National Bank of Romania review: It's largely going according to plan but...

The National Bank of Romania (NBR) delivered as expected by us and the market, maintaining the key rate at 7.00% and making no changes to the standing facilities. The recently announced fiscal changes are added to the list of uncertainties marking the inflation outlook, which has shifted somewhat higher in the mid-part of the two-year forecast horizon

The Romanian National Bank in Bucharest

As usual for some time already, there is no press conference after the rate decision. However, we will have one on 9 August when the most recent Inflation Report will be published.

Main points from the press release:

- So far so good on the inflation front: annual headline and the core rate went down largely in line with forecasts, and it is expected to drop below 10.0% at the beginning of the third quarter (July inflation is to be published on 11 August)
- Weaker GDP growth: the output gap is narrowing faster than expected and the latest data point to subdued growth ahead

- While the trade deficit is improving visibly, the current account is not, due to "outflows of reinvested earnings and dividends distributed"
- The inflation outlook is a tad foggier: NBR's most recent forecasts (to be presented on 9 August) "reconfirms the outlook for a further fall in the annual inflation rate over the next two years, on a somewhat higher-than-previously-anticipated path only in the medium segment of the projection horizon". Apparently, the NBR still doesn't project the inflation within its 1.5%-3.5% target range at the end of the two-year forecast horizon, but rather "near the variation band of the target"
- The recently announced fiscal changes and the temporary cap on selected food products' mark-up are added to the list of uncertainties highlighting the inflation outlook (which include the already usual references to commodities, war in Ukraine and associated sanctions, EU funds, etc.)

What we make of it

The reference to the "somewhat higher-than-previously-anticipated path only in the medium segment of the projection horizon" is worth paying attention to and should normally be a hawkish sign. However, we believe that this is fully offset by the slower-than-expected GDP growth and the associated narrowing of the excess aggregate demand. We believe that the NBR is not yet contemplating the timing for a dovish pivot, despite the more frequent dovish statements coming from other central banks in the region. We maintain our view of a first rate cut in the first quarter of 2024 with a key rate of 5.5% by the end of 2024.

What to expect in FX and markets

The liquidity surplus fell only marginally in June, remaining at a near-record RON25.2bn, indicating scant central bank activity. EUR/RON briefly broke through 4.920 last week, again likely due to high demand for Romanian government bonds (ROMGBs) and has been higher since but still well below any line in the sand set by the central bank. FX implied yields have also risen a bit in the last two months but still remain firmly anchored. We expect the NBR to take the opportunity to withdraw some liquidity from the market if EUR/RON moves higher. In the long term, we expect the NBR to move the bar up for EUR/RON at least once more and we should see the 5.02 level by the end of the year.

ROMGBs eased the pressure a bit in July and we see current valuations as more justified. The spread against Polish government bonds has returned above 100bp in the 10y tenor and even against other CEE peers, the levels seem more fair. The funding story remains unchanged. According to our calculations, the Ministry of Finance (MinFin) has secured about 82.5% of this year's planned issuance, the highest figure in the CEE region. We also saw strong activity in retail issuance in July, making the overall funding situation the best in the region. On the other hand, we see potential incoming problems on the fiscal side. The government is discussing further measures to improve the state budget and we should hear more in the coming days. Despite the fiscal issues, we should see a reduction in the supply of ROMGBs. However, we expect the MinFin to want to stay on the safe side given the uncertainty and if market demand continues the MinFin will be open to issue more than indicated.

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