# National Bank of Romania review: Acting on the window of opportunity

While officials' decision to begin cutting by 25bp in July remains relevant in the short run, the real challenge for the Bank will remain to fine tune a cautious easing cycle in what we foresee as a relatively sticky inflation environment ahead. At this stage, we no longer expect a rate cut in August and we narrowly hold on to our November 25bp rate cut call

Mugur Isarescu, Governor of the Romanian National Bank

The NBR's decision not to hold fire anymore came on the back of an improving disinflation picture, with food and gas prices as key contributors. Overall, this brought enough policy space to allow for a small 25bp cut at this stage, bringing the key rate to 6.75%. However, the prospects of material progress on the inflation front through the medium term are uncertain, in our view, and this is set to matter much more ahead.

In the very short run, according to our projections, while data is likely to show that inflation dipped below 5.0% in June, higher fuel excises and higher distribution costs for gas are set to reverse some of the recent gains in July, with a potential impact on expectations as well.

Going further, we foresee services and non-food inflation being quite sticky on their way to the target level. While we think that non-food inflation is set to hit the target in the forecast horizon, we expect services inflation to marginally miss it. Our view is that wage growth and its impact on private consumption, the persistent fiscal slippage and a likely increase in next year's tax burden will contribute visibly to this stickiness we foresee.

Ultimately, these factors should weigh the most in the NBR's decisions going forward because they are directly linked to internal demand dynamics and the response of firms and consumers to fiscal policy developments. On the other hand, the recent positive contributions of food and gas prices are rather related to international markets and local regulation, so basically things that are not under the NBR's umbrella. As such, we think that while officials took the opportunity to cut, they are unlikely to treat the matters ahead too lightly. Most likely they will want to see significantly more progress on what they directly influence with their policy before being confident in anything more than a cautious easing cycle.

Elsewhere, globally, central banks are in no rush to cut too much ahead either. The Federal Reserve is pushing its easing more and more towards year-end, the European Central Bank is not offering much guidance after its June cut and regionally, central banks in Poland and Hungary are signalling no more cuts this year.

As such, on the outlook, after considering everything, we continue to think that a cautious easing cycle still remains in place, despite the "significantly" lower inflation trajectory compared to the previous forecasts envisioned now by the Bank. We don't think that a second consecutive cut in August is a viable option and, at this stage, we narrowly hold on to our November 25bp rate cut call, taking the key rate down to 6.50%.

## Author

**Stefan Posea**
Economist, Romania
tiberiu-stefan.posea@ing.com

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