpower Employment Outlook Survey paints a similar picture for 2021 Q3, also indicating that all categories of companies expect to hire workers, employment intentions being stronger in the case of large firms.

16 June 2002 – June 2021.

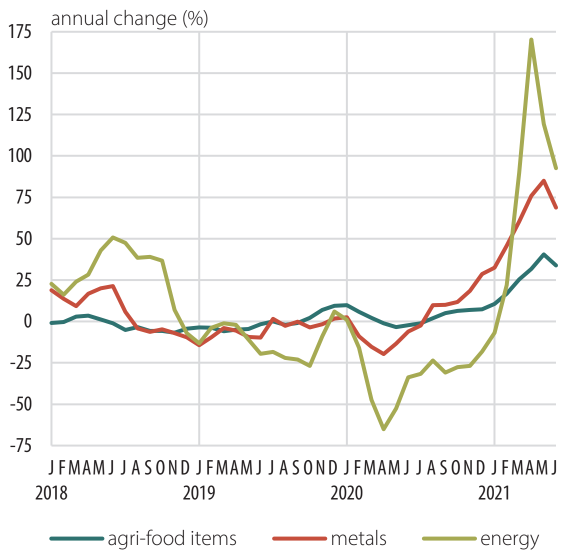
2. Import prices and producer prices on the domestic market

The broad-based rise in commodity prices in the first part of 2021 has led import prices to return to positive annual dynamics and producer prices on the domestic market to step up their annual growth rate. Economic agents have been affected by higher costs via several channels (materials, transport, energy), the significant increase in demand facilitating their pass-through to prices. Pressures from agri-food commodities have slightly alleviated recently, amid favourable estimates for crops.

2.1. Import prices

Commodity prices went up further in 2021 H1, significantly exceeding pre-pandemic levels. This trend is broad-based, associated with the economic recovery, whose surprising dynamics have led to widespread obstacles along supply chains, related to either the actual supply of inputs (e.g. the shortage of semiconductors, affecting many industrial sub-sectors) or their transport to production facilities (disruptions in transport networks, such as the lack of containers, bottlenecks in ports, etc.). In addition, the annual growth rates are strongly influenced by statistical effects.

Chart 2.15. International commodity prices



Source: World Bank, FAO, NBR calculations

In terms of current developments, the World Bank's energy price index advanced by 12 percent in Q2 after having soared by more than 35 percent in the previous quarter, with increases for all categories of goods (oil, coal, natural gas). The further upward trend in oil prices, with the Brent crude oil trading around USD 73 per barrel on average in June 2021, rested on the stronger demand and the ongoing control of production by OPEC+, although the group has gradually eased output restrictions in the context of market recovery. Prices for base metals have gone up significantly this year, given the rebound in industrial activity and the faster green transition, recording an almost 13-percent rise in Q2 against Q1. Similarly, agri-food commodity prices stayed on an upward trend, the FAO index picking up in the first two quarters by 10.7 percent and 7.3 percent, respectively. The buoyant demand from China continues to put pressure on prices, even though global markets for most agri-food commodities remain well supplied. In Q2, larger increases were reported for sugar (unfavourable weather conditions in Brazil) and meat (high global demand amid the resumption of activity in the hospitality industry). The pressures from grains and oils, as well as from dairy products have abated as of June, amid the favourable estimates for the 2021 crops and the rebalancing of supply and demand, respectively (Chart 2.15). The rising trend of commodity prices is likely to moderate somewhat in the period ahead, due to the appreciation of the US dollar and the signals from China regarding a crackdown on practices that lead to prices ramping up contrary to economic fundamentals.

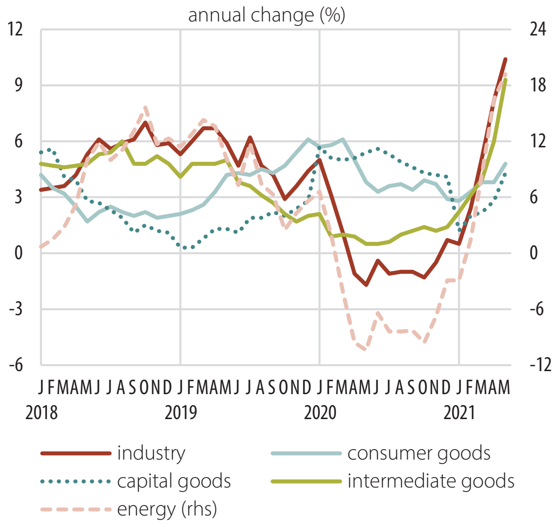
The surge in commodity prices, compounded in annual terms by some unfavourable base effects, was reflected also in the unit value index of imports, which consolidated its uptrend, returning in Q1 to levels above one (up by 5.1 percentage points from 2020 Q4, to 101 percent). However, the impact of external prices on imported inflation was partly offset by the evolution of the domestic currency versus the major currencies, especially by the stronger appreciation of the leu against the US dollar.

The increase was noticeable in the case of most groups of goods, being more pronounced for mineral products, chemicals and base metals. As regards the goods holding a relevant share in the CPI basket, upward pressures on imported inflation came mainly from non-food items, induced by hikes in prices for fuels and pharmaceuticals. More moderate pressures were exerted by food items, linked with the movements of international agri-food commodity prices, rises in UVI being seen for sugar, animal and vegetable fats, as well as for fruit.

2.2. Producer prices on the domestic market

The annual dynamics of industrial producer prices on the domestic market accelerated in April-May 2021 to 9.3 percent (up by 6.6 percentage points against the 2021 Q1 average), the jump being ascribable to energy prices, whose developments were strongly influenced by the base effect associated with the large declines recorded in the same year-ago period (Chart 2.16). In quarterly terms, the fast and broad-based increase in commodity prices, in line with the recovery of global economic activity, amid the improvement of the epidemiological situation, has seen a quick pass-through into local prices, facilitated also by the favourable developments in domestic demand. The build-up of pressures via this channel is becoming increasingly manifest, as shown also by the NIS/DG ECFIN survey for June-August 2021, the balance of answers rising faster to 17.8 points (a 10-year high).

Chart 2.16. Industrial producer prices on the domestic market



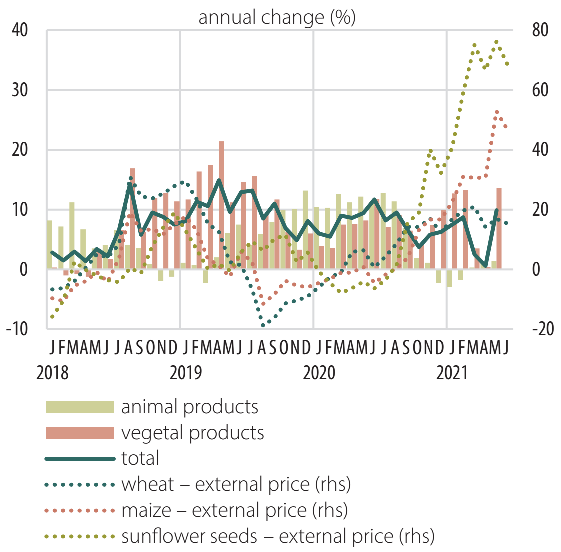
Source: NIS, Eurostat

Energy prices stepped up their pace of increase by more than 15 percentage points to 17.8 percent. Apart from the base effect associated with the slump in energy prices in the same year-ago period, at the onset of the COVID-19 pandemic, pressures were further exerted by the upward path of the oil price, followed closely by that of the natural gas price. In addition to the common influences on these two types of commodities, behind the natural gas price resuming a rising trend stood also domestic factors. Specifically, the lower local supply associated with the lack of investment has been accompanied, as of 2020 H2, by an increasingly strong export orientation of the economic agents in this field, given the price caps imposed by the Romanian Energy Regulatory Authority under the "Gas Release Programme"[17]. At the same time, the electricity price has recently increased on the deregulated market, a trend visible in other countries in the region, given the problems in the area of coal-fired electricity[18], concurrently with the growing consumption and the still narrow share of electricity from renewable sources. Despite the many large investment projects in new production facilities announced in the latter sector (some of which are already under way), it is likely to take several years to rebalance the situation, by shifting production from polluting to renewable sources of energy.

Alongside the rise in energy prices, the upward path of other international commodity prices (metals, wood) and the high investment demand have affected the dynamics of producer prices for intermediate and capital goods, their pace of increase picking up by 4.6 percentage points and 1.8 percentage points to 7.7 percent and 3.6 percent, respectively.

Looking at producer prices for consumer goods, the growth rate for durables recorded a faster step-up (the manufacture of furniture, in particular), the pass-through of higher commodity costs being facilitated by the strong domestic demand in this sub-sector, in connection with the booming residential investments. In the food industry, the emerging signs of alleviating pressures from agri-food commodities amid the favourable estimates for new crops have contained the impact of cost increases in meat processing industries. Inflationary pressures have persisted in the pigmeat segment (given the hike in animal feed prices, especially as a result of the high demand from China owing to the recovery of the livestock destroyed by the African swine flu epidemic) and in the poultry segment, many European countries witnessing outbreaks of avian influenza.

Chart 2.17. Agricultural producer prices



Source: NIS, Bloomberg, NBR calculations

In April-May 2021, the annual change in agricultural production prices decelerated by 1 percentage point from Q1, to 5.2 percent (Chart 2.17). This was driven by the decline in the annual dynamics of prices for vegetal products to 6.9 percent (down by 2.7 percentage points), against the backdrop of the favourable estimates for crops at both local and European level. By contrast, the annual growth rate of prices for animal products accelerated to 1.3 percent, the meat products posting the widest changes.

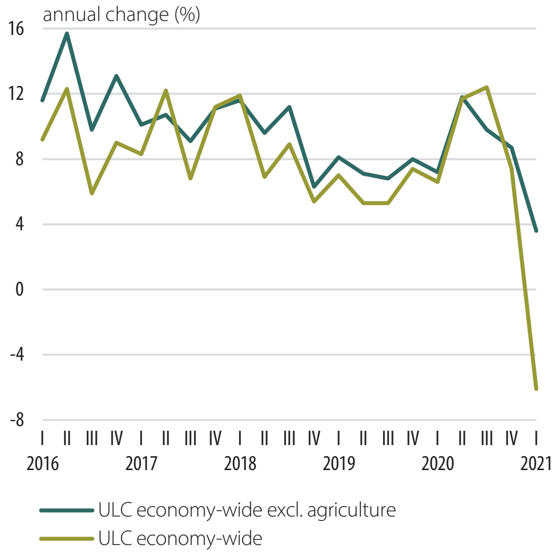
17 The "Gas Release Programme" established an obligation to sell 40 percent of output through auction at a fixed maximum starting price by end-2022.

18 Sector facing a strong rise in purchase costs of carbon dioxide emissions certificates, their price nearing EUR 50 in April-May (versus an average of EUR 37 in Q1 and of around EUR 20 in April-May 2020); the trend will continue amid the tighter EU legislation in the field.

Unit labour costs

In 2021 Q1, the annual growth rate of unit labour costs economy-wide fell significantly to -6.1 percent (from 7.4 percent in 2020 Q4), owing less to economic factors, i.e. the recovery of economic activity, and more to the methodological change in employment[19]. The annual pace of increase of ULC, excluding agriculture, was less dynamic, decelerating however to 3.6 percent from 8.7 percent at the end of the previous year (Chart 2.18).

Chart 2.18. Unit labour costs



Source: NIS, NBR calculations

Nevertheless, in April-May 2021, the industrial sector saw a much stronger annual contraction in unit wage costs (nearly -20 percent against 0 percent in 2021 Q1 and 3 percent in 2020 Q4). This value is significantly affected by the base effect associated with the unfavourable developments in the same year-ago period, when many firms ceased operations in an effort to stop the spread of the virus. Specifically, the magnitude of the collapse and then of the recovery of output exceeded by far that of labour adjustments (given the wide recourse to furlough schemes, where the amount of the benefit was lower than the actual wage).

By contrast, according to the analysis based on seasonally adjusted data, the ULC in industry saw its quarterly dynamics worsen somewhat in April-May 2021 compared with January-March 2021 (2.1 percent), whereas the cumulative change versus 2019 Q4 went up to 5 percent. Consumer goods industries posted fast cumulative rates versus the pre-pandemic level, namely the light industry, the manufacture of furniture, but also the pharmaceutical sub-sector (around 20 percent), mirroring the build-up of inflationary pressures, as well as competitiveness losses. Deteriorations in this indicator were also reported in the automotive industry and in some related sub-sectors, which experienced disruptions in production on account of the bottlenecks in supply chains generated by the microchip crisis. Nevertheless, negative cumulative rates of change of ULC compared to the pre-pandemic level were seen in the energy or intermediate goods industries (metallurgy, chemistry), in construction-related industries, and in the manufacture of computer and electronic products, where the sharp and substantial increase in demand has led to a faster recovery in economic activity than the dynamics of wages.

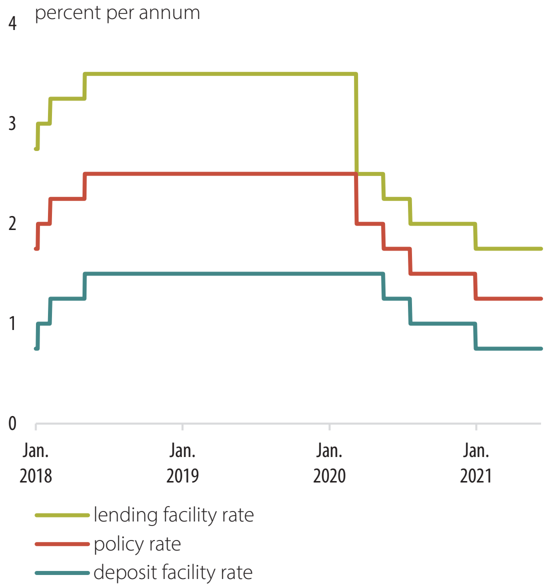
[19] The exclusion of a considerable number of households that produce agricultural goods exclusively or mostly for self-consumption from employed persons.

3. Monetary policy and financial developments

1. Monetary policy

May through July 2021, the NBR kept the monetary policy rate at 1.25 percent and left unchanged the deposit facility rate at 0.75 percent and the lending facility rate at 1.75 percent (Chart 3.1). Moreover, minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions were maintained at 8 percent and 5 percent respectively. Such a calibration of the monetary policy conduct aimed to preserve price stability over the medium term in line with the 2.5 percent ±1 percentage point flat inflation target, in a manner conducive to achieving sustainable economic growth in the context of the fiscal consolidation process, while safeguarding financial stability.

Chart 3.1. NBR rates



At the May meeting, the NBR Board decisions were taken as the new data and assessments showed that the annual inflation rate had increased considerably during 2021 Q1 overall[20] – under the transitory impact of the liberalisation of the electricity market for household consumers and following the rise in fuel prices[21] – and reconfirmed[22] the much sharper-than-expected upturn in economic activity in 2020 Q4[23], which implied the absorption to a very large extent of the aggregate demand deficit at the end of the prior year. At the same time, the anticipated path of the annual inflation rate was again revised significantly upwards in the short term and to a smaller extent over the latter part of the projection horizon. Specifically, according to the updated forecast, the annual inflation rate was expected to climb visibly above the upper bound of the variation band of the target in 2021 H2, to 4.1

20 The annual inflation rate rose to 3.05 percent in March 2021 from 2.06 percent in December 2020. At the same time, the annual adjusted CORE2 inflation rate continued to decrease, falling to 2.8 percent in March against 3.3 percent in December 2020, mainly on account of the disinflationary base effects associated with developments in the prices of some processed food items.

21 Driven by higher oil prices.

22 The second provisional version of statistical data on GDP developments.

23 Economic activity picked up 4.8 percent in 2020 Q4 from a quarter earlier, thus reversing another significant part of the contraction witnessed in Q2; its decline in annual terms therefore slowed to -1.4 percent from -5.6 percent in Q3.

percent in December 2021, before returning to the upper half of the band at the onset of 2022 and subsequently remaining therein, close to 3.0 percent (versus 3.4 percent and 2.8 percent anticipated in the earlier forecast[24] for end-2021 and end-2022 respectively).

However, the worsening of the short-term inflation outlook was again attributable almost entirely to the action of supply-side factors, especially to the anticipated hikes in fuel, electricity and natural gas prices, as well as to the rise in some international agri-food commodity prices[25]. These developments were conducive to disinflationary base effects in 2022, adding to those stemming from the increases already seen by some prices in the first quarter of the year. Thus, the prospective step-up in the annual inflation rate above the variation band of the target was envisaged to be temporary.

Nevertheless, underlying pressures were expected to exhaust their slightly disinflationary action in a short while and then become more visibly inflationary than in the previous forecast. The rationale was the outlook for a faster widening of the positive output gap after its reopening in 2021 Q3, in the context of relatively swifter economic growth 2021 through 2022, spurred by the disbursements of EU funds allotted to Romania under the Recovery and Resilience Facility, likely to mitigate or counterbalance the contractionary impact of fiscal consolidation. The step-up in inflationary pressures was seen to be slowed, however, to a certain extent, by the lagged pass-through of the effects from the positive output gap and by the likely improvement in the composition of aggregate demand in terms of its inflationary potential[26], but also by the possible steep deceleration in the growth rate of unit labour costs, mainly amid the persistence of loose labour market conditions.

Mild inflationary effects were also expected from non-energy import price dynamics, and in the short run from the abrupt rise in demand for services after the removal of mobility restrictions, possibly amid supply-side constraints. Against this background, the annual adjusted CORE2 inflation rate was expected to see its decline slow down over the following months, before re-embarking and remaining on a slight uptrend, climbing to 2.8 percent in December 2021 and to 3.1 percent at the end of the forecast horizon[27].

Considerable uncertainties and risks to the new outlook further stemmed, however, from the evolution of the pandemic and of the associated restrictive measures, largely dependent on the extent and effectiveness of the vaccination process, both domestically and across the EU/the globe. Moreover, major sources of uncertainties and risks consisted in the fiscal policy stance, amid the budget consolidation presumed to be carried out gradually over the medium term, as well as in the absorption of European funds, especially those under the Next Generation EU programme, considering *inter alia* the still ongoing procedures

24 March 2021 *Inflation Report*.

25 Affecting core inflation in particular.

26 Through a higher contribution of investment to forecasted economic growth, to the detriment of private consumption, with implications also for the future evolution of potential GDP.

27 Instead of stabilising in the vicinity of 2.7 percent, as previously anticipated.

related to the 2021-2024 Convergence Programme and the National Recovery and Resilience Plan. Uncertainties were also associated with labour market conditions, given the recent positive developments in terms of new jobs and hiring intentions, but also the near-term outlook for government support measures.

According to subsequently-released statistical data, the annual inflation rate rose to 3.24 percent in April and to 3.75 percent in May, thus exceeding the variation band of the target somewhat earlier than expected, mainly under the influence of exogenous CPI components, particularly the hike in fuel prices amid higher oil prices[28]. The annual adjusted CORE2 inflation rate also rose in April, to 2.9 percent, while remaining flat in May, contrary to the forecast indicating a further slow decline. This was attributable to a slight step-up in the annual depreciation of the leu against the euro, as well as to the temporary effects of the increase in consumer demand once with the easing of some mobility restrictions, overlapping those resulting from supply-side disruptions and costs associated with more expensive commodities and anti-coronavirus measures.

At the same time, economic activity continued to recover in 2021 Q1 at a considerably faster pace than expected, albeit slower than in the previous quarter[29], implying an almost full recovery in this period of the economic contraction in 2020 Q2, as well as the reopening of the positive output gap, two quarters ahead of the most recent medium-term forecast. Moreover, in terms of annual changes, the recovery continued to be driven by domestic demand, and household consumption became again its major determinant, ahead of the hefty contribution from gross fixed capital formation[30]. Conversely, the negative contribution of net exports recorded a significant pick-up, as the growth rate of imports of goods and services increased somewhat more swiftly than that of exports thereof, entailing also a more pronounced widening of the trade deficit compared to the same period of the previous year. Amid the marked deterioration of the primary income balance, as well as of the secondary income balance – on the back of flows of reinvested earnings and, to a lower extent, of net inflows of EU funds –, the current account deficit recorded the largest annual increase in the past 14 quarters.

In turn, labour market parameters improved further starting March 2021, including vis-à-vis expectations, due to the ongoing recovery in several economic sectors and the progress in vaccination, as well as with the support of government's job retention scheme.

On the financial market, key interbank money market rates continued to fall slightly May through June; yields on government securities extended their slowly downward course at the short end of the maturity spectrum, while, for longer maturities, they saw moderate upward adjustments. Lending rates on the main types of new business to non-bank clients extended or steepened their downtrend April through May 2021.

[28] Modest additional influences stemmed from higher tobacco prices and the relatively more pronounced increase in VFE prices.

[29] Specifically, the economy lowered its decline in annual terms to only -0.2 percent from -1.4 percent in 2020 Q4, given a 2.8 percent quarterly growth.

[30] The contribution of this component to annual GDP dynamics came to prevail.

At the same time, after the mild increase in the first part of April, the EUR/RON exchange rate tended to stabilise at the new readings, underpinned *inter alia* by the interest rate differential, which narrowed, however, slightly versus some markets in the region, given the recent launch by two central banks of the policy rate hiking cycle.

The annual growth rate of credit to the private sector stepped up considerably in the first two months of 2021 Q2, its average for the period overall advancing to 9.2 percent[31]. The developments reflected both a base effect and the intense lending activity across both major segments – non-financial corporations and households[32] –, supported by government programmes only to a small extent, yet somewhat more firmly than in the previous two months.

The short-term forecast updated in this context showed that the annual inflation rate would witness a steeper rise over the near-term horizon than previously anticipated. However, the increase was expected to be largely of a temporary nature, the same as the pick-up seen in the first half of the year, being attributable almost entirely to the action of supply-side factors, conducive to considerable disinflationary base effects in the following year. Determining factors were the larger hikes anticipated for natural gas and electricity prices in July 2021, to which added the markedly costlier fuels, in correlation with the rise in oil prices[33].

Underlying inflationary pressures were, however, envisaged to surface somewhat sooner than anticipated in the May forecast, given the likely renewed reversal – two quarters earlier – of the cyclical position of the economy. Moreover, economic activity was expected to increase further during Q2 and Q3, posting quarterly dynamics somewhat faster than anticipated in the prior rounds, although decelerating gradually versus Q1[34]. These prospects rendered likely the widening of the positive output gap at mid-2021 H2 to a visibly higher value than that indicated by the May medium-term forecast.

The evolution of the pandemic and of the associated restrictive measures continued, however, to generate – at least in the near run – high uncertainties and risks to the medium-term macroeconomic outlook, amid the pace of vaccination slowing markedly on the domestic front and the more contagious Delta coronavirus variant tending to spread in some European countries. The fiscal policy stance also remained a source of uncertainties and risks, in the context of the budget consolidation presumed to be carried out gradually over the medium term, considering – on one hand – the constraints stemming from the large volume of permanent expenditures and from the recent hike in some commodity prices, as well as the positive impact exerted on budget revenues by nominal GDP growth well above the

31 From 5.7 percent in Q1.

32 The flows of leu-denominated housing and consumer loans stood in this period close to their historical peaks.

33 Somewhat stronger-than-previously-envisaged inflationary effects were also likely in the case of VFE prices, *inter alia* in the context of demand from some sectors tending to recover amid the easing of restrictive measures.

34 In the context of the sizeable base effect associated with the economic contraction in the same year-earlier period, the quarterly dynamics implied a considerable increase, to a two-digit level, in the annual GDP growth rate in Q2, followed by a moderate decline during the following period.

budget assumption[35] and – on the other hand – the European institutions' recent recommendations in the context of the excessive deficit procedure[36]. Under the circumstances, the coordinates of the upcoming budget revision and especially the budget consolidation strategy presumed to be prepared by autumn and submitted to the European Commission were particularly important in terms of the short- and medium-term characteristics of the fiscal policy. High uncertainties were further associated with the absorption rate of EU funds allocated to Romania via the Recovery and Resilience Facility, as well as of those under the new Multiannual Financial Framework 2021-2027, amid the delay in completing – and hence in the EC approving – the National Recovery and Resilience Plan.

In the analysed context, ensuring adequate monetary conditions in terms of preserving price stability over the medium term in line with the 2.5 percent ±1 percentage point flat inflation target, in a manner conducive to achieving sustainable economic growth amid fiscal consolidation, while safeguarding financial stability, warranted the policy rate status quo. Consequently, the NBR Board decided in its meeting of 7 July 2021 to keep the monetary policy rate at 1.25 percent and to leave unchanged the deposit facility rate at 0.75 percent and the lending facility rate at 1.75 percent. Furthermore, the NBR Board decided to maintain the existing levels of minimum reserve requirement ratios on both leu- and foreign currency-denominated liabilities of credit institutions (5 percent and 8 percent respectively).

2. Financial markets and monetary developments

The daily average interest rate on interbank transactions[37] and longer-term rates on the interbank money market fell further during Q2 overall, yet more slowly than in the previous three months. The EUR/RON exchange rate rose slightly in the first part of April 2021, before tending to stick to the new readings in the following two months. The annual growth rate of credit to the private sector picked up considerably in the period from April to May as a whole, while that of liquidity across the economy moderated visibly, albeit remaining particularly high.

2.1. Interest rates

The daily average interbank money market rate declined at a fast rate at the onset of Q2 and stayed afterwards mainly in the lower half of the interest rate corridor, climbing only sporadically to the vicinity of the monetary policy rate. Thus, its quarterly average remained on a downward path, shedding 0.19 percentage points against the previous three months, to 1.08 percent, i.e. the lowest reading in approximately four years.

35 Largely explaining also the improvement in the budget execution for the first five months of the year.

36 They set forth a certain adjustment path in the 2021-2024 period, as well as a particular treatment of unanticipated revenues, also calling for the implementation of additional corrective measures.

37 The average interest rate on transactions in deposits on the interbank money market (excluding the NBR), weighted by the volume of transactions.

Behind these developments stood the re-emergence of a net liquidity surplus on the money market – under the expansionary impact of Treasury operations – and its mop-up by the NBR primarily via the deposit facility and additionally through 1W deposit-taking operations, whose role increased gradually in the latter part of Q2[38]. Amid the easing of liquidity conditions versus the second part of the previous quarter[39], ON rates on the interbank money market went down steeply during the first 10-day period of April and then tended to stay in the lower half of the interest rate corridor, climbing only temporarily above or to the vicinity of the monetary policy rate at the beginning of the reserve maintenance periods in April and May respectively.

Chart 3.2. Policy rate and ROBOR rates

In turn, 3M-6M ROBOR rates stayed in the first half of April on the downward path that had emerged towards end-Q1 and then remained relatively constant, before witnessing renewed slight declines in mid-May and at the onset of June, fully reversing the increase seen in the first part of March. By contrast, 12M rates stayed almost flat over the period as a whole. Thus, the quarterly averages of these rates continued to go down across the maturity spectrum, although more slowly than in Q1, reaching 1.55 percent (down 0.09 percentage points) for the three-month maturity, 1.66 percent (down 0.07 percentage points) and 1.75 percent (down 0.04 percentage points) for the 6M and 12M rates respectively – the lowest values in almost four years (Chart 3.2).

Looking at the government securities market, relevant factors in Q2 were also the improved global financial market sentiment and the mixed developments in long-term government bond yields both in developed economies and regionally[40], alongside the decisions to maintain Romania's sovereign rating taken by S&P and Fitch in April[41], but especially the May announcements on the further pick-up in inflation rate domestically and the much stronger-than-expected economic growth in 2021 Q1.

Against this backdrop, long-term reference rates on the secondary market for government securities[42] saw the generally downward path on which they had re-embarked in the previous month extend until towards end-April, before recording

38 The central bank held one deposit-taking auction, with full allotment, in each of April and May (on 15 April and 17 May, at which it took 1W deposits worth lei 4.9 billion and lei 7.3 billion respectively) and two auctions in June (on 8 and 15 June, the volume of deposits taken amounting to lei 8.5 billion and lei 9.1 billion respectively). The average monthly stock of these operations rose from lei 1.2 billion in April to lei 1.7 billion in May and to lei 4.1 billion in June (when the NBR conducted repo transactions as well, amid episodes of daily reserve shortfalls).

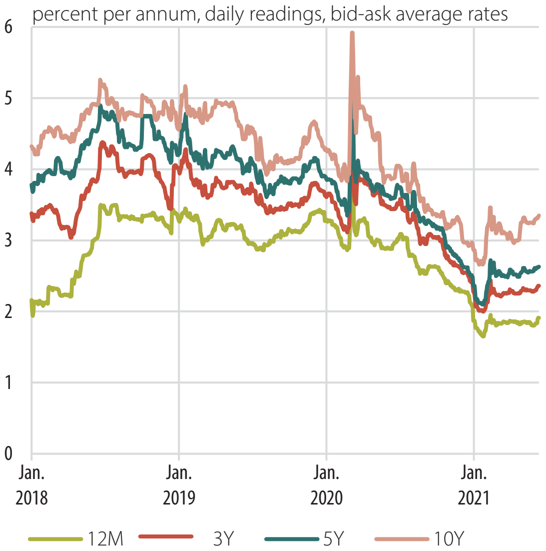
39 More restrictive liquidity conditions persisted at the beginning of April, prompting the NBR to carry out purchases of leu-denominated government securities on the secondary market worth lei 0.135 billion.

40 Long-term government bond yields in the euro area and, at a regional level, in Poland and Hungary steepened their upward path in the first half of the quarter, before witnessing a partial correction, whereas those in the US and Czechia trended slightly downwards versus their end-Q1 peaks.

41 With S&P also revising its outlook from negative to stable.

42 Bid-ask averages.

Chart 3.3. Reference rates on the secondary market for government securities



moderate upward adjustments – in the second 10-day period of May and towards the end of the quarter –, returning to the vicinity of the values prevailing in the first part of March (Chart 3.3). The rates on the short- and medium-term segments of the yield curve declined slowly or remained relatively stable for most of Q2, before also rising mildly towards the end of the period. Hence, the June averages of secondary market rates edged down 0.08 percentage points versus March for 6-month securities (to 1.70 percent), remained unchanged at 1.84 percent in the case of the 1-year maturity, and advanced slightly, by up to 0.08 percentage points, for the 3-, 5- and 10-year maturities, to 2.30 percent, 2.58 percent and 3.27 percent respectively. Consequently, the positive slope of the yield curve steepened further, albeit more moderately.

On the primary market as well, average rates saw their uptrend manifest in the second part of Q1 come to a halt in April and then, after a period of stability, recorded more significant rises in the latter part of May and more moderate in June[43]. Thus, compared to March 2021, the average accepted rates went up in June by around 0.1 percentage points for 1-year securities (1.97 percent), 0.03 percentage points (2.43 percent) for 4-year securities, and by up to approximately 0.20 percentage points for securities with a residual maturity of 8 years (3.00 percent) and 13 years (4.11 percent) respectively. Investors' weakening appetite for this type of assets during Q2 overall was also reflected by the reduction in the ratio of the amounts of bids submitted to the announced volume (to 1.3 from 2.2 in the previous three months), but also by the decrease in the ratio of the volume of issues to the announced volume (0.8 versus 1.2)[44]. Thus, both the total volume of securities issued and that of net issues posted a steeper decline against the previous three months[45, 46].

Amid the mild decline in relevant ROBOR rates, the reduction in the IRCC in Q2, as well as some changes in the composition of the credit flow, the average lending rate on new business to non-bank clients shed 0.13 percentage points April through May 2021

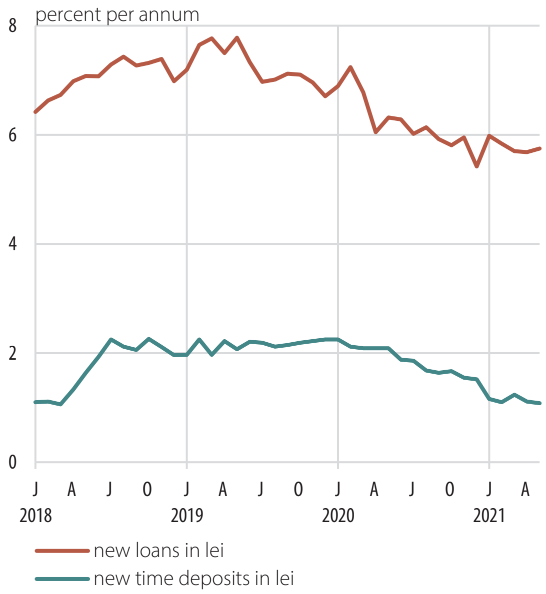
43 Except for the 10-year auction, where the rate diminished marginally against the prior month.

44 In May, the ratio of the volume of issues to the announced volume fell to 0.6 – the lowest value in almost two and a half years.

45 During Q2, the MF fully rejected the bids submitted at five auctions for government securities (of which three in May) compared to three in the prior quarter; the volume of maturing government securities increased in Q2 to lei 12.4 billion from lei 10.3 billion in the previous three months.

46 In the first month of Q2, the MF issued on the external market euro-denominated securities totalling EUR 3.5 billion (of which EUR 2.0 billion with a 12-year maturity and a 2.10 percent rate and EUR 1.5 billion over a 20-year maturity and at a rate of 2.77 percent). Moreover, the MF carried out in the period from April to June two programmes consisting in issues of government securities for households: (i) the "Tezaur" programme, for which subscriptions were made in each month of the quarter and which saw the issuance of securities with 1-, 3-, and 5-year maturities and rates of 2.95 percent, 3.35 percent and 3.75 percent (3.65 percent in June) respectively, worth a total of lei 643 million and (ii) the "Fidelis" programme, for which subscriptions spanned the period from 26 June to 12 July and whereby the MF put into circulation, via the BSE, both leu-denominated securities totalling lei 614.6 million (with 1- and 2-year maturities, at 2.95 percent and 3.25 percent rates) and euro-denominated securities in amount of EUR 58.9 million (with a 2-year maturity and a 1.00 percent rate).

Chart 3.4. Bank rates



against the Q1 average, to stand at 5.71 percent, thus correcting its advance seen in the previous three months. The downward path was broad-based across the major sectors and types of loans. Specifically, the average lending rate on new business to households shrank 0.29 percentage points versus Q1 (to an average of 6.79 percent), given the protracted decline in the average interest rate on both housing loans (down 0.27 percentage points, to 4.36 percent) and consumer credit (0.32 percentage points lower than in Q1, to 8.54 percent). In both cases, the average interest rate hit in May new lows – for the past three and a half years (also under the influence of the higher volume of loans under the "New Home" programme) and approximately six years respectively[47] –, while the monthly volume of new credit remained close to historical highs during the period under review (Chart 3.4).

In turn, the average lending rate on new business to non-financial corporations stuck to the downward path, shedding 0.21 percentage points against Q1 (to an average of 4.16 percent[48]). This reflected developments in both types of loans, i.e. below and above EUR 1 million equivalent respectively (-0.26 percentage points, to 4.39 percent, and -0.33 percentage points, to 3.79 percent respectively). After having witnessed a steep rise in March, nearing the historical high recorded in December 2020, the total flow of loans to non-financial corporations saw significant downward corrections April through May – in the latter month even amid a stronger contribution from the "IMM Invest Romania" programme.

The average remuneration of new time deposits from non-bank clients declined further, albeit at a slower pace, edging down 0.08 percentage points versus the previous three months, to an average of 1.09 percent in the period from April to May overall. The decrease was somewhat more visible in the case of households (-0.19 percentage points from the prior quarter, to 1.10 percent), yet marginal for non-financial corporations (down 0.04 percentage points, to 1.09 percent).

2.2. Exchange rate and capital flows

The EUR/RON exchange rate rose slightly in the first part of April 2021 and then tended to stick to the new readings in the following two months of Q2 (Chart 3.5).

After an upward adjustment in March, the EUR/RON continued to go up slowly in the first part of April, before quasi-stabilising at the levels thus reached, amid the deterioration trend of the economy's external position and the significant pick-up in

[47] 4.28 percent and 8.50 percent respectively.

[48] In May it reached 4.09 percent, close to the lowest reading in over three and a half years.

Chart 3.5. Nominal exchange rate

Table 3.1. Key financial account items

EUR million

	5 mos. 2020			5 mos. 2021		
	Net acquisition of financial assets*	Net incurrence of liabilities*	Net	Net acquisition of financial assets*	Net incurrence of liabilities*	Net
Financial account	4,522	6,691	-2,169	1,067	5,136	-4,069
Direct investment	-779	-37	-742	1,076	3,487	-2,412
Portfolio investments	-1	6,586	-6,587	354	1,993	-1,640
Financial derivatives	-32	x	-32	51	x	51
Other investment	2,456	142	2,314	-625	-345	-280
– currency and deposits	2,340	-145	2,485	-1,089	-260	-830
– loans	248	952	-705	-25	-490	465
– other	-132	-665	533	489	405	85
NBR's reserve assets, net	2,878	0	2,878	211	0	211

*) "+" increase/"-" decrease

the inflation rate – affecting also expectations on the evolution of the currency pair –, but also due to the relative upturn in global risk appetite and the improvement in the public health situation across Central and Eastern Europe, conducive to soothing investor concerns over the economic impact of the third pandemic wave. Against this background and benefiting from the reversal of the downtrend in the EUR/USD exchange rate, the major currencies in the region corrected their depreciation against the euro seen in the previous month[49], although amid some fluctuations, *inter alia* due to influences of local factors.

The exchange rates of these currencies saw their downward path resume/steepen in May[50], in the context of an improvement in the epidemiological situation and the vaccination progress in Europe, with favourable implications for the economic outlook – reflected also in the protracted strong appreciation of the euro against the US dollar. Behind this evolution stood expectations on the sooner-than-previously-anticipated launch of the monetary policy stance adjustment by some central banks in the region[51], following the considerable pick-up in the inflation rate and the largely better-than-expected performance of the respective economies in 2021 Q1. However, the EUR/RON exchange rate remained in May at the relatively higher readings reached in the first part of April, amid the widening of the external imbalance, as well as the further increase in the inflation rate at the onset of Q2 and the much larger-than-envisaged upturn in the economy during 2021 Q1, as indicated by the new statistical data. It recorded, nevertheless, a slight decline towards the end of the month, given the brighter prospects surrounding the absorption of European funds allocated to Romania under the Next Generation EU programme, once the National Recovery and Resilience Plan was presented in Parliament (Table 3.1).

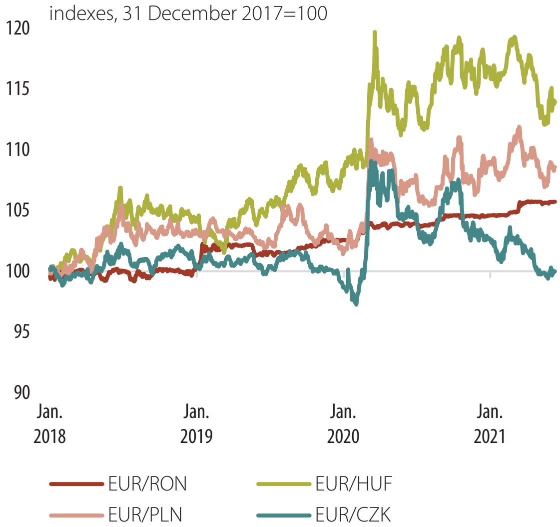
49 In April, the zloty, the Czech koruna and the forint strengthened by 0.8 percent, 1.0 percent and 1.4 percent respectively against the single currency.

50 In terms of daily values, they hit the lowest readings in three months (zloty), nine months (forint) and 15 months (Czech koruna) respectively. Looking at the exchange rate monthly averages, the zloty appreciated 0.7 percent versus the euro, the Czech koruna 1.4 percent, and the forint 2.0 percent.

51 The Hungarian central bank signalled, in mid-May, its intention to raise the base rate in June.

The decline was, however, fully reversed during June, in an environment characterised by the steepening of the uptrend in consumer price dynamics across the domestic economy, but also by some central banks in the region launching the monetary policy tightening cycle. The Fed's signals on the earlier start of monetary policy normalisation[52] were also important, a context in which the EUR/USD largely corrected the previous two months' advance, while the exchange rates of the major currencies in the region witnessed upward adjustments.

Chart 3.6. Exchange rate developments on emerging markets in the region



Source: ECB, NBR

On the interbank forex market, net demand for foreign currency shrank April through June overall to the lowest level in the past three quarters, but this masked the progressive increase in its monthly values, on account of non-residents' transactions.

During 2021 Q2[53], the domestic currency depreciated against the euro by 0.7 percent in nominal terms[54] and appreciated 0.5 percent in real terms. In relation to the US dollar, the leu strengthened by 0.5 percent in nominal terms and 1.8 percent in real terms, given the former's weakening against the euro. Looking at the average annual exchange rate dynamics in 2021 Q2, the leu saw its depreciation versus the euro step up slightly and its appreciation against the US dollar remain constant (Chart 3.6).

2.3. Money and credit

Money

The annual dynamics[55] of broad money (M3) slowed down notably in April-May 2021, primarily on the back of the base effect associated with the significant easing of budget execution in the same year-ago period, under the impact of the pandemic shock and of the relief measures implemented; they remained, however, particularly high, at an average of 14.1 percent versus 16.4 percent in 2021 Q1[56] (Table 3.2).

The slacker growth rate of M3 owed solely to the visible deceleration in the pace of increase of its most liquid component (M1) – particularly due to the evolution of

52 The macroeconomic forecast updated by the Fed in the context of the FOMC meeting on 15-16 June was based on the assumption of raising the federal funds rate starting 2023, i.e. sooner than previously anticipated.

53 Based on the June and March averages of the exchange rate.

54 By contrast, the main currencies in the region strengthened vis-à-vis the single currency during this period (the zloty by 2.2 percent, the Czech koruna by 2.8 percent, and the forint by 4.5 percent).

55 Unless otherwise indicated, percentage changes in this section refer to the average of annual growth rates in nominal terms.

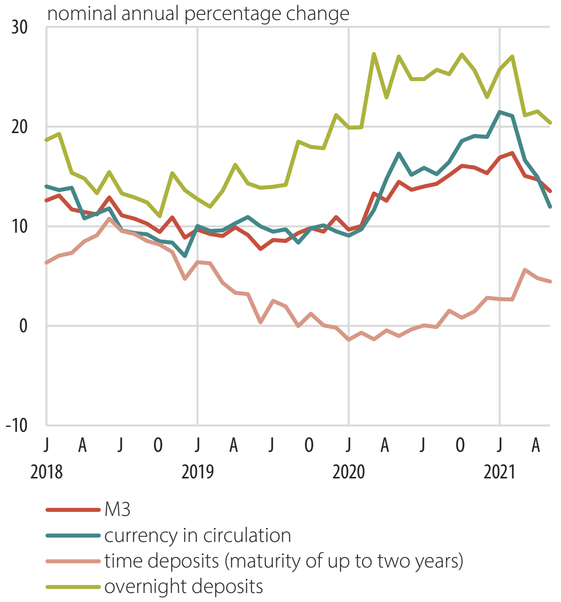
56 The average annual M3 dynamics saw a somewhat steeper decline in real terms, given the higher inflation rate, yet stayed at two-digit levels (10.2 percent in the first two months of Q2 – a 5-quarter low –, from 13.0 percent in the previous three months).

Table 3.2. Annual growth rates of M3 and its components

nominal percentage change

	2020			2021		
	II	III	IV	I	Apr.	May
	quarterly average growth					
M3	13.6	14.5	15.7	16.4	14.7	13.5
M1	22.2	22.5	23.5	23.3	19.7	18.0
Currency in circulation	15.7	15.8	18.9	19.7	14.9	12.0
Overnight deposits	24.9	25.2	25.3	24.6	21.5	20.4
Time deposits (maturity of up to two years)	-0.6	0.5	1.7	3.6	4.8	4.4

Chart 3.7. Main broad money components



currency in circulation and households' overnight deposits –, which however remained very swift. These developments largely reflected the base effect associated with the significant expansion of liquidity across the economy and of demand for liquid monetary assets, *inter alia* for precautionary reasons, in the same year-ago period, given the outbreak of the pandemic crisis and the very high uncertainties thus generated. By contrast, the dynamics of time deposits with a maturity of up to two years continued to gain traction in April-May (up to a 9-quarter high), amid the protracted step-up in the particularly high dynamics of leu-denominated corporate deposits[57]. Households' time deposits with a maturity of up to two years steepened however their loss of momentum – practically coming to a near standstill compared to the same year-earlier period, for the first time in three years –, on account of both leu- and foreign currency-denominated deposits. The share of M1 in M3 resumed, nevertheless, its increase, reaching 69.4 percent in May – a new post-April 1994 high (Chart 3.7).

Looking at institutional sectors, the slowdown in the annual M3 advance was driven by the steeper decline in the dynamics of household deposits. Given the faster growth rate of disposable income and household loans in this period, the evolution can be attributed to the swifter dynamics of private consumption, as well as to the ongoing step-up in the rate of change of individuals' holdings of government securities[58], along with the dynamics of households' placements in investment funds returning to a strongly positive value. Conversely, the change in corporate deposits further increased (to a more than 12-year high[59]), on the back of the stepped-up economic activity, also in trade and services, as well as of the faster dynamics of amounts received from EU funds[60] and of the sharper rise in credit to non-financial corporations.

From the perspective of M3 counterparts, the slower monetary expansion was mostly driven by the evolution of net credit to central government, amid the faster pace of increase of central government deposits – not only in the case of the lei component,

57 An 11-quarter high.

58 In April-May 2021, there were two new issues of leu-denominated government securities for households under the "Tezaur" programme (total subscribed volume of lei 388.2 million).

59 Assessment based on quarterly data.

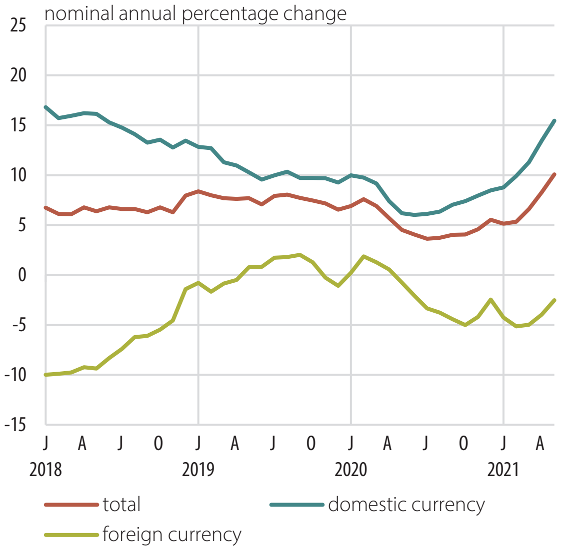
60 According to general government budget execution data.

but especially in that of the foreign currency component[61] –, concurrently with the slight decline in the rate of change of monetary financial institutions' holdings of government securities[62]; the ensuing influences were partly offset by those coming from the significantly swifter growth of credit to the private sector.

Credit to the private sector

The growth rate of credit to the private sector picked up markedly in the first two months of 2021 Q2, climbing to slightly above 10 percent in May and to a 9.2 percent average for the period as a whole[63], from 5.7 percent in 2021 Q1[64]. The evolution was again driven by the lei component, whose annual dynamics advanced more visibly to two-digit levels, up to a 3-year high[65]. These developments reflected both a base effect[66] and intense lending activity, amid the further fast economic growth and the protraction of the generally downward trend in interest rates, to which added the government programmes ("IMM Invest Romania"[67], "New Home"), whose contribution rose slightly in May, although remaining modest. The foreign currency component (expressed in EUR) also had a small positive impact, its pace of decline moderating somewhat more notably, yet remaining significant from the perspective of the past two and a half years (-3.2 percent in the first two months of 2021 Q2 versus -4.8 percent in 2021 Q1, based on EUR-expressed values). Against this background, the share of domestic currency loans in total private sector credit stuck to a slightly upward path, reaching a post-January 1996 high of 70.6 percent in May (Chart 3.8).

Chart 3.8. Credit to the private sector by currency



The stronger increase in credit to the private sector was driven by loans to both institutional sectors. Specifically, corporate credit grew at a faster pace (to a 12-year high[68]), particularly on account of developments in the leu-denominated component,

61 This reflected the impact of the Ministry of Finance issuing Eurobonds worth EUR 3.5 billion in April 2021, as well as the base effect of the Eurobond issue worth EUR 3.3 billion in May 2020. At the same time, in counterpart, net foreign assets of the banking system recorded a significantly slower deceleration in their average annual growth rate.

62 Also as a result of a base effect, as the central bank launched in April 2020 the purchase of leu-denominated government securities on the secondary market.

63 A 12-year high in terms of quarterly averages.

64 In real terms as well, the average annual pace of increase of credit to the private sector stepped up considerably, to 5.5 percent in the period from April to May – a 9-year high – versus 2.6 percent in the previous three months.

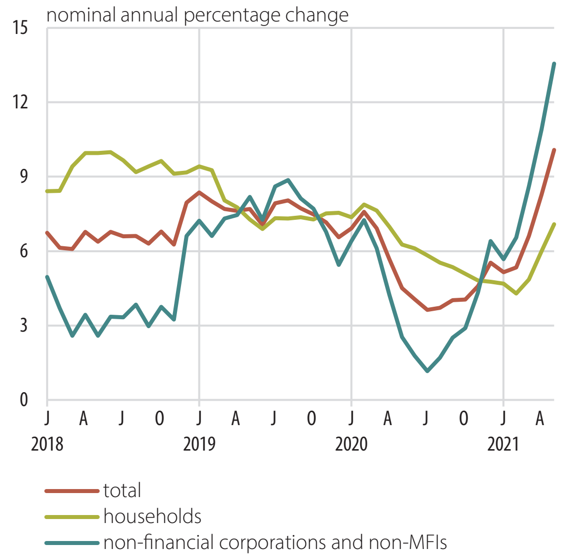
65 Assessment based on quarterly data.

66 Associated with the monthly contractions incurred by the stock of loans to the private sector in the same year-ago period, under the impact of the pandemic crisis.

67 "IMM Invest Romania" is a government support programme approved in the context of the pandemic crisis through GEO No. 42/2020 and supplemented by GEO No. 89/2020, whereby the state guarantees up to 90 percent of the amount of some leu-denominated loans to SMEs and micro-enterprises and subsidises the interest for a period of eight months after the loan origination date and other financing costs (management and risk fees) over the entire term of the guaranteed loan under the programme. This government support scheme was extended until 31 December 2021; for 2021, the total guarantee ceiling amounts to lei 15 billion, of which lei 1 billion is allocated for the "AGRO IMM INVEST" sub-programme.

68 Assessment based on quarterly data.

Chart 3.9. Credit to the private sector by institutional sector



whose dynamics rose to the highest quarterly value of the past 12 and a half years. At the same time, the rate of change of foreign currency loans (expressed in EUR) to this sector slightly re-entered positive territory after staying negative for four quarters. These developments were further manifest primarily for medium- and long-term loans (whose advance in annual terms saw a new leap[69]) and reflected, *inter alia*, the strong pick-up in financing granted through lines of credit[70] (Chart 3.9).

The annual dynamics of household credit witnessed a turning point, increasing in April-May after four quarters of decline. This was attributable to the rebound in the rate of change of the lei component, which climbed again to two-digit levels, under the impact of the fast rise in housing loans gaining momentum and as a result of the dynamics of consumer credit and other loans returning to a significant positive level – given that the flows of both loan categories remained close to their historical peaks. By contrast, the stock of foreign currency-denominated loans (expressed in EUR) to households further contracted at a swifter annual pace April through May.

69 A 12-year high in terms of quarterly averages.

70 Revolving loans and overdraft loans.

4. Inflation outlook

The baseline scenario of the macroeconomic projection is based on the assumption of keeping the epidemiological situation in check. In 2021 H2, the annual CPI inflation rate is projected to stay on the upward path seen in 2021 H1 and to end the year at 5.6 percent, above the upper bound of the variation band of the target. The main contribution to this increase is expected to come from the dynamics of some CPI basket components beyond the scope of monetary policy, namely natural gas, electricity and volatile food (VFE) prices. The gradual fading-out of the temporary unfavourable influences accumulated in the energy component will cause the annual CPI inflation rate to embark on a downward path in the course of next year. This is projected to re-enter the variation band of the target in 2022 Q3 and to remain close to 3.4 percent until the end of the projection interval, i.e. 2023 Q2. The annual core inflation rate is forecasted to rise until the end of this year, reaching 3.4 percent, before following a quasi-stable path until the forecast horizon. Persistent underlying inflationary influences are building up gradually on account of the output gap. Conversely, inflationary pressures currently expected to be only of a temporary nature and therefore to moderate in the course of next year stem from import prices, as well as from inflation expectations, especially in the short term, which stepped up markedly over the past months. The balance of risks to the annual inflation rate is assessed to be tilted to the upside compared to its path in the baseline scenario, over the short run in particular. Along with public health developments that have regained momentum, important uncertainty sources are associated with the future dynamics of international commodity prices and domestic energy prices.

Baseline scenario

4.1. External assumptions

The epidemiological situation in Romania's main trading partners improved significantly in 2021 Q2, in step with the pick-up in the vaccination rate[71] and, implicitly, with the removal of important administrative restrictions imposed previously, which allowed an increase in population mobility. Subsequently, the spread of the Delta variant of the virus led to a suspension or even a slight reversal of the easing of restrictions, the severity of which remains however well below that in

[71] Across the EU, the proportion of adult population vaccinated with at least one dose rose from around 15 percent at end-March to about 62 percent at end-June.

the first part of the year, amid the progress of the vaccination campaign[72]. Under the circumstances, the effective EU real GDP, a proxy for the developments in external demand, resumed growth in 2021 Q2, with the favourable evolution anticipated to continue over the quarters ahead. Nevertheless, the advance is expected to be mitigated by the dynamics of industrial activity, affected by the disruption of global value chains (notably the microchip crisis).

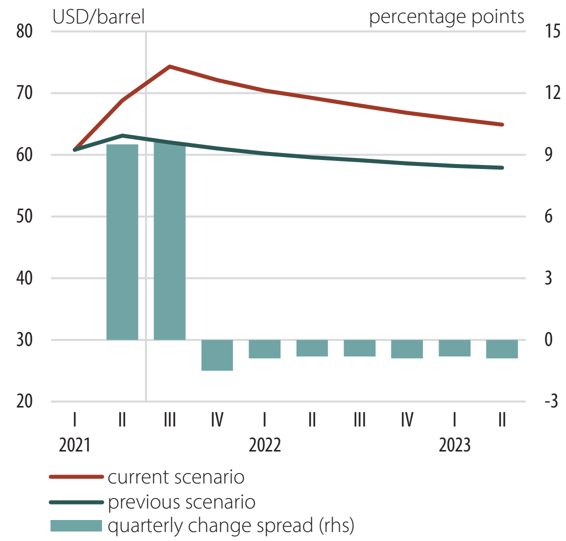
Table 4.1. Expectations on the developments in external variables

annual averages

	2021	2022
Effective EU economic growth (%)	4.8	4.5
Annual inflation rate in the euro area (%)	1.9	1.5
Annual inflation rate in the euro area, excluding energy (%)	1.2	1.4
Annual CPI inflation rate in the USA (%)	3.7	3.1
3M EURIBOR (% per annum)	-0.5	-0.5
USD/EUR exchange rate	1.20	1.21
Brent oil price (USD/barrel)	69.0	68.6

Source: NBR assumptions based on data provided by the ECB, European Commission, Consensus Economics and Bloomberg

Chart 4.1. Brent oil price scenario



Source: U.S. Energy Information Administration, NBR assumptions based on Bloomberg data

Therefore, effective EU real GDP is anticipated to reach the pre-pandemic level at the end of this year, with average annual dynamics of external demand expected to be relatively high, above the potential growth rate (Table 4.1). In this context, the effective EU GDP gap will follow an upward trajectory over the entire projection interval. Compared to the previous *Inflation Report*, the average annual growth of external demand was revised upwards, more significantly in 2021, given the progress of the vaccination campaign and the improved global outlook.

The annual HICP inflation rate in the euro area is projected to go up during 2021 and to reach 2.6 percent in Q4. However, the evolution is assessed to be temporary (see the Box entitled "External inflation – recent developments and outlook"). Thus, the annual inflation rate is subsequently expected to become relatively moderate again, running at 1.4 percent at the forecast horizon, i.e. 2023 Q2. The annual HICP inflation rate excluding energy is foreseen to stay relatively low and reach 1.6 percent at the projection horizon. The trajectory was revised slightly upwards compared to the previous *Inflation Report*, mainly amid expectations of brisker growth in economic activity.

In the absence of prospects for a robust convergence of inflation rate towards the target, the ECB's monetary policy is expected to remain accommodative over the projection interval, most likely supported also by the strategy changes that the institution has announced recently. Against this backdrop, the nominal 3M EURIBOR will run in negative territory. The path of the EUR/USD exchange rate points to a gradual appreciation of the euro, possibly marked by increased volatility over the quarters ahead.

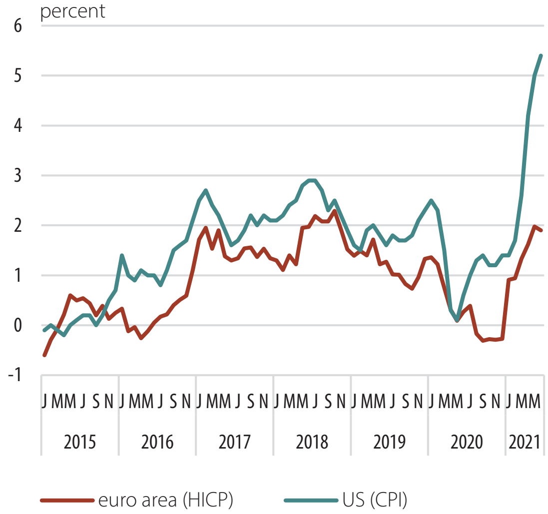
[72] The European Commission's target, as part of the EU vaccines strategy, to protect 70 percent of the adult population with at least one vaccination, was reached at end-July.

The scenario for the Brent oil price is based on futures prices and foresees a gradual declining trend of prices over the projection interval, down to USD 65/barrel at the projection horizon (Chart 4.1). The key drivers of the expected price dynamics remain world oil demand, strictly conditional on developments in the global epidemiological situation, and, on the supply side, the OPEC+ agreements on the pace of return to production levels similar to pre-pandemic ones[73]. The projection of future developments in oil prices continues to be marked by considerable uncertainty.

External inflation – recent developments and outlook

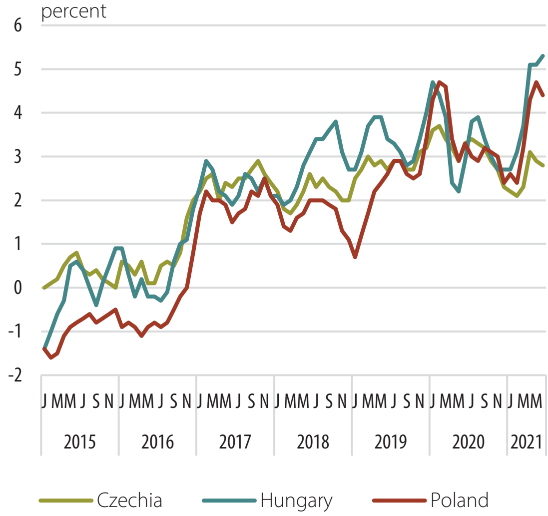
In 2021 H1, inflation saw a general uptrend at global level, accompanied, however, by significant heterogeneity among countries in terms of magnitude. In the euro area, the annual HICP inflation rate went from negative territory to slightly above the 2 percent benchmark, while in the US, the CPI inflation rate rose more sharply (5.4 percent in June – Chart A). The differences between the two geographical blocs may also be attributed to the US's swifter progress of post-pandemic economic recovery. Central and Eastern European countries saw a pick-up in CPI dynamics, as well (Chart B). These developments have fuelled a debate on the prevalent level of inflationary pressures in the medium and long term, related primarily to the temporary or persistent nature of the recent bout of price hikes and, consequently, to the mismatch between demand and supply[74]. Under the circumstances, this box aims to provide an overview of the main factors that led to the recent rise in inflation, as well as of the prospects for future price dynamics.

Chart A. Annual HICP/CPI inflation rate in the euro area/US



Source: Eurostat, OECD

Chart B. Annual CPI inflation rate in emerging economies in the region

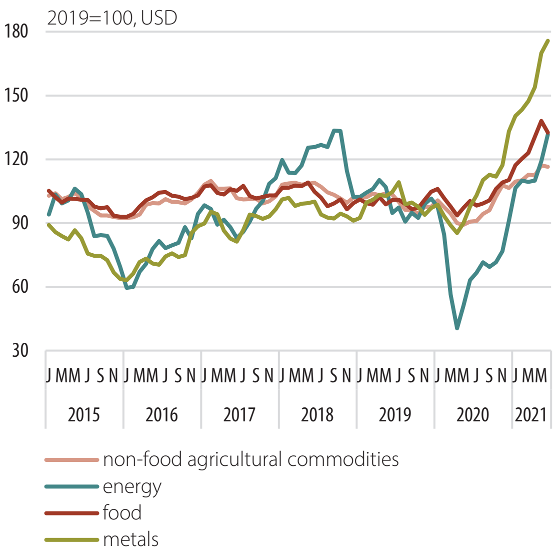


Source: OECD

73 On 19 July, OPEC+ agreed an increase by another 400,000 barrels/day for each month of the current year as from August, over the next five months. Specifically, a further 2 million barrels/day will be added to the production level only by the end of the year. OPEC+ also set September 2022 as a target for reaching pre-pandemic production levels.

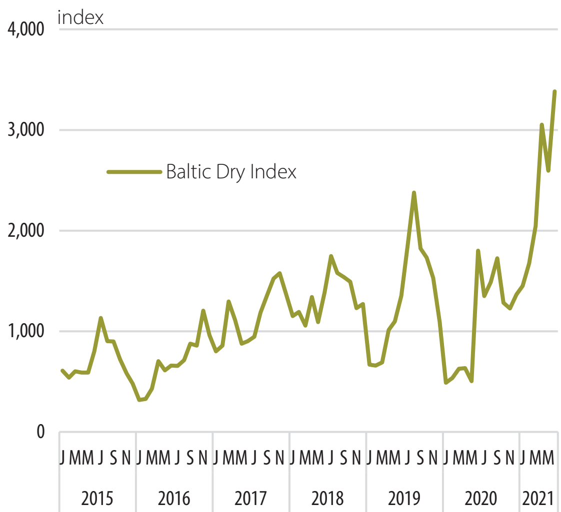
74 This debate is also relevant for participants in international financial markets (inflation trade).

Chart C. Developments in commodity prices



Source: IMF Primary Commodity Price System

Chart D. Developments in water transport prices



Source: Bloomberg

The energy component contributed notably to the recent pick-up in inflation, on the back of the hike in oil prices and of some significant base effects, associated with the extremely low levels recorded in spring 2020, following the outbreak of the pandemic. In addition, commodity prices have witnessed broad-based increases of late, amid robust demand from manufacturing and construction, and for stock replenishment, especially in China (Chart C).

The advance of inflation was also ascribable to the surge in demand for certain intermediate goods, to which supply could not respond sufficiently fast in the short term. One such example is the shortage of microchips, used alternatively for manufacturing several categories of industrial goods, e.g. motor vehicles, computing or other electronic equipment. After the onset of the pandemic, demand for the latter was strongly boosted by a rise in digitalisation, i.e. growing recourse to telework[75], which involved an adjustment process for companies. Specifically, the microchip shortage led, for example, to a sharp hike in motor vehicle prices in the US[76], which spilled over – via the supply-demand imbalance – to the prices of used cars. This was also amplified by supply-side factors, such as bottlenecks in global supply chains, given the disruptions to water transport, which had direct consequences, namely higher freight rates[77] (Chart D).

Additionally, as restrictions are eased, some categories of services strongly affected by the pandemic witness significant base effects, associated with the decline in prices in the previous year.

It should be noted that these developments are attributable to a fragile climate of aggregate demand, according to output gap assessments. The latter, despite marked by heightened uncertainties, continue to indicate, in 2021, further negative values for the euro area and approximately neutral values for the US[78]. These

75 See Box entitled "The Semiconductor Shortage and its Implication for Euro Area Trade, Production and Prices" in the ECB's *Economic Bulletin*, Issue 4/2021.

76 The US covers most of its microchip needs from imports, as the share of its own production decreased to 12 percent of total global production from 37 percent in 1990.

77 See Box entitled "What is Driving the Recent Surge in Shipping Costs?" in the ECB's Economic Bulletin, Issue 3/2021.

78 For example, from the European Commission's Spring Forecast or World Economic Outlook, IMF, April 2021.

aggregate assessments notwithstanding, the breakdown shows several economic sectors that faced a pronounced imbalance between demand and supply. These individual developments led, in fact, to the ample changes in some commodity prices.

According to the forecasts of the main international financial institutions[79], global inflation will decline in 2022, *inter alia* amid some base effects, when the significant price hikes throughout this year drop out of the calculation of the annual inflation rate, after 12 months. The sharp slowdown in annual inflation will occur as the supply-demand ratio rebalances, under the influence of the easing of the above-mentioned factors, which are assessed as having only a transitory impact. Looking at commodity prices, futures prices indicate their stabilisation or moderation. For developed economies, inflation expectations, albeit slightly accelerating in recent periods, continue to be anchored around the inflation targets in the medium and long term. Moreover, the improvement of labour market indicators is estimated to remain slow. However, the balance of risks to the inflation rate is assessed as being tilted upwards, yet primarily in the short term.

The risks to medium-term inflation are numerous and can act in both directions. Persistently high demand, in tandem with a supply deficit in the case of some intermediate goods and commodities, may generate additional pressures on corporate costs. Furthermore, their pass-through into final prices may be facilitated by the advance in aggregate demand, which is in turn influenced by the packages – extremely stimulative in some cases – adopted by the authorities to combat the effects of the pandemic. In addition, these may fuel a prolonged period of increase in commodity prices (a so-called "super-cycle"[80]). The second-round effects of corporate cost hikes also cannot be excluded. There are, however, risks in the opposite direction as well, connected, for example, to labour market developments. Before the pandemic, despite the increase in economic activity and the decline in unemployment, wage dynamics were relatively moderate in developed economies, contributing to a slowdown in inflation to low levels. If economic growth is not also reflected in higher wage earnings, the conditions for fast-paced and long-lasting inflation dynamics will not be met.

In the longer term, both inflationary and disinflationary pressures are expected from the evolution of such factors as global value chains, demographics, automation, digitalisation or climate change. In the case of production and distribution chains, the activities of certain strategic industries may be relocated due to disruptions observed during the pandemic, leading to increased production costs. The dynamics of global demographic factors will also contribute to higher inflation, as the share of working-age population continues to narrow. In its turn, climate change may have a direct impact on the level and volatility of food prices. Indirectly, via policies to reduce greenhouse gas emissions, it may affect energy

79 European Commission (Summer Forecast – July 2021), IMF (World Economic Outlook – July 2021), ECB (Staff Macroeconomic Projections – June 2021), World Bank (Global *Economic Prospects* – June 2021), OECD (*Economic Outlook* – May 2021).

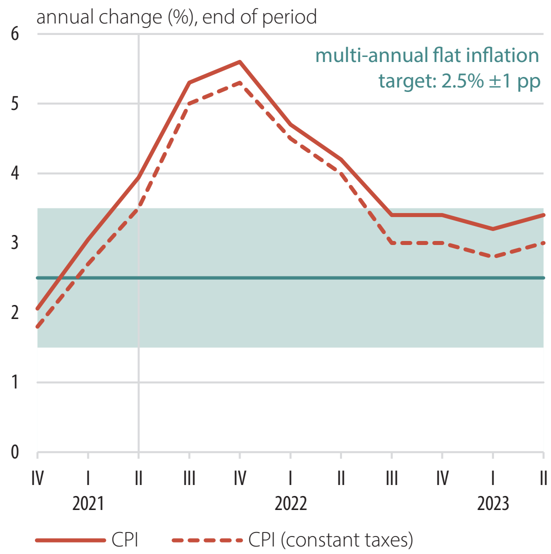
80 However, analysing the previous relevant episodes, it was found that commodity prices tended to be volatile, often exceeding the historical trends in the early phases of economic recovery and subsequently stabilising close to the trend values.

prices and, hence, the prices of some considerably larger categories of intermediate and final goods. By contrast, automation will further generate productivity gains. Moreover, the advance of online trade (which received an additional boost during the pandemic) will lead to greater price transparency, increasing competition and, possibly, reducing inflation. This positive influence could be, however, mitigated/offset by market concentration to a limited number of players and by the possibility of them applying significantly high mark-ups.

4.2. Inflation outlook

After having risen sharply in the first half of this year, amid hikes in fuel and electricity prices, the annual CPI inflation rate is forecasted to stay on an upward path until end-2021, when it is seen reaching 5.6 percent, 2.1 percentage points above the upper bound of the variation band of the target (Chart 4.2). The main contribution to this increase is expected to come from some exogenous components of the CPI basket, in particular the anticipated increases in natural gas and electricity prices and the swifter growth of volatile food prices (VFE). The gradual fading-out of the temporary unfavourable influences accumulated in prices of energy – fuels, electricity and natural gas – will cause the annual CPI inflation rate to re-embark on a downward path in the course of next year. This is projected to re-enter the variation band of the target in 2022 Q3 and then to remain at 3.4 percent both in December 2022 and at the end of the forecast interval, i.e. 2023 Q2 (Table 4.2). The contribution of changes in indirect taxes[81] to the annual CPI inflation rate is estimated at 0.3 percentage points at end-2021 and 0.4 percentage points at end-2022. The average annual CPI inflation will, in turn, follow an uptrend in the first half of the projection interval, peaking at 5 percent in 2022 Q2, before falling to 3.3 percent in 2023 Q2.

Chart 4.2. Inflation forecast



Source: NIS, NBR projection

Table 4.2. The annual inflation rate in the baseline scenario

annual change (%); end of period

	2021		2022				2023	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Central target	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
CPI projection	5.3	5.6	4.7	4.2	3.4	3.4	3.2	3.4
CPI projection*	5.0	5.3	4.5	4.0	3.0	3.0	2.8	3.0

*) calculated at constant taxes

Compared to the May 2021 *Inflation Report*, the annual CPI inflation rate was revised upwards by 1.5 percentage points for end-2021, chiefly on account of sharp rises in energy prices, together with the contribution of the adjusted CORE2 index and, to a lesser extent, that of VFE prices. The revision of the CPI inflation rate projection by 0.4 percentage points for end-2022 is mainly ascribable to the revision

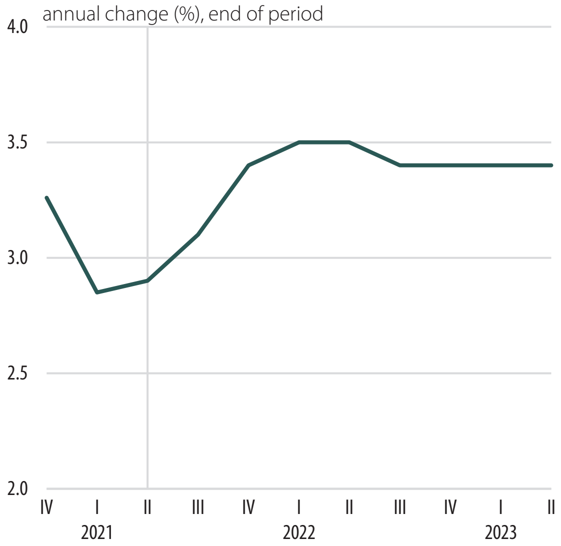
81 It refers to the updating of the excise duty on motor fuels and tobacco, which, pursuant to the law in force, is carried out on an annual basis, i.e. in January and April respectively.

Table 4.3. Annual adjusted CORE2 inflation rate in the baseline scenario

annual change (%); end of period

	2021		2022				2023	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Adjusted CORE2	3.1	3.4	3.5	3.5	3.4	3.4	3.4	3.4

Chart 4.3. Annual adjusted CORE2 inflation



Source: NIS, NBR projection

Table 4.4. Components' contribution to annual inflation rate*

percentage points

	2021	2022
Energy	2.7	0.3
VFE prices	0.4	0.3
Administered prices	0.2	0.2
Adjusted CORE2	2.1	2.1
Tobacco and alcoholic beverages	0.2	0.4

*) end of period; values have been rounded off to one decimal place

of the adjusted CORE2 inflation projection. At this horizon, energy price inflation is only marginally above the May forecast, i.e. by 0.1 percentage points. The annual CPI inflation rate is anticipated to re-enter the variation band of the target two quarters later than in the previous *Inflation Report* (2022 Q3 compared to 2022 Q1).

After discontinuing in 2021 Q2 the downtrend consolidated at the end of the previous year and the beginning of the current year, the annual core inflation rate is projected to rise until December 2021, reaching 3.4 percent, and then to remain close to this level until the forecast horizon (Table 4.3). This evolution is based on persistent underlying inflationary influences building up gradually on account of aggregate demand[82]. Conversely, inflationary pressures currently expected to be of a temporary nature and therefore to moderate in the course of next year stem from import prices, under the impact of rising external prices[83], as well as inflation expectations[84] in the short term, fuelled by recent energy price hikes (Chart 4.3).

Compared to the May 2021 *Inflation Report,* the annual adjusted CORE2 inflation rate was revised upwards by 0.6 percentage points and 0.4 percentage points for end-2021 and end-2022 respectively. The reassessment took place amid upward revisions of the output gap, inflation expectations, and import prices. The latter refer to both final goods and commodities, which were affected by imbalances between increased demand and scant supply for certain categories of products during 2021 Q2.

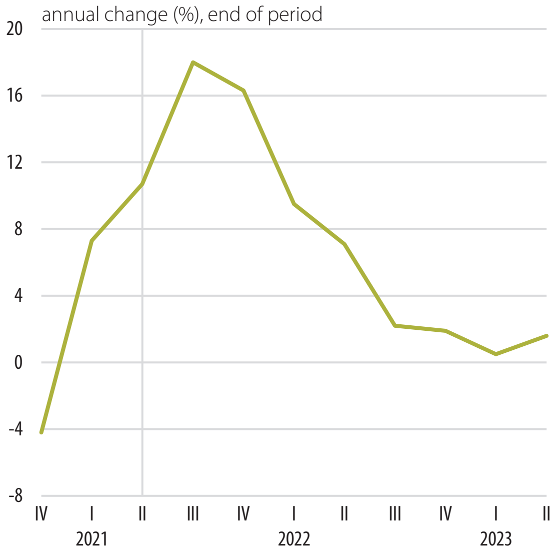
The forecasted cumulative contribution of inflation components beyond the scope of monetary policy, namely energy prices, volatile food prices, administered prices and tobacco product and alcoholic beverage prices, to the annual CPI inflation rate for the end of this year was subject to a new upward correction (by 1.1 percentage points to 3.5 percentage points), driven by energy in particular. For the end of next year, the anticipated value (1.3 percentage points) was only slightly revised upwards by 0.1 percentage points (Table 4.4).

82 For further details, see Section 4.3. Demand pressures in the current period and over the projection interval.

83 Based on euro-area HICP inflation excluding energy.

84 Over the medium term, they are foreseen to remain anchored in the upper half of the variation band of the target.

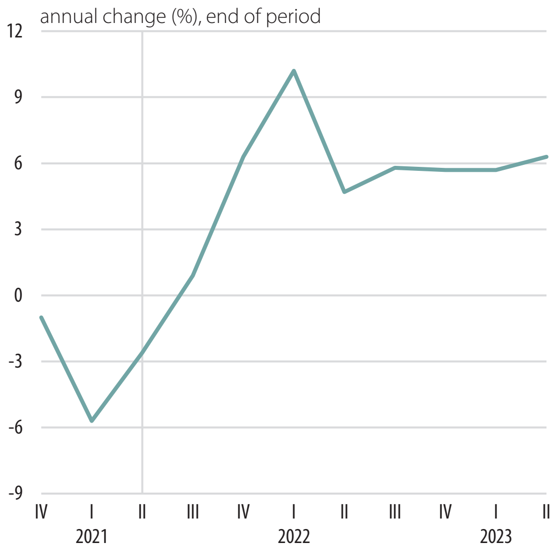
Chart 4.4. Energy price inflation



Source: NIS, NBR projection

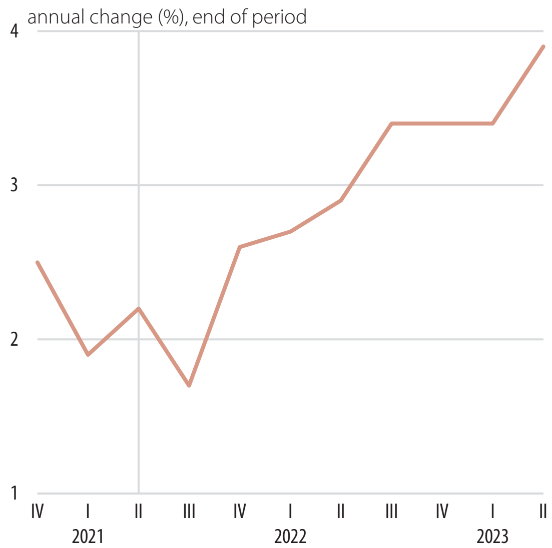
This year, the significant leap in the dynamics of inflation components beyond the scope of monetary policy, from approximately nil in December 2020, is mainly driven by energy (fuels, electricity and natural gas). The annual growth rate of this component is projected to pick up further in 2021 H2[85], before re-entering a downward path in the context of substantial base effects. Its forecasted values are 16.3 percent for the end of this year and 1.9 percent for the end of next year (Chart 4.4). They were revised upwards compared to the previous *Inflation Report*, more significantly in December 2021 (6.4 percentage points) and only marginally in December 2022 (0.4 percentage points). The reassessment for the end of the current year is based on an upward adjustment of the path of both fuel prices[86] and electricity and natural gas prices, the evolution of which took into account the latest information available on price adjustment by the main suppliers in the market[87].

Chart 4.5. VFE price inflation



Source: NIS, NBR projection

Chart 4.6. Administered price inflation



Source: NIS, NBR projection

85 Especially amid the expected movements in natural gas prices, whose path is marked by a significant hike in July 2021, estimated at 20 percent. This occurs in the context of a recent surge in domestic and European wholesale prices, as a result of high demand for natural gas (because of the need to replenish stocks across Europe after a long winter, with below-average temperatures).

86 Following the upside revision of Brent oil prices, but also the relatively higher inflation expectations of economic agents.

87 Similarly to natural gas prices, electricity prices are also expected to be subject to an upward adjustment of about 3 percent in July, amid a nearly 6 percent increase in universal service prices. The previous projection envisaged a 5 percent decline in prices in July, given the discounts anticipated to be offered by suppliers (based on Order No. 5/2021 issued by the Romanian Energy Regulatory Authority), which, however, failed to materialise.

The annual dynamics of volatile food prices (VFE) are anticipated at 6.3 percent and 5.7 percent at the end of 2021 and 2022 respectively (Chart 4.5). Compared to the previous forecast, more unfavourable developments are foreseen over the short term, amid growing demand for such goods, in the context of the gradual reopening of the hospitality industry. Hence, the annual growth for December 2021 was revised upwards by 3.4 percentage points. In both years included in the projection, the path was built on the assumption of normal harvests[88].

Looking at the trajectory of administered prices, their growth rate is seen standing at 2.6 percent and 3.4 percent at the end of 2021 and 2022 respectively (Chart 4.6), close to the multiannual average. Only the value for end-2021 was revised slightly downwards, by 0.6 percentage points, in light of the most recent developments.

The annual dynamics of tobacco product and alcoholic beverage prices are projected at 3.1 percent at the end of the current year and 4.5 percent at the end of next year. The path is shaped mainly by the increases in excise duties provided by legislation, considering also the behaviour of companies in this field as regards the final price adjustment. Compared to the previous projection, the level for December 2021 was revised downwards by 1.8 percentage points.

4.3. Demand pressures in the current period and over the projection interval[89]

Output gap

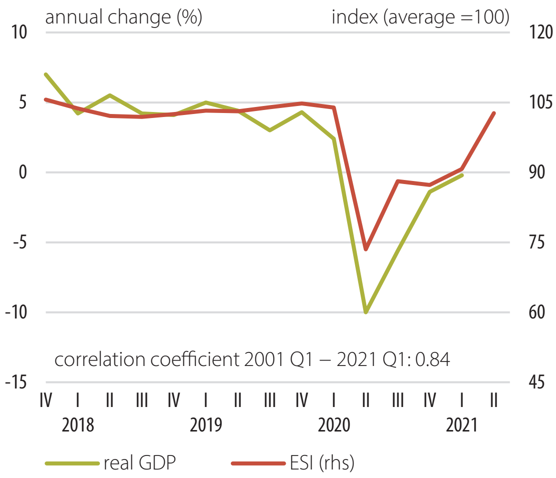
Despite the tighter mobility restrictions in the latter half of 2021 Q1, associated with the third pandemic wave, real GDP witnessed positive dynamics (+2.9 percent in quarterly terms[90]), significantly exceeding the expectations in the previous *Report,* as well as market expectations. These developments can be ascribed to a better-than-expected resilience of the sectors not directly affected by social distancing measures, such as industry, construction and trade, and to their significant share in creating gross value added in the economy. Compared to the assumptions in the previous baseline scenario, the breakdown shows a larger positive contribution from individual consumption, a positive (instead of almost zero) contribution from gross fixed capital formation and a wider negative contribution from net exports, respectively. Moreover, the contributions from the statistical discrepancy and from the change in inventories (to which an explicit economic substance is difficult to assign based on historical developments) remained high, suggesting that statistical data quality is affected by the pandemic-induced difficulties and, therefore, significant revisions of the GDP composition might occur in the future.

88 Relative to their multiannual averages.

89 Unless otherwise indicated, quarterly percentage changes are calculated based on seasonally adjusted data series. Source: NBR, MF, NIS, Eurostat, EC-DG ECFIN and Reuters.

90 NIS Press Release No. 174 of 08 July 2021.

Chart 4.7. Economic sentiment indicator* and economic growth



*) seasonally adjusted data

Source: NIS, EC-DG ECFIN

For the next two quarters (2021 Q2 and Q3), real GDP is expected to post new substantial increases[91], yet at a gradually decelerating pace. In the first two months of 2021 Q2, most of the available high-frequency indicators, i.e. retail trade, market services to households and construction works, sent favourable signals; a notable exception, however, was the performance of industrial output (which saw a decline in May, driven largely by the manufacture of motor vehicles due to the ongoing microchip crisis). The factors contributing to the envisaged advance in the economy in Q2, in a context marked by the significantly improved medical situation, include, *inter alia*: (i) an increase in people's mobility, as a result of the gradual removal of numerous social distancing measures starting with the latter half of May (with an impact mostly on the directly affected sectors, such as accommodation and food service activities or cultural and recreational services); (ii) a much stronger confidence in Romania's economy (in April 2021, the 100 points threshold was exceeded for the first time since the outbreak of the pandemic; Chart 4.7) and in that of the euro area, reflected also by the economies of Romania's trading partners gaining momentum; and (iii) the relatively favourable labour market conditions. The near-term forecasts are further supplemented by the monitoring of a large range of high-frequency indicators[92], correlated with the dynamics of economic activity.

In Q3 as well, economic activity is foreseen to benefit from a relatively low stringency of mobility restrictions, coupled with the economic rebound in Romania's trading partners[93]. Opposite influences might come from the gradual unwinding of government support measures for the labour market, but also from a potential decrease in the confidence of economic agents, as a result of the rising number of infections with the new Delta variant in an increasing number of European countries. The latter poses a risk to economic activity, given the relatively slow pace of the vaccination campaign in Romania. Thus, neither the reintroduction of new restrictions, nor the voluntary reduction in the mobility of the population can be excluded.

Following the -3.9 percent decline in 2020, real GDP is foreseen to witness substantially positive average annual dynamics in both 2021 and 2022. In addition to the anticipated strong quarterly rates following that in Q1, the remarkable growth

91 The forecasted quarterly dynamics are deemed as strong in comparison with the multi-annual average (equalling 0.8 percent for the period 1995 Q2 – 2021 Q1).

92 In the latter half of 2021 Q2, favourable signals regarding economic activity came from indicators such as: the 3M ROBOR, company and freelancer registrations, the stock of loans to the private sector, the option adjusted spread (OAS), the Sentix Index, the road traffic in Bucharest and the Google Mobility Index.

93 Within the extended range of monitored high-frequency indicators, in the first month of Q3, favourable signals come mainly from the Sentix Index, the 3M ROBOR, international flights and the Stringency Index.

during this year also reflects: (i) a significant carry-over effect[94], stemming from the fast recovery in the latter half of last year and (ii) favourable influences linked to the likely transition to a normal year in terms of weather conditions, which implies the fading away of the negative contribution of agriculture to GDP dynamics in 2020.

The breakdown shows that the average annual GDP growth is driven by that of household consumption, to which adds the robust contribution from gross fixed capital formation (a component that was resilient even since the onset of the pandemic), whereas net exports make a negative contribution, yet abating versus the prior year. Compared to the outlook in the May 2021 *Inflation Report*, the economic activity forecast for this year has been revised upwards, mainly due to Q1 developments, which significantly exceeded the forecast made in the previous round. The updated projection also mirrors a more favourable trajectory of the overall economic recovery of Romania's trading partners. A scenario regarding the further moderate absorption (given the limited information currently available) of European funds via the Next Generation EU programme has been included in the current round as well, with a cumulative impact over the entire 2021-2022 period similar to that in the prior round, but shifted more towards the following year.

The potential GDP dynamics are assessed to accelerate strongly during the current year, the component thus having a notable contribution to annual economic growth. This assessment incorporates important base effects as a result of the fading-out of adverse shocks generated by the outbreak of the pandemic crisis. Subsequently, the developments in potential GDP will see a relative slowdown, while further posting hefty annual rates that reflect the robust contributions from analytical determinants (primarily capital stock and total factor productivity – TFP). Compared to the prior *Inflation Report*, the forecasted annual pace of potential GDP was revised upwards, especially for this year, in correlation with the revision of economic growth. Capital stock accumulation is supported by the uptrend in investments, their resilience, which became manifest ever since the pandemic outbreak, being expected to persist, including on the back of the use of additional funds (the beneficial impact being relevant over several years) allocated via the Next Generation EU programme. After a slight deterioration during last year, the improving labour contribution captures the favourable trends of the activity rate and of the average number of worked hours per employed person, together with the prospects for a stabilised unemployment rate. The TFP trend contribution[95] is supported by efficiency gains which mirror the efforts of companies to adjust their business strategies by accelerating digitalisation and automating the operational processes[96]. However, the COVID-19 pandemic may lead to lasting structural changes. The economic impact of the crisis varied substantially across different sectors, with those based on physical interaction, such

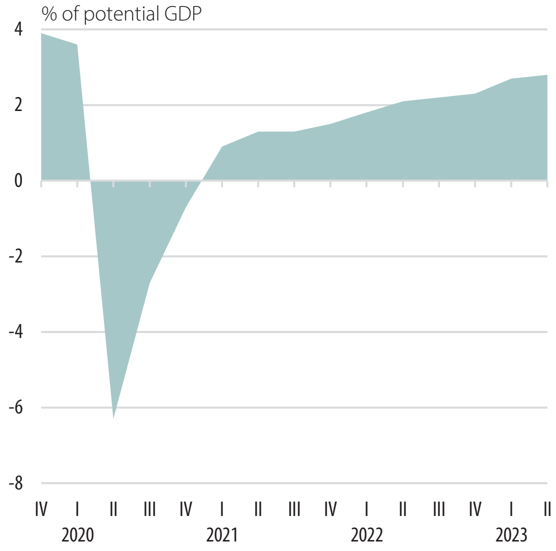
94 Assessed at 2.8 percentage points. For methodological references, see the Box entitled "The impact of the carry-over effects on average annual real GDP growth rate" in the August 2013 *Inflation Report*.

95 Over the longer term, the dynamics highlight persistent adverse effects of the economy associated with the regulatory framework or the quality of infrastructure (weighing also on labour mobility). Evidence is brought by the *Ease of Doing Business* ranking of the World Bank, the *Global Competitiveness Index Report* of the World Economic Forum or the *European Innovation Scoreboard* analysis of the European Commission (which ranks Romania among emerging innovators, with a performance level below 70 percent relative to the EU average).

96 Related assessments based on reports such as *Will Productivity and Growth Return after the COVID-19 Crisis?* of the McKinsey Global Institute or *Impacts of the COVID-19 Pandemic on EU Industries* of the European Commission.

as accommodation and food service activities, witnessing extremely sharp declines in output. If this divergence of sectoral developments persists, the supply side of the economy might be impacted while production factors shift across sectors.

Chart 4.8. Output gap



Source: NBR assessments based on data provided by the NIS

The swift GDP growth during 2020 Q3 and Q4, followed by an unexpectedly high rate in 2021 Q1, suggests a full closure of the negative output gap even since the beginning of this year[97] (Chart 4.8), two quarters ahead of the forecast in the previous *Inflation Report*. Subsequently, the indicator will remain on a slightly upward trend, reaching 2.8 percent at the projection horizon. This trajectory of the output gap is correlated with: (i) the slow progress of the vaccination campaign and (ii) the significant role played by potential GDP in driving future economic growth as a result of the favourable path for investments, which are also intensified via the overlapping absorption of European funds from multiple sources[98]. The output gap of Romania's trading partners also contributes to the gradual pattern of the domestic output gap, the former being assessed to remain negative for a longer period of time than the latter. The monetary policy stance acts in a stimulative manner (with persistent effects over the entire projection interval), whereas the impact coming from the fiscal and income policies is projected to become restrictive as of this year, given the start of the fiscal adjustment process.

Compared to the May *Inflation Report,* the output gap was revised upwards over the entire projection interval, the differential being visible mostly in the first part of the interval, whereas over the medium term the magnitude of revisions tends to diminish. The reshaping of the indicator, which will preserve, despite expectations of a fast-paced economic recovery, a moderately increasing pattern over the medium term, reflects: (i) the lingering statistical effects associated with the unexpectedly swift economic growth in 2021 Q1 and (ii) the faster fading-out, compared to the previous assessment, of the aggregate demand deficit of Romania's trading partners; the contributions of the two above-mentioned factors are partly offset by (iii) the slightly less stimulative impact of real broad monetary conditions over most of the projection interval[99]. Versus the prior *Report*, the counter-cyclical nature of the discretionary

97 The gaps of GDP components are also assessed to enter positive territory in the first part of this year. Mention should be made about the GFCF and public consumption gaps, which have been positive ever since last year, these GDP components being the only ones with resilient paths during 2020. From the perspective of aggregate demand components, over the entire forecast interval the output gap path is shaped by that of domestic demand, whereas net exports make a slightly negative contribution.

98 The Multiannual Financial Framework 2021-2027, the Next Generation EU programme (2021-2026), the extension of disbursements within the Multiannual Financial Framework 2014-2020.

99 Mainly as a result of the higher inflation differential between Romania and its trading partners, and implicitly due to the dampening effect of the differential on the gap of the real effective exchange rate of the leu. The latter impacts the price competitiveness of Romanian products. For further details, see Section "Broad monetary conditions".

conduct of fiscal policy is envisaged to be more moderate throughout this year and slightly more pronounced over the medium term.

Aggregate demand components

Subsequent to the 2020 contraction generated by the pandemic crisis, final consumption is foreseen to post a robust increase, due largely to the contribution of households' individual consumption. The latter is envisaged to increase significantly in both 2021 and 2022, mirroring the dynamics of disposable income[100], with a sizeable contribution from wages, amid the relatively favourable labour market conditions, the latest surveys[101] pointing to a rise in labour demand across the main economic sectors. The recovery of private consumption could also be supported by a possible rise in the propensity to consume, due to the unwinding of pent-up demand, with households spending some of the savings accumulated since the beginning of the pandemic crisis.

Gross fixed capital formation is envisaged to make new robust contributions to GDP growth over the forecast interval. The developments in this component are driven by the strong dynamics in construction and equipment purchases (aimed at technological upgrading, in response also to the requirements stemming from the pandemic outbreak). In the medium and long run, the favourable outlook is related as well to the authorities' stance regarding public investment expenditure, also spending from EU funds[102], expected to have an additional positive contribution. Moreover, the anticipated recovery of foreign direct investment flows, already relatively swift in the first months of 2021, is yet another factor underpinning the significant contribution of GFCF to economic growth. Nevertheless, the hikes in the prices of building materials and transport services are likely to create some uncertainties around the trajectory of investments, also amid an envisaged skill mismatch, on account of low supply of skilled workforce.

The flows of imports and exports are projected to increase over the forecast interval. The 2021 swift dynamics also reflect a base effect associated with the 2020 severe fall in international trade, amid the disruptions in global production and supply chains, in the context of the protection measures adopted in a synchronised manner by most economies.

Exports of goods and services further benefit from the favourable prospects on the upturn of effective external demand (in this respect, flash data for 2021 Q2 were released by Eurostat at end-July 2021), whereas the real effective exchange rate is foreseen to have slightly restrictive effects on the price competitiveness of Romanian products. Additional favourable influences are expected from EU funds absorption (in particular via the Next Generation EU programme – NGEU), which can also help increase productivity of exporting firms. Over the longer term, the dragging structural

100 For the 2021-2023 period, disposable income growth (expected to pick-up at first and then slightly abate over the medium term) is however marked by a deceleration in the annual dynamics of budget transfers, against the backdrop of the government's fiscal consolidation plans.

101 DG-ECFIN, European Commission.

102 These are foreseen to be allocated mainly via the Multiannual Financial Framework 2021-2027 and the NGEU programme.

features of the economy (e.g. the slow catching-up process regarding infrastructure development) are seen to exert a downward effect.

Imports of goods and services are forecasted to post high annual growth rates, taking into account as well the stimulative effects of aggregate demand components and exports, given that numerous exporting sectors extensively use imported intermediate goods. Thus, net exports of goods and services are seen to make a negative contribution to average annual GDP growth, albeit smaller than the year before.

The current account deficit continued to worsen, widening significantly in the first five months of 2021 versus the same year-ago period. At the end of this year, it is anticipated to increase from 5.2 percent of GDP in 2020 to values above 6 percent of GDP. The projected deterioration of the external position is also explained by the reassessment of the cyclical position of the economy, with an excess aggregate demand deemed to prevail as early as the first part of the current year. Favourable influences come from current transfers from the EU. Over the medium term, the external imbalance is envisaged to be corrected only gradually as a share in GDP, further posting values above 5 percent. The financing of the current account deficit is foreseen to be only partly covered by stable, non-debt-creating capital flows over the entire projection interval. The implementation of investment projects via the NGEU recovery instrument lays the groundwork for a more favourable investment climate, which may also be mirrored by an increase in direct investment. At the same time, capital transfers implicitly benefit from favourable conditions, owing to the overlapping of EU funds disbursements from several sources: the multiannual financial frameworks (2014-2020 and 2021-2027) and the NGEU economic recovery programme, respectively.

Broad monetary conditions

Broad monetary conditions capture the cumulated impact exerted on future developments in aggregate demand by the real interest rates applied by credit institutions on leu- and foreign currency-denominated loans and deposits of non-bank clients and by the real effective exchange rate[103] of the leu. The exchange rate exerts its influence via the net export channel, as well as via the effects on wealth and balance sheets of economic agents[104].

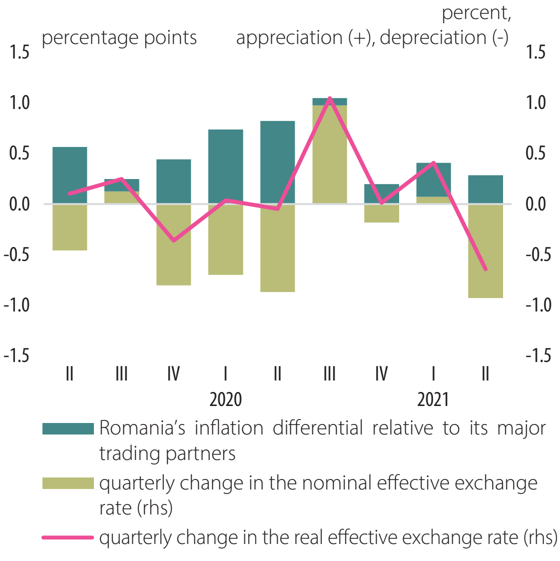
The baseline scenario of the projection shows that real broad monetary conditions will have a stimulative impact on economic activity, at values slightly higher than those in the previous *Report* for the current year, and lower afterwards.

The breakdown shows that real interest rates on both new loans and new time deposits in lei are anticipated to exert stimulative effects over the projection interval.

[103] The relevant exchange rate for the NBR's macroeconomic model for analysis and medium-term forecasting relies on the EUR/RON and USD/RON exchange rates, with the weighting system mirroring the weights of the two currencies in Romania's foreign trade.

[104] The relevance of this channel has gradually declined in recent periods, given the narrowing of the share of foreign currency-denominated loans in total credit to the private sector, amid the faster rise in leu-denominated flows versus those in foreign currency.

Chart 4.9. Quarterly change in the effective exchange rate



Source: Eurostat, U.S. Bureau of Labor Statistics, NBR, NBR calculations

The component related to the effect of the real effective exchange rate (Chart 4.9) is estimated to make, via the net export channel, a quasi-neutral contribution in 2021 H1. Subsequently, the impact is expected to be slightly restrictive, due to the appreciation in real terms of the domestic currency, against the background of a higher domestic inflation compared to those of Romania's trading partners.

The wealth and balance sheet effect is estimated to further make a stimulative contribution to real broad monetary conditions over the entire projection interval. The breakdown shows that the real foreign interest rate (3M EURIBOR) exerts favourable effects against the background of the ECB's persistently accommodative monetary policy, whereas the changes in the gap of the real effective exchange rate of the leu are assessed to have a quasi-neutral impact, and the sovereign risk premium makes a slightly restrictive contribution.

The anticipated dynamics of the sovereign risk premium occur amid investors showing a fluctuating risk aversion towards emerging markets, the most exposed being those with macroeconomic imbalances built up before and exacerbated by the current pandemic.

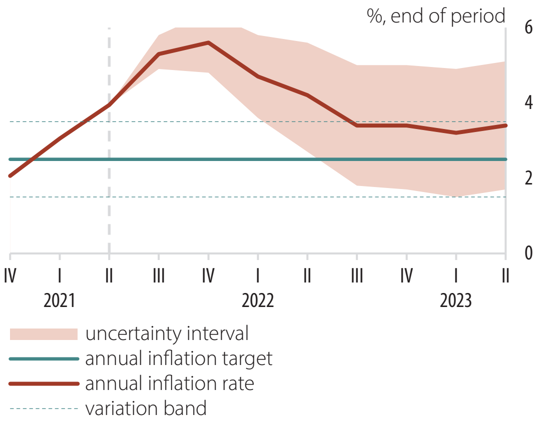
In the particular context of the persisting health crisis, the monetary policy stance of the NBR was tailored in a prudent manner to preserve price stability over the medium term, in an approach conducive to achieving sustainable economic growth amid the fiscal consolidation process, while safeguarding financial stability.

4.4. Risks associated with the projection

At the current juncture, the uncertainties surrounding the future evolution of the health situation have been gaining momentum recently. The Delta variant of the SARS-CoV-2 virus has become a dominant strain in several countries and an escalation in the number of infections in Romania cannot be therefore ruled out, given the extremely slow immunisation process of the population. A worsening of the health situation could lead to a voluntary reduction in mobility, which would impact demand for face-to-face services.

The balance of risks to the annual inflation projection is assessed to be tilted to the upside with respect to the values of the baseline scenario, especially in the short term. Significant risks stem from the domestic environment amid the uncertain magnitude of the hike in electricity and natural gas prices, as well as the unknowns associated with the fiscal consolidation strategy and labour market configuration. Risks also

Chart 4.10. Uncertainty interval associated with inflation projection in the baseline scenario



Note: The uncertainty interval was calculated based on the annual CPI inflation forecast errors in the NBR projections during 2005-2020. The magnitude of forecast errors is positively correlated with the time horizon they refer to.

Source: NIS, NBR calculations and projections

arise from future developments in global economic activity and international commodity prices (Chart 4.10).

High uncertainties continue to be induced by the future fiscal and income policy stance, in view of the unknown size, speed and structure of fiscal consolidation. In order to achieve the targets committed to by the authorities[105] and at the same time considering the European institutions' recent recommendations in the context of the excessive deficit procedure, further corrective measures might be taken. Thus, the net impact on the annual inflation rate would be strictly conditional on the type of these measures, being impossible to predict at this moment. In the short term, a relevant source of uncertainty is the upcoming budget revision.

Although labour market developments are more favourable than previously anticipated, the most important sources of risks arise from the evolution of the sectors most affected by the pandemic (for instance, the hospitality sector). Against the background of the withdrawal of government support measures and the increase in some commodity prices, additional production or health protection costs could pass through into consumer prices, the transmission being facilitated by the recent change in the cyclical position of the economy, i.e. the re-emergence of excess demand. At the same time, should the pandemic crisis and sectoral dispersion persist, the frictions associated with the reallocation of labour and capital across sectors could also have an impact on the potential GDP growth rate. In the medium term, *inter alia* in the context of the multiple investment projects announced in the National Recovery and Resilience Plan, a skill mismatch risk could also materialise, carrying the potential to lead to additional wage pressures, with a persistent impact on the annual inflation rate.

New inflation bouts could come from electricity and natural gas prices, considering, *inter alia*, the pressures on the costs incurred by market participants generated by the transition towards green energy and energy efficiency. These risks can materialise even in the short run, given that forward energy prices on international markets indicate that prices may go up as the cold season approaches, also following the rise in demand amid the recovery of global economy, major purchases of natural gas by some countries for storage purposes, as well as the steps taken to improve green efficiency.

A risk that has recently emerged in the current projection round refers to possible increases in the prices of mobile telephony services. Following the announcement made by one of the main mobile telephony providers relative to updating the pricing

105 On the gradual reduction of the ESA budget deficit and bringing it below the 3 percent-of-GDP threshold by 2024, in line with the path set out in the 2021-2024 Convergence Programme.

policy for certain subscriptions on account of increased network performance and capacity, other providers might adopt a similar behaviour, which would thus lead to additional inflationary pressures.

Externally, high uncertainties stem from the future evolution of the pandemic. The resurgence of the public health crisis, also on the back of slow immunisation campaigns, has the potential to bring about new trade barriers and lower technology transfer to less developed economies. At the same time, the economic policy mix remains clouded in uncertainty in view of the economic recovery efforts and the build-up of inflationary pressures.

Conversely, favourable prospects come from stimulus packages, both at European level and in the US economy, with the potential to drive a relatively fast economic recovery.In the case of the Romanian economy, risks arise from the implementation of the Next Generation EU programme and from the final configuration of the Plan endorsed by European officials. Possible difficulties in meeting the targets committed to by the authorities could be induced by disruptions in the institutional capacity to manage and implement investment projects and additional uncertainties are fuelled, *inter alia,* by the National Recovery and Resilience Plan becoming operational probably only towards the end of the year. However, a relatively rapid absorption of these funds is not ruled out, being even desirable.

Future commodity prices continue to be a notable source of uncertainty against the backdrop of a synchronised upward trend, having the potential to affect medium-term inflation expectations. To this could contribute a possibly faster pass-through of commodity price changes into final prices, fuelled, for instance, by companies' moves to restore the lower profit margins recorded during the pandemic. Moreover, additional inflationary pressures stem from a possible exacerbation of disruptions in global production and distribution chains (e.g. in the case of construction materials or microchips).

The prices of agri-food commodities are also surrounded by elevated uncertainties owing to extreme weather conditions, with the prospects for bumper crops in 2021 mitigating such inflationary uncertainties. On the other hand, additional inflationary pressures could arise from the pork meat segment, given the possible renewed outbreaks of African swine fever.

Looking at the international energy prices, risks are associated with the future evolution of the Brent oil price, especially amid its high volatility and direct correlation with the evolution of the pandemic crisis. Two-way developments are not ruled out, as new inflation bouts may be generated by demand-side factors in the context of the economic recovery (partly moderated by OPEC+ latest decisions to normalise production), whereas disinflationary pressures could be associated with the resurgence of the pandemic crisis and the reduced mobility that comes with it.

Abbreviations

CPI	consumer price index
DG ECFIN	Directorate General for Economic and Financial Affairs
EC	European Commission
ECB	European Central Bank
ESI	Economic Sentiment Indicator
EU	European Union
Eurostat	Statistical Office of the European Union
FAO	Food and Agricultural Organization of the United Nations
GDP	gross domestic product
GFCF	gross fixed capital formation
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Office
IMF	International Monetary Fund
IRCC	benchmark index for loans to consumers
MF	Ministry of Finance
NBR	National Bank of Romania
NIS	National Institute of Statistics
OPCOM	Romanian Electricity and Gas Market Operator
ROBOR	Romanian Interbank Offer Rate
TFP	total factor productivity
VAT	value added tax
VFE	vegetables, fruit, eggs
3M	3 months
12M	12 months
3Y	3 years
5Y	5 years
10Y	10 years

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