Romania: NBR holds rates steady, maintains hawkish bias

The National Bank of Romania kept rates on hold at 2.50%, in line with our call. We are now forecasting another rate hike this year, most likely in October

The National Bank of Romania building in Bucharest

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While the consensus called for no change in rates, the majority was thin, with eight out of 18 participants in a Bloomberg survey looking for a 25 basis point hike. Hence, the decision came as a slight surprise. NBR governor Mugur Isarescu mentioned that monetary policy is firmer than suggested by the current rate level due to the positive gap between market rates and the key rate. This contributed to the decision to hold rates steady, as such tighter market conditions are appropriate to curb CPI pressures. He actually reiterated a couple of times that tighter market conditions are needed to bring down inflation. The governor also pointed out that core inflation coming down by 0.1 percentage point to 2.95% already shows that the NBR's decision to frontload rate hikes was appropriate and is having the desired impact.

2.50%

NBR key policy rate

In line with our call

As expected

The governor said that during the summer months inflationary pressures are very low, which could help the inflation rate and interest rates to converge at a relatively low level. He also said NBR monetary policy cannot be decoupled from the European Central Bank and central and eastern European banks. Governor Isarescu said that the liquidity squeeze is temporary due to payments to the state budget and the liquidity position of the banking system should return to a “lower surplus” once the ministry of finance starts to spend. He said that interest rate volatility within ±1 percentage point around the key rate level is normal. Hence, he suggested that liquidity injections via the repo operation at the key rate level are unlikely and during temporary liquidity shortages, the credit facility rate- which is 100 basis points above the key rate- would be the relevant policy instrument. The governor did not deny the central bank FX interventions given the managed float regime and the FX impact on expectations in Romania.

The press release mentions the above expectation regarding inflation while 1Q GDP growth “points to a sharper-than-anticipated loss of momentum”. The press briefing still labels monetary conditions as accommodative, though “less accommodative in May through June, amid the increase in relevant money market rates and in credit institutions’ interest rates in relation to non-bank clients, as well as the relative stability of the leu exchange rate”. The press release, for a second time, did not mention fiscal policy as a risk to the inflation outlook. Minutes are due 11 July and the self-censorship on the fiscal debate is likely to persist.

The next meeting is on 6 August, with the Inflation Report presented afterwards. We expect the NBR to revise its headline inflation forecast higher, but to narrow the projection for the output gap and subsequently lower the CORE3 CPI outlook. Despite a hawkish message, given the outlook for core inflation, we put the chances of a hike at the next meeting at 30% unless the emerging markets sell-off intensifies. We think a hike is more likely at the October meeting and still see the peak of the current cycle at 3.25% in 3Q19.

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