Romania: Five takeaways from central bank minutes

The key things we learnt were inflation has peaked and is now descending towards the target, GDP has slowed in 1Q18 but should recover and monetary policy is set to tighten but at a softer pace

Source: istock

1 Inflation was revised lower and is set to re-enter the target in Dec-18

After noting “significant excess aggregate demand” contributed to inflation reaching its year-high of 5.4% in May-June, some board members pointed to a temporary leveling-off in pressures stemming from consumer demand.

The central bank revised its 2018 year-end inflation forecast from 3.6% to 3.5% and from 3.0% to 2.7% for 2019. Inflation is now expected to “re-enter a slowly upward path in 4Q19”. Uncertainties have been brought up related to administered prices, indirect taxes and oil. Core inflation is also expected to be lower than the initial forecast, at 2.6% from 3.20% in December 2018 and 3.20% from 3.40% in 2019.

Upside pressures to prices still remain

The tight labour market means that "pressures on wages would remain elevated" as finding workers could become even more difficult. The re-acceleration of wages in April and May was noted, after four consecutive quarters of the slowdown "when it had stuck, however, to two-digit levels". Higher inflation expectations and import prices are also mentioned as upward risks.

3 Economic growth set to recover

"Exclusively on account of base effects" the economic growth is set to decelerate in the second and third quarter, but to recover in sequential quarterly terms.

This means that the declining output gap could "re-embark on a slight uptrend in the second quarter" but remain below previous estimates. This forecast has two important assumptions: 1) "a marked abatement...of the expansionary nature of the fiscal policy in 2018" and 2) "a somewhat slower reduction in the degree of accommodation of monetary conditions".

4 Monetary conditions are less accommodative but there's still room for tightening

Board members have noted tthe "relevant" interbank rates were "substantially" above the key rate in July which points to tighter monetary conditions than the ones indicated by central banks key rate.

These developments, together with the EUR/RON downtrend "could witness slight corrections in the context of the central bank providing liquidity via the recently launched repos". Though, this is far from a commitment, we tend to read this as a future intention of the central bank to provide liquidity at the key rate when the system needs it.

5 Fiscal stance should not lead to monetary policy "overburdening"

Several references regarding fiscal aspects/decisions have been made in the meeting.

Firstly, uncertainties to "future configuration of the indirect tax system" have been noted. Secondly, the uncertain outlook for administered prices; 3) an already mentioned "marked abatement...of the expansionary nature of the fiscal policy in 2018, which was then seen becoming neutral in 2019"; 4) the need for a balanced macroeconomic policy mix to avoid "overburdening" of monetary policy.

And finally, concerns were also raised "to the composition of budget expenses unfavourable for public investment and to its outlook" and "as well as to the legislative initiatives in the banking sector".

We think today's minutes were marginally dovish. While the general outlook of the monetary policy seems still bound for tightening, the central bank will probably try to delay it for as long as possible.

We believe that a hike this year is still in the cards but is more dependent on the external context since on the internal front the inflation seems under control for now.

Author

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com