

Romania: A dovish hike from NBR

The central bank surprised everybody by hiking the key rate by 25bp to 2.00%. The governor hinted at firmer liquidity management after the next meeting



We were looking for a hawkish on hold decision, but the National Bank of Romania Board opted for our risk scenario (20% probability), with the governor mentioning a slightly pro-active approach aiming at anchoring the inflation expectations and acting gradually. The NBR sees a higher-than-previously forecast short-term inflation projection but more significant uncertainties related to the medium-term outlook.

The overall message was dovish in our view. The governor said the firm liquidity management came from a narrower standing facilities corridor and mopping up liquidity at the 1.00% deposit facility looks 'sufficient' right now. The Board discussed even tighter liquidity management by draining liquidity also at the key rate. A decision on this would 'probably' be taken at the next meeting on 7 February. The broad stance remains to aim for lower interest rate volatility with a relatively higher flexibility for the exchange rate.

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On the FX side, comments from the governor were quite ambiguous and, if anything, he suggested a slight preference for a mild weakness if needed. He argued that the moderate RON depreciation over the past few years has been positive of the economy, to avoid a deeper correction while emphasising a general low volatility FX regime. The governor mentioned that the favourable interest rate differential 'in favour of the RON' would last and already helped preserve RON stability.

The outlook for rates now looks again aligned with the scenario we had until the liquidity squeeze late last year. We are likely to see key interest rate hikes accompanied by surplus liquidity conditions, provided there is not an intensifying weakening pressure on the currency.

Apparently, the NBR is trying a balance between higher key rates to keep inflation expectations anchored and lower transmission of the hikes into the cost of credit to mitigate the likely political/public pressures. This scenario did not play out well last time ending with higher rates and softer RON.

We still look for three additional rate hikes this year, of 25bp each, with the first two coming in the first half. The pro-active approach is unlikely to lead to a lower terminal rate for the cycle than we currently see at 3.50% if it is not accompanied by consistent policy implementation to keep the key rate relevant. Minutes of the meeting are due on 15 January.

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