

NBR preview: An incoming pivot to a cautious easing cycle

While the latest disinflation developments bring some justification for the National Bank of Romania to cut rates at its meeting on Friday, we narrowly expect policymakers to proceed with caution once again. Robust consumption, wage growth and services inflation remain problematic. Two 25bp cuts in August and November are our base scenario



The Romanian National Bank in Bucharest

At face value, the National Bank of Romania would have the policy space to cut as early as this Friday. Headline inflation decelerated to 5.1% in May and could dip below 5.0% in June, while the de facto policy rate (the deposit rate) sits at 6.00%. Cutting down on restrictiveness is certainly on the table. However, as we have emphasised here, the asymmetric positive developments across the inflation basket are likely to remain a discomfort for policymakers.

Indeed, food inflation is now quite well-behaved and back within target. But services and non-food inflation are far from there, and they arguably matter more for the NBR right now. While the central bank clearly welcomes the positive developments on the food inflation front, they are nevertheless more of an outcome stemming from international markets. As such, the NBR is

unlikely to celebrate too much given that non-food and services inflation – which are much more closely intertwined with local demand dynamics – remain at levels inconsistent with the target.

All of this also happens at a stage when credit activity is blossoming, real wages continue to grow strongly and the fiscal slippage persists. On top of this, external developments also predominantly go against a rate cut, with the Federal Reserve pushing its easing more and more towards year-end, the European Central Bank not offering much guidance after its June cut and regionally, Poland and Hungary's central banks signalling no more cuts this year.

We think that August is a better option for the NBR to start cutting. Sure, one month will not substantially change the non-food and services inflation picture. But with one more confirmation that they're at least headed in the right direction, coupled with an opportunity to communicate this key policy decision in tandem with fresh forecasts in a new Inflation Report, there looks to be a stronger case for August than July. However, we still think that the probability of a cut on 5 July is relevant at around 30%.

Ultimately, the most important element here in our view is less about the first cut itself and more about type of easing cycle we have ahead of us. The NBR can't deliver more than a cautious easing cycle as long as structural factors related to internal demand keep inflationary pressures sticky across most of the consumer basket. So while policymakers deciding to become a bit less restrictive in July or in August remains relevant, we think it's of secondary importance. The longer term fine-tuning of the easing cycle is the real challenge, especially as our view is that inflation will remain above the upper range of the inflation target in the vicinity of 4.0% throughout the forecast horizon.

Romanian government bonds (ROMGBs) remain a complicated story despite NBR rate cuts looming. On the supply side, we estimate that the Ministry of Finance has covered about 51% of the issuance, assuming a public deficit of 6.5% of GDP. This alone seems like sufficient progress. On the other hand, demand has gradually declined since the beginning of the year and bid-to-cover is around 1.3, the lowest among CEE peers after POLGBs. Moreover, fiscal risk remains here, which could further increase ROMGBs issuance by the end of the year.

On the demand side, we see ROMGBs breaking away from the region and trading separately with a much lower beta to core markets. 10-year yields have gradually moved up from January lows of 6.20% to the current 6.85-6.90%, usually underperforming against its CEE peers. At the same time, the region has also lost some gains in recent weeks and valuations are not as attractive for ROMGBs. Especially with the HGBs yield at the same level, we believe market demand will head there.

The only attraction for ROMGBs these days is the upcoming start of the NBR's rate cutting cycle. Looking at FX implieds, the market seems to have shifted in recent weeks and some rate cuts are priced in, limiting gains for ROMGBs. It's still possible that we could see some inflow on the back of the NBR story, but it's likely to be a short-term tactical move. Overall, we can see why a more negative view on ROMGBs could be taken when compared against other CEE peers.

Author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.