Romania's central bank in wait-and-see mode

The National Bank of Romania might wait for more evidence of the impact of its recent massive tightening

Source: istock

On hold for now

After the last meeting, the NBR's governor suggested that monetary policy would stay on hold. Since then, inflation has surprised greatly to the upside, increasing the risk of near-term rate hikes. Both headline and core inflation prints have been higher than the central bank's short-term projections, but we believe the NBR will not be overly proactive. We keep our call for the first rate hike to come at the 7 February meeting when an updated inflation forecast will be presented, likely seeing the short-term inflation path revised higher with the medium-term outlook little changed. The hike in February is likely to be telegraphed at the 8 January meeting in order to preserve credibility.

20%

Chance of an NBR rate hike next week

ING's view

Hawkish stance

With the interest rate indexes relevant for the cost of credit jumping by around 125 basis points in a couple of months- equivalent to five rate hikes- and the subsequent repricing of outstanding loans, we believe the central bank will delay further tightening, citing the need for more assessment, though it will still sound hawkish.

> *We have seen a sharp weakening in soft data such as consumer sentiment surveys recently*

Despite a weakening of some recent data, we've not yet seen evidence of changing consumer behaviour. The NBR might need time to assess how the fiscal changes, especially those related to labour taxation and the impact of the wage bargaining process in business, are affecting disposable income and consumer behaviour. Add to this some downside uncertainties around the inflation outlook from regulated prices and imported inflation, a dovish NBR board, subsiding softening pressures on the Romanian Leu and some, at least verbal, political pressure, and the NBR option to wait until February seems more likely, in our view.

Outlook for 2018

We think that the NBR will go for a measured approach on rates in 2018 and deliver a total of 100bp in tightening via four 25bp key rate hikes, one in each quarter. This would allow the NBR to remain data dependent and adjust if inflation surprises to the downside. This might give the impression that the central bank is falling behind the curve, and back-dated Romanian bonds and the currency should underperform peers, at least initially. We expect another 75bp of hikes in 2019 with the terminal rate for the tightening cycle at 3.50%. As an alternative scenario, if the NBR becomes more proactive - unlikely given that it is tying its decisions to policy stances elsewhere in Europe - and frontloads the tightening, it might gain more credibility and end up with a lower terminal rate

Leu view

We do not see NBR moving to free-floating, but rather adjusting its EUR/RON comfort range higher to 4.60-4.70. Two days after announcing increased flexibility in FX moves, the NBR governor was considering a RON exchange rate near equilibrium level after close to a 1% depreciation against the EUR.

We expect the Romanian government bond yield curve to steepen as the front-end is likely to continue to rally due to money market liquidity shifting back into surplus after heavy government spending in December and a comfortable liquidity outlook on expected large January redemptions. The mix between no change in January and a hawkish message pointing to a February hike should be neutral for back-end government bonds.

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