

Romania's central bank masks a dovish stance with a hawkish twist

The National Bank of Romania (NBR) delivered a mild surprise today, hiking the key rate by 25 basis points to 1.75%, versus the 50-basis points hike we, and the market, had expected. More are likely in the pipeline, but one thing looks certain: the NBR is not enthusiastic about joining the hawkish camp



- By widening the standing facilities corridor to ± 75 bp from ± 50 bp, the NBR essentially delivered another 25bp hike, on top of the 25bp hike in the key rate. This is because, in the current market context, the level of the Lombard rate - which is now set at 2.50% - is more relevant than the key rate level. However, this logic holds water only for as long as liquidity conditions remain scarce, and they currently are. Should the Ministry of Finance embark on more impetuous spending towards the end of the year, which we expect to happen, the liquidity conditions could improve markedly, making the key rate more relevant again.
- The new NBR inflation projections will be presented on 11 November. For now, we know that the updated forecasts show a "significant additional worsening...under the strong impact of supply-side shocks". In line with [our expectations](#), the NBR sees headline inflation only returning to the 1.5%-3.5% target range in the third quarter of 2023.
- Referring to economic activity, the NBR notes that excess aggregate demand has likely

narrowed in the third quarter and that the growth acceleration expected for 3Q21 will be “due to the very good performance of agriculture”. Seeing the rather pronounced activity slowdown in the industrial and construction sectors and noticeable growth fatigue in the retail space, the assumptions for third-quarter agriculture must be extremely strong in order to achieve an acceleration above 1.9% in the quarterly GDP growth rate. The third quarter flash GDP numbers will be released on 16 November.

We continue to believe that the NBR will try to limit the rate hiking cycle as much as possible but given the inflationary background and the CE3 central bank's behaviour, it might not have a choice but to continue with its tightening cycle until it reaches a terminal rate of 3.00% in mid-2022. At the next Board meeting on 10 January 2022, the NBR could walk along the same lines, delivering a 25bp key rate hike and bringing the standing facilities corridor back to ± 1 pp from the current ± 75 bp. A lot will depend, however, on the decisions taken by the central banks in Poland, Czech Republic and Hungary as the interest rate differential needs to stay predominantly positive for Romania.

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