

Romania: Central bank defies consensus on rates

The governor of Romania's central bank was dovish at the latest meeting, saying the battle on inflation has been won while not ruling out more rate hikes. But liquidity management might be the preferred tool



The National Bank of Romania building in Bucharest

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NBR goes against consensus

The decision was in line with our call but against the consensus, with 15 out of 18 contributors to a Bloomberg survey expecting a 25 basis point rate hike. The NBR statement labelled monetary conditions as “less accommodative, amid the increase in relevant money market rates and the slight appreciation trend of the leu versus the euro”. There was no consensus within the NBR Board as to what “normalisation means”, as it is waiting to see how far the ECB will go with its own policy of gradual normalisation. The outlook for inflation is “quasi-similar” in the near-term, with CPI expected to fall at the upper end of the target band by year-end, though this “has been slightly revised downwards over the longer time horizon”.

July monthly CPI seen negative

NBR Governor Mugur Isarescu mentioned at the press briefing that, based on preliminary data, CPI is expected to fall in month-on-month (MoM) terms in July, highlighting that two-thirds of the inflation has come from exogenous factors. We forecast July CPI at -0.3% MoM which translates into 4.8% year-on-year (YoY) and we stand at the lower end of the Bloomberg consensus with a median/average of 5.15%/5.17%. This implies a positive MoM reading for July, which might turn out to be a surprise for the market.

Liquidity conditions in equilibrium

On liquidity conditions, the governor said that NBR data shows that the central bank is currently a net creditor of the banking system but depending on the pattern of public spending, we could see periods of surplus liquidity, considering the general backdrop as “equilibrium”. Isarescu said that the central bank “has to ensure the necessary liquidity”. We believe the instrument by which the NBR provides liquidity will depend on FX pressures.

Rates won't rise much

The governor reiterated that the central bank's pre-emptive action was appropriate and reduced the scope for ending up with higher interest rates, adding that there is a “good chance that interest rates won't rise much more”. However, by keeping the outlook for rates dependent on the ECB's outlook, the governor has not ruled out further hikes. He also reiterated that the NBR does not want to induce carry-driven appreciation for the Romanian leu, especially given the external shortfall. He suggested that key rate hikes could be avoided and the central bank might instead use liquidity management to keep money market rates at levels similar to the inflation forecast. Hence, it seems the NBR will try to delay hiking its key rate as much as possible and use liquidity management to fend-off potential RON weakening pressure.

We see two hikes from the NBR ahead of ECB's first hike

Overall this was a dovish press briefing. We expect one more 25 basis point rate hike this year, but it is likely to be delayed from October to the November meeting (the two meetings left for this year). Without meaningful softening pressure on the leu, it is likely to be further postponed into 2019. We doubt that the NBR can wait for the ECB decision (which we expect in 3Q19) to raise rates. We see two hikes by the NBR ahead of the ECB. Afterwards, we expect the NBR to maintain the interest rate differential.