

National Bank of Romania preview: A last minute hawkish twist?

A 25bp rate cut to 6.75% at the NBR's 13 May meeting seemed a done deal just a few weeks ago. Since then, reasons for cautiousness have gathered on both the external front with the Fed pushing cuts further away and increasingly hawkish regional central banks and the domestic front, with fiscal slippage and strong consumption growth amid robust wage gains



The National Bank of Romania, Bucharest

Back in February, the National Bank of Romania was unusually transparent regarding its perspective on policy easing, linking it to a much-anticipated return and stay of the annual inflation rate on the envisaged downward path". We don't believe that the inflation prints released in the meantime (7.2% in February and 6.6% in March) have meaningfully deviated from NBR's expectations. However, at its following meeting in April, any reference to potential policy easing was removed from the central bank's official statement.

Without placing specific emphasis on any particular item, we believe that a little bit of everything can be blamed for the less dovish rhetoric. This ranges from external to domestic factors and makes the 13 May decision a very close call, in our view, between a 25bp cut and a no-change

decision. So, what has changed compared to February?

The external context is less helpful

The direction of travel in core markets over the last couple of months has generally been pointed at pushing estimates for a first Federal Reserve rate cut further and further towards year-end. Our house view is currently for three rate cuts starting in September but this is arguably a non-consensus view, with markets are currently pricing less than that. Even for the European Central Bank, where a rate cut in June looks almost like a done deal, policy visibility gets quite blurred beyond that point (see [here](#) for more detail).

At the regional level, we have the National Bank of Poland apparently on hold for the rest of the year, while central banks in Hungary and Czech Republic are contemplating a slowdown in their easing pace.

On top of the slightly more hawkish central banks (or as a result of that) we've had the oil price topping US\$90 per barrel less than a month ago on increasing geopolitical tensions in the Middle East.

Domestic developments are pointing to stickier inflation pressures

- On the fiscal front, the budget deficit slipped visibly to 2.06% of GDP in the first quarter (2024 official target: 5.0% of GDP). At this stage, we pushed up our 2024 deficit forecast from 5.5% to 6.0% of GDP, with upside risks still at play. The key factor to watch is the outcome of the negotiations with the European Commission (EC), as the local authorities will try to extend the deficit reduction plan and lower the annual pace of reduction as much as possible. In any case, getting to -3.0% of GDP looks very unlikely to be reached before the next electoral cycle in 2028.
- On the other hand, while the first quarter budgetary slippage is real, one could argue that it is not necessarily out of control. It rather looks more like a conscious decision to maintain spending at elevated levels and play the Romania needs investments" card. At the limit should the EC grow tougher and require swift progress Romania is likely to comply. Meanwhile, however, we remain rather amazed by the relative leniency shown so far by the Commission on Romania's budget performance.
- Another point likely to raise eyebrows at the NBR is the strong recovery in consumption, with retail sales advancing by 5.5% in the first quarter. As real wage gains remain comfortably within double digits, we believe that private consumption still has decent room to accelerate this year. Arguably, the increasing gap between the private and public sector wage gains (in favour of the latter) might suggest a less rosy fundamental picture, but still strong enough to expect substantial inflationary pressures from the demand side.
- While inflation has indeed edged lower after the January spike (when the higher tax burden came into play), services inflation still remains problematic. It is still in double digits and prices pressures remain quite spread out across the categories. Moreover, non-food inflation picked up significantly over the quarter, with private consumption far stronger than expected and oil picking up on geopolitical tensions.
- Looking beyond this year, a new fiscal package (i.e., higher taxes) is likely in the works. While it's hard to tell precisely what policy mix officials will choose, it is clear that some

inflationary pressures could arise from there as well. An important factor to consider is that the new package will likely catch the economy in an acceleration phase. This is likely to fuel inflationary pressure more than taking a toll on growth.

- Last but not least, in line with private consumption, lending has recently been on the rise, with consumer loans looking particularly good. The significant rise in wage gains and the decline in market rates on the back of the liquidity surplus boosted consumers' willingness to get into debt. That said, rates still remain at relatively high levels nevertheless, and consumers were anything but hesitant to spend. This is another reason that we likely won't see many rate cuts soon. The swift and sharp positive reaction of consumers is simply unlikely to bring policymakers the necessary comfort needed to soften financial conditions too much.

That said, any reasons to cut?

- Inflation: while still high in regional and historical terms, it is nevertheless dipping below the policy rate, and we expect it to close below 5.0% in December this year. This might not look overly impressive given the regional inflation performance, but it does give some space for modest rate cuts, which the NBR is likely to take advantage of.
- A 25bp rate cut does not mean the beginning of a huge easing cycle or a major policy shift. If carried out, it could be delivered as a hawkish cut with no commitment to do more.
- Politics: the 13 May meeting will be the last one before the electoral cycle officially begins. While not a reason to cut in itself, the next meeting offers an opportunity to make a relevant policy decision in a still relatively calm political context.

To cut or not to cut

All said, inflationary pressures remain, and the central bank wants to manage these without compromising the progress achieved so far. As per NBR Governor Mugur Isărescu's words, the worst-case situation would be one in which the central bank would begin cutting rates and subsequently be forced to raise them again. For these reasons, we narrowly believe that NBR will stay on hold next week and wait for a better moment to start cutting.

Irrespective of next week's decision, we think that we are unlikely to see a meaningful easing cycle this year and anticipate only 50bp of rate cuts until year-end. This is likely to be accompanied by nominal FX stability and lower levels of liquidity in the interbank market. The surplus liquidity should, however, remain at levels elevated enough throughout the year to maintain the deposit facility rate as the de-facto policy rate in Romania. In the medium term, we maintain our call for a key rate at 5.50% by the end of 2025.

ROMGBs offer decent value after global rally

In the Romanian government bond (ROMGB) space, on the supply side, the Ministry of Finance has covered more than a third of the planned ROMGB issuance for this year (according to our calculations), proportionally covering supply. Auction demand remains average, stronger at the longer end of the curve especially, while the front end has less interest. However, given the deteriorating fiscal picture (similar to other CEE peers), we do not see significant issues on the issuance side for now. Valuations have improved significantly in favour of ROMGBs in recent weeks, with ROMGBs traditionally lagging behind the global rally, resulting in the widest spreads against CEE peers this year.

While the macro and fiscal picture does not look good, we believe current valuations have gone too far. We think that ROMGBs may offer decent value with a good chance of the cutting cycle beginning soon and inflation falling later this year. Overall, we can see the potential appeal of ROMGBs, especially in the belly of the curve at current levels.

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