Romania: Bank minutes leave door open for hikes

Minutes from the National Bank of Romania's last meeting reflect a broadly neutral tone but note that the inflation outlook is dependent on “gradually less accommodative monetary conditions”. Hence, more hikes

Source: istock

Unanimous decision

The vote to raise the key rate was unanimous again. Relative to monetary conditions, the minutes mentioned that the “key interbank money market rate” (ROBOR 3M) is near the monetary policy rate, which underlines that the NBR is closely monitoring the transmission of its monetary policy into the cost of credit. The minutes also notde that Romania has the highest key rate in the region and the EU, a point that governor Mugur Isarescu stressed several times in the press briefing following the decision, linking it to the central bank’s intention to discourage the carry trade. Nevertheless, monetary conditions are projected to become “gradually less accommodative” and “quasi-neutral” in 2019. Our reading on this is that the NBR will continue to remove policy accommodation by increasing its key policy rate, while leaving surplus liquidity unsterilised.

Worries about inflation

On the inflation outlook, “some Board members” noted the “temporary nature” of the “significant overshooting of the upper bound”. The Board members are preoccupied in particular by worsening inflation expectations, “hence the need for an adequate monetary policy response”, while the fiscal risks also warrant a response. The high FX pass-through was also mentioned as a risk.

From the internal environment perspective, the minutes cited Board members' concerns regarding a continued deterioration of the trade balance (in particular the food segment), the labour market tightness, the pro-cyclical and unpredictable fiscal policy and a potential “re-euroisation” of the economy.

In addition to “gradually less accommodative monetary conditions (which are) envisaged to become quasi-neutral in 2019”, the NBR CPI forecast for 2019 implies a “return to a countercyclical stance in 2019” of fiscal policy and a gradual contraction of excess demand. We have to keep in mind that there are scheduled presidential and European Parliament elections scheduled in 2019, which make fiscal assumptions a bit unrealistic.

Outlook for 2018

We have two more key rate hikes pencilled in for this year with gradual tightening via liquidity management in the second part of the year. If the “quasi-consensus” in the NBR Board on loose liquidity management remains unchanged, we could see one more hike on top of our baseline scenario. For the next rate-setting meeting on 4 April, we expect the NBR to hike the key rate by another 25bps to 2.50%.

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