Romania: NBR holds at 2.50%, door for easing stays closed for now

Despite the external environment becoming the main factor in the policy-making process, elevated core inflation keeps the easing option off the table. Still, the NBR is in a "ready to act" rather than a "wait and see" mode. If yield driven capital inflows persist, the NBR might ease liquidity controls by the end of the year

Mugur Isarescu, the Governor of the National Bank of Romania

The National Bank of Romania maintained the key rate at 2.50% in line with our call and the market consensus. In a relatively short press conference, the NBR's Governor Mugur Isarescu delivered a balanced speech, maybe just a bit less dovish than we had envisaged. In essence though, nothing has changed after this rate setting meeting.

Main messages:

- Reference to "strict control over money market liquidity" was maintained and the NBR still explores options on how to better manage the liquidity in the system, if needed. A few days with carry below the key rate is not a problem though in the central bank's view.
- Inflation is forecasted to stay above the target band this year and in the upper half of the

interval for the rest of the forecast horizon.
- Lending activity is not adding to the excess demand which is currently pushing CORE inflation higher. Moreover, lending is slowing down, mainly due to the macro-prudential measures aimed at capping the debt service and less by the interest rate component.
- It's hoped the fiscal deficit will close the year "slightly below last year" (-2.9% of GDP). The current developments are "preoccupying us but we don't see everything that darkly".
- The month-on-month inflation could be negative in July 2019, but mind the base effects and regulated prices such as tobacco.
- The high CORE inflation was mentioned more than once, suggesting that the NBR is focusing a bit more than before on this metric, linking it to the strict liquidity controls.
- The global context is the dominant factor these days. Capital inflows were mentioned again by the governor who hinted at possible heavy FX interventions: "FX reserves grew by EUR3 billion (in July)...2 billion from external borrowings but 1 billion from other sources".

The fiscal outlook, despite being somewhat played down by governor Isarescu, apparently remains the main idiosyncratic source of concern which prevents the NBR from joining the dovish "tide". The fear that that tide might retreat exposing the ones who - as in Warren Buffet's aphorism - are "swimming naked" persists in the NBR decision-making process. Still, if our expectations for the September ECB meeting materialise, we see NBR gradually loosening liquidity controls while keeping the key rate unchanged, just to have the flexibility to grab back the swimsuit if the tide turns quickly.

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