

Romanian National Bank Preview: No hikes but more nuanced approach likely

With the inflation rate set to exceed 4.0% in the second half of the year and at least two regional central banks in tightening mode (Czech Republic and Hungary) the National Bank of Romania will have a hard time playing down these developments. Nevertheless, we still expect the NBR to refrain from signalling a policy tightening at its 7 July meeting



The National Bank of Romania building in Bucharest

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The National Bank of Romania (NBR) will announce its latest decision on Wednesday 7 July. We expect the key rate to be maintained at 1.25%. Inflation developments will not be the only thing the Board will focus on

- We have recently revised our year-end inflation forecast to 4.7% which is starting to look like more than just a mild departure from the NBR's 3.5% upper limit of its 1.5%-3.5%

inflation target range. However, with core inflation still around 3.0% and most of the spike in headline inflation coming from prices outside monetary policy control, it looks sensible for the NBR to look through the current inflation bout.

- Economic activity might be scrutinised as closely as inflation, as the latest high frequency data is compatible with another very strong quarter in terms of GDP growth. As the economy is heading towards one of its best years in the post-communist era, the story of a great but still fragile economic recovery might be more difficult to argue. Largely offsetting these developments, the threat of a possible fourth wave of infections will likely maintain the NBR's current stimulative stance at least throughout the autumn.
- NBR Governor Mugur Isarescu highlighted recently that local interest rates are at historically low levels, despite not being as low as in other countries in the region due to the twin deficits. Moreover, interest rates "are likely to remain low as we manage to keep the inflation under control". Although we do not read this as a commitment to a "no change" policy, it does underline what we believe to be the NBR's stance against the current inflation bout, which is not to overreact to it and try to smooth policy reactions over cycles.

So what to expect next?

We maintain our view of no change in the policy rate in 2021. The recently started deposit taking operations will likely be continued on a regular basis (some more clarity on this could be offered after tomorrow's meeting) to consolidate more firmly the front-end rates around the key rate. We still see rate hikes coming in 1H22, although the chances for a frontloading of rate hikes in 4Q21 have increased.

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