

## Romania: NBR hikes key rate by 25bp

The hike to 2.25% was in line with our expectations and consensus. The governor reiterated the aim to anchor inflation expectations and a data dependent policy outlook



The National Bank of Romania building in Bucharest

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The press release mentions that the latest CPI release was 'higher than the forecast' mainly driven by CORE inflation due to 'still rising excess aggregate demand'. Household consumption jumping by 12.5% YoY in 3Q17 – 'similar to the pre-crisis levels' is also pointed out. The upbeat high frequency data at the start of 4Q17 was also noted. On the inflation outlook, the communique says that 'the new scenario of the projection points to prospects for a pick-up in the annual inflation rate in the months ahead, followed by a slowdown starting with the latter part of 2018'. The governor mentioned at the press briefing that the central bank sees year-end inflation back within the target band. The new forecast will be presented with the Inflation Report on 9 February.

Governor Isarescu tried to balance the two main concerns: the transmission of the rate hikes into the cost of lending and the anchoring of inflation expectations. On the former, he voiced a gradual rise in interest rates with a lag versus the key rate hikes, emphasizing that the increase is marginal versus historic norms. On the latter, he said that the central bank aims to 'jugulate' inflation and targets keeping inflation expectations at bay. He said that the central bank 'wants to temper inflation and subsequently rate hikes'. We forecast the CPI rise peaking near 4.5% in March and

returning within the NBR band in October. This points to more frontloading risks for rate increases this year. More hints could surface in the minutes due 14 February.

The governor suggested that part of the policy tightening could come via firmer liquidity control saying that 'sooner or later' interest rates would be aligned with the key rate. Still, he mentioned that there is a 'quasi-general' view within the NBR Board for keeping some flexibility for interest rate volatility within  $\pm 1$ ppt standing facilities corridor. This could be a trade-off with controlling FX volatility, in our view. This is due to relatively high FX pass-through. The NBR closely watches the RON real effective exchange rate (REER). Given the inflation differential, this could mean that versus 2017, a marginal nominal weakness for the RON could be accepted. On this topic, the governor said that the RON trades 'where it should be'.

We continue to see two more hikes this year, with the next one coming in 2Q18, the second one in 3Q18 to 2.75%, with risks to our call skewed towards frontloading them and gradual firming liquidity management between the hikes. The governor reiterated that the rate outlook depends also on the policy stance of ECB/regional central banks. Hence, with inflation stabilising over the medium-term around the upper bound of the NBR band, more tightening would be needed in 2019 to be in sync with peers. We see the peak of the tightening cycle at 3.50%.