

## Romania: NBR rhetoric must be backed by action

The National Bank of Romania kept interest rates on hold at 2.50%, in line with the broad consensus, and pledged to further tighten liquidity control, likely by introducing new policy tools to enable a faster policy reaction



The National Bank of Romania building in Bucharest

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The NBR was surprised by the higher-than-expected inflation numbers and consequently “the new scenario of the projection indicates the outlook for the annual inflation rate will remain above the variation band of the target during the next three quarters and thereafter return to and stay in the upper half of the band until the end of the forecast horizon”. NBR Governor Mugur Isarescu added that the inflation forecast is based on the assumption of tight control of money market liquidity. He suggested that the NBR will be flexible in guiding market rates within a 1.50-3.50% interval between the two standing facilities and that the NBR can’t raise the key rate because of the policy backdrop of the European Central Bank and other central and eastern European central banks.

Domestically, aside from fiscal worries, the inflation outlook faces a new risk relating to the impact of “the new benchmark index for consumer loans (IRCC) on lending and on the monetary policy transmission mechanism” which is likely to lead, at least in the short-term, to an unwanted (by the

NBR) easing in the policy stance and increases the transmission lag of monetary policy, in our view. The current account deficit remains a concern.

2.50% NBR key rate

Broadly expected

As expected

Strict liquidity management seems to be the NBR's strategy for now, aimed at pushing the banking system to raise the interest rates paid for liabilities. Isarescu said that the NBR will implement "strict" liquidity control but "not beyond the 3.50% credit facility level" in order to persuade banks to do so. The governor mentioned the possibility of introducing new tools for open market operations in order to react much faster to changes in liquidity conditions. In our view, this could come in the form of variable rate tenders liquidity sterilisation auctions (deposits, certificates of deposit with different maturities) not capped by the key rate level in a multi-tier rate mechanism, and also by increasing the frequency of the operations depending on market conditions. Daily publication of the current liquidity conditions and perhaps projections could help enhance the efficiency of the NBR's operations.

The NBR tried to send out a hawkish message today but action is needed to show it can swiftly control money market liquidity conditions. Otherwise, a higher revision to the CPI outlook with slower monetary policy transmission and a likely, though transitory, easing of monetary conditions due to changes in the benchmark rate for new retail loans, risk sending inflation expectations higher. While we continue to see rates on hold this year and tightening via twists in policy implementation, we attached a material probability to rate hikes, especially if the Romanian leu comes under renewed depreciation pressures.

## Author

**Ciprian Dascalu**

Chief Economist, Romania

+40 31 406 8990

[ciprian.dascalu@ing.com](mailto:ciprian.dascalu@ing.com)