

Romania: Cautious cut from the central bank

We believe that 1.75% will be the terminal key rate of this short rate cut cycle. We expect the National Bank of Romania to continue to support the bond market and keep the FX as stable as possible



The National Bank of Romania building in Bucharest

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In an unscheduled meeting (there is no meeting calendar in fact) the National Bank of Romania decided to cut the key rate from 2.00% to 1.75% and proportionally adjust the deposit rate to 1.25% and Lombard rate to 2.25%. This decision is a touch more cautious than our 50bp forecast for the next key rate decision and – in our view – it likely marks the end of the road for this key rate cut cycle. We base our statement on:

1. The NBR sees inflation rebounding higher in the second part of the year, printing in the upper range of its 2.5%±1pp corridor. We have the same view, although our forecast sees headline inflation closer to the 2.5% mid-point rather than the 3.5% upper limit.
2. The NBR's decision comes after the other relevant regional central banks have already cut their policy rates close to zero. We know that preserving an adequate interest rate differential is important for the NBR and we believe that the near-term objective will be to maintain the current differential. Since the other central banks do not really have more

room for lowering rates, we find it unlikely that the NBR will differentiate itself by continuing to cut the key rate.

3. Somewhat a novelty, the press release mentions that the central bank will seek to maintain international reserves at adequate levels. There is obviously no clear cut choice here, but we think this could have at least two implications:
 - that interventions on the FX market by selling euro to the same extent as it has probably happened in March and April are less likely to be employed. For this to happen, the NBR needs to maintain its ability to increase the carry rates whenever RON depreciation pressures accumulate.
 - the perspective of lowering the minimum reserve requirements for hard currency is a touch more distant now.

The NBR has also decided to continue to purchase government securities from the secondary market while continuing to inject liquidity through repo operations. We maintain our view that the NBR's intention is not to flood the market with liquidity, but rather maintain the functionality of public finances, to the extent the market cannot do that itself. And given the magnitude of the budget deficit (we now expect it to reach -8.6% of GDP this year), the NBR's presence in the market will probably remain a constant in the upcoming months. We estimate that the central bank will need to buy the equivalent of at least 1.5% of GDP this year. In the short term this will probably do the job (ie, ensuring that this year's funding needs are met) but for the next year we believe that tougher measures on the fiscal side will be needed and we foresee at least a VAT increase.

FX-wise the EUR/RON will probably remain very tightly managed for the foreseeable future. We maintain our 4.88 forecast for the year-end.

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