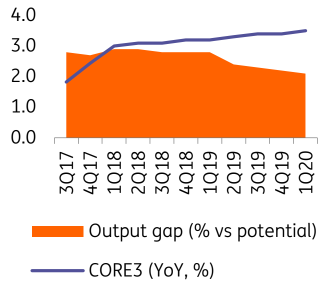
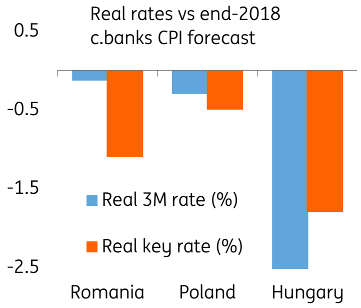
2 August 2018
Emerging Markets

Latest NBR forecast



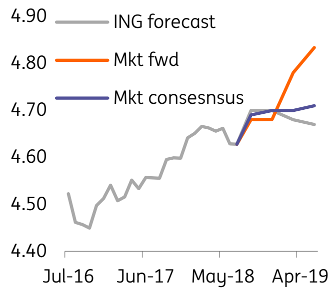
Source: NBR

NBR stance vs peers



Source: NBR, NBP, NBH

EUR/RON forecasts



Source: NBR, NBP, NBH

Latest indicator surprises

Output	Neutral
Consumption	Weaker
Inflation	Lower

Source: Bloomberg

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NBR Preview

We call for an out-of-consensus hold at 2.50%

Reasons for our call for 6 August meeting: (1) already tighter policy stance due to higher ROBOR and stronger RON; (2) likely narrower revision for the output gap and subsequently a shift lower for core inflation outlook; (3) dovish NBR Board likely needs more time to assess mixed-to-weaker high frequency indicators, including soft data; (4) more details needed on upcoming budget revision; (5) no sign of a credit driven assets price bubble. We attach a 20% probability to a 25bp hike as the policymakers might factor in the consensus in their decision.

(1) Over the last month ROBOR rates have been quoted closer to the credit facility rate of 3.50% owing to swings in liquidity conditions due to MinFin tax collection and spending patterns, as well as to NBR firm liquidity management. NBR governor Mugur Isarescu said that tighter market interest rate conditions are needed to bring inflation down. In the past, the NBR preferred liquidity management easing instead of rate cuts when inflation undershoots the target band due to VAT cuts. Symmetrically, we expect it to predominantly use liquidity management rather than rate hikes when inflation overshoots due to supply shocks. This policy implementation, while somewhat reducing the signalling role of the key rate, provides the central bank with more flexibility in case the economy slows more than expected. Unwanted media noise about ROBOR is also likely to weigh on the decision of policymakers. Hence, with the credit facility rate more relevant for the policy stance for the time being, we do not expect the NBR to waste its ammunition at the next meeting.

(2) July NBR minutes mentioned "likely narrowing of excess aggregate demand contrary to expectations of a slight increase", implying a lower core CPI outlook. Actually, CORE3 inflation fell over the past two months by 0.2ppt to 2.9% YoY in June.

(3) Growth in industry and construction shifted into a lower gear at the start of the second quarter. Eurozone GDP second quarter growth was also confirmed lower. Domestically, July printed the weakest economic confidence since September 2014. Hence, the NBR is likely to try to buy more time to digest the data.

(4) Budget revision is looming, which might change the forecast assumptions. There is a risk that, without a structural change in the fiscal policy, more burden is likely to fall on monetary policy in the macro rebalancing process.

(5) There is no evidence of a credit-driven growth and house price developments are seen in a green and stable mode in the NBR's latest Stability Report.

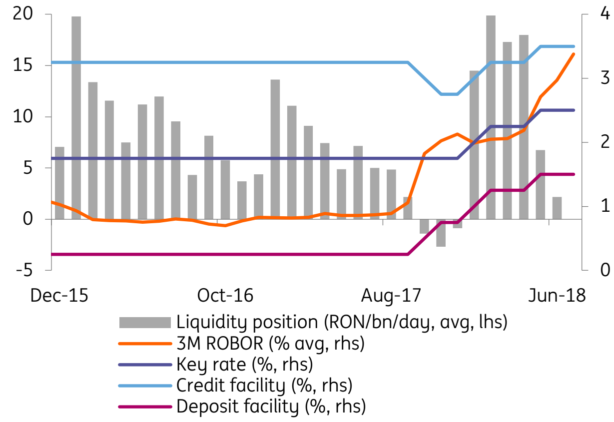
NBR minutes still labelling monetary conditions as accommodative, though "visibly less accommodative" in 2Q18, a mild hawkish tone of the minutes and fear of disappointing the market consensus pose a risk to our no change call. A hawkish tone is likely to be maintained in our view, leaving the tightening cycle open, but data dependent.

FX: Stronger RON helps offset supply side price shocks from oil and regulated gas prices. Some leu weakness could be accepted when inflation starts to fall and/or if we see a permanent decoupling from peers, which would threaten competitiveness. Isarescu said that "rate differential helps keep a stability of the leu". Hence, 4.60-4.70 range to hold.

ROMGBs: With Bloomberg consensus looking for a rate hike, a no change decision could be mildly positive for bonds.

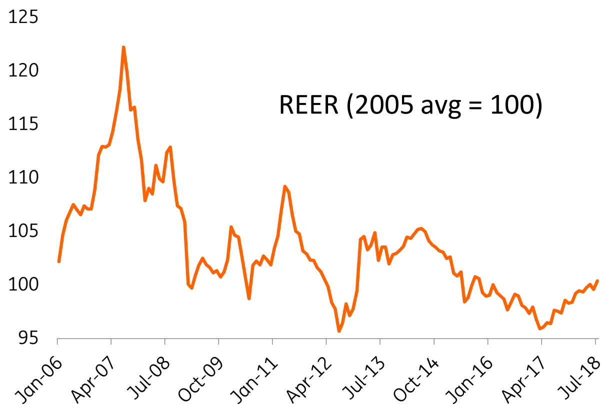
Less orthodox policies, weaker data

Fig 1 NBR tightening via liquidity management...



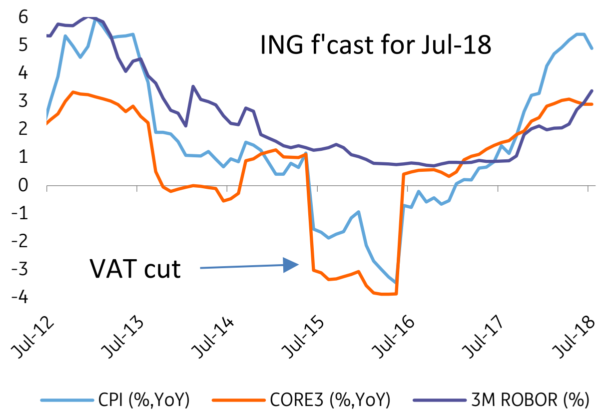
Source: NBR, ING

Fig 2 ...and real effective exchange rate appreciation



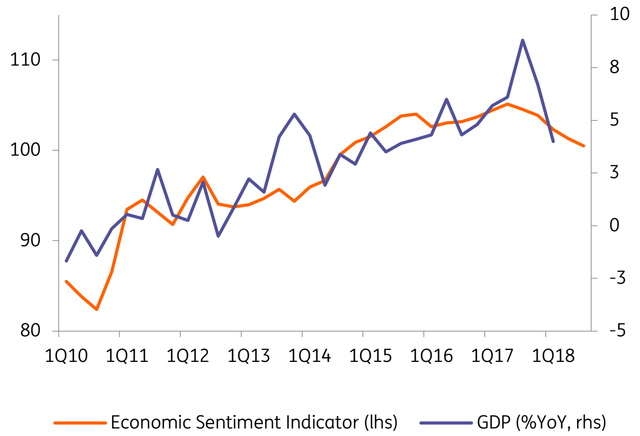
Source: BIS, ING

Fig 3 3M ROBOR already above CORE3 CPI ...



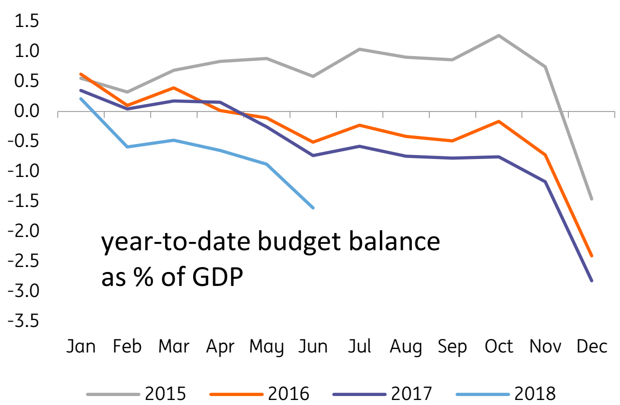
Source: NBR, NIS, ING estimates

Fig 4 ...while GDP growth shifts into lower gear



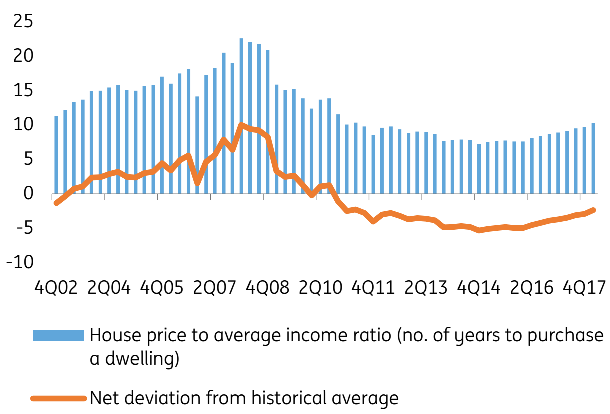
Source: EC, NIS, ING estimates

Fig 5 Fiscal policy not helping the NBR



Source: MinFin, ING

Fig 6 No asset price bubble in sight



Source: Eurostat, NBR, NIS, ING estimates

Fig 7 ROMGBs: bull-bear

	Bull ↓	Bear ↑	ING ↑ / → / ↓
Monetary stance	Relevant interbank indexes for loans are already near credit facility rate and the NBR is comfortable with this policy framework. Hence, less chances of a key rate hike.	Consumers' price expectations continued to inch higher in July.	→ The NBR to hold rates, using liquidity management to tame inflation.
Inflation	NBR to look through the inflation spike resulting from supply shocks. Core inflation inched lower and is likely to stabilise below 3M ROBOR rates. NBR is likely to revise lower the outlook for CORE3.	The outlook CORE3 inflation is likely to show inflation in the upper part of the target interval, despite expected downward revision.	↑ Inflation expectations are still elevated.
Economic growth	1Q18 GDP growth disappointed, details were weak.	Leu consumer lending and labour market remain robust.	→ Growth slowdown is likely to lead to a narrower output gap forecast.
Fiscal policy and politics	The government is committed to a budget gap narrower than 3% of GDP. The government has some buffers from budgeted investment spending and likely a pipeline of measures that could be adopted at short-notice if the target is at risk.	At the end of June the budget deficit came in at -1.6% of GDP, the widest after six months since 2011.	→↑ The NBR is likely to wait for budget revision, but more burden is likely to fall on monetary policy.
Exchange rate and asset prices	The RON was decoupled from the EM sell-off by the NBR's intervention as high FX pass-through has the potential to lead to an "inflation-depreciation-inflation" spiral. There is no compelling sign of a domestic asset bubble.	Twin deficits and their divergent path versus peers are exposing the RON to more prolonged external shocks, despite higher carry insulating it from short-term noise.	↓ The carry seems enough to protect the RON as FX Swap implied yields are quoted above the credit facility level of 3.50%.
External environment	Recent Eurozone data points to a lower cruising speed for the moment. NBR governor tied future policy actions to the ECB.	We look for rate hikes from the US Fed in September and 4Q18 – probably December – with two more coming in 2019. The risks, in our view, remain skewed to the upside for Fed rates.	→ The weaker cyclical picture and low core inflation provide little reason for the ECB to increase rates before autumn next year. However, EM sensitivity to Fed policy and Romania's twin deficits require higher rates versus peers.

Source: ING

Fig 8 Recent hints on policy outlook from NBR officials

Date	Dovish	Hawkish
05-Jul-18	"Romania is an emerging market on par with Hungary and Poland, where interest rates are still low, about 1%." "This rate differential helps keep a stability of the leu." ***NBR governor Isarescu**, quoted by Bloomberg* "Why should I raise the rates now when I'm confident inflation will slow and stagnate at some point?" "We'll have to see how low it goes." ***NBR deputy governor Voinea**, quoted by Bloomberg*	"There shouldn't be any fuss over money-market rates exceeding 3% with 5% inflation." ***NBR governor Isarescu**, quoted by Bloomberg* "We have uncertainties but we're not done yet." "We're assessing what we've done so far." ***NBR deputy governor Voinea**, quoted by Bloomberg*
04-Jul-18	"The firmer policy stance due to higher market rates weighted in the decision to hold rates and such tighter market conditions are appropriate cu curb CPI pressures." "CORE inflation coming down by 0.1ppt to 2.95% is already showing that NBR decision to frontload rate hikes were appropriate and with the right dose and are having the desired impact." "During the summer months inflationary pressures are very low and it would help inflation rate and interest rate to converge to each other and meet at a relatively low level." "NBR monetary policy cannot be decoupled from ECB and central banks in the region." ***NBR governor Isarescu**, ING translation*	"The policy stance is firmer due to the positive gap between market rates and key rate. (...) Tighter market conditions are needed to bring down inflation." "Interest rate volatility within ±1ppt around the key rate level is normal." ***NBR governor Isarescu**, ING translation*
20-Jun-18	"As long as the real interest rates remain negative across Europe, a too high interest rate differential versus the other central banks in the region would exert excessive appreciation pressure of the leu, which - although with favourable inflationary effects - would not be desirable, given the widening of the external imbalance." "Therefore, identifying the appropriate size of the interest rate differential is essential - after substantial tightening since September 2017, which has resulted in an increase of almost 200 basis points in interbank money market rates (a normal development given the inflation differential), a more cautious approach from now on is probably wise. As a consequence, the future actions of the NBR will depend on how the normalization process of monetary policy takes place in Europe." ***NBR governor Isarescu**, quoted by www. hotnews.ro, ING translation*	"As far as I am concerned, I see normalization as meaning the return, finally, to positive values of real interest rates. I doubt, though, that this will be a quick process." "The impact of the reversal of the central bank's monetary policy on emerging economies should not be underestimated." ***NBR governor Isarescu**, quoted by www. hotnews.ro, ING translation*
14-Jun-18		"We are at the beginning of a new financial cycle (...) the era of low and negative interest rates is over. Interest rates in Romania are still low and we don't know where the cycle will end. (...) We must see the reality. Those who borrow and those who lend must be careful in order not to repeat past mistakes" ***NBR governor Isarescu**, ING translation*
07-May-18	"Romania will follow the example of the other countries in Europe and keep the key rate below the inflation rate, probably at a difference of two percentage points." "We are fighting with all of the weapons at our disposal to anchor expectations. I'm sure we will tame inflation without going too high with the key rate." ***NBR governor Isarescu**, quoted by Bloomberg*	"Normalization of the monetary policy means positive real interest rates, in my view, not shared by all Board members. (...) The era of low and negative real interest rates is over." ***NBR governor Isarescu**, ING translation*
04-Apr-18	'We decided to hold today because the previous two decisions have yet to produce effects and we want to see if the trend we forecast for inflation is confirmed. Based on the data we have so far, we see CPI peaking at about 5 percent and then declining gradually' ***NBR governor Isarescu**, quoted by Bloomberg*	

Fig 8 Recent hints on policy outlook from NBR officials

Date	Dovish	Hawkish
28-Mar-18		"An eventual lack of reaction from NBR, in the first two months of the year, and into perspective, would amplify the risk of anchoring inflation expectations at a new level, higher (...) and increase the risk of additional leu depreciation. (...) Such a context could generate new inflationary pressures and lead to an inflation-depreciation-inflation cycle. " ***NBR Board reply to Liviu Dragnea****, president of the Chamber of Deputies, ING translation*
27-Mar-18		'If the fiscal policy does not help the monetary policy, the NBR has no other solution that to hike even more the rates (...) and this might be the only alternative.' ***NBR governor Isarescu****, ING translation* 'Currency depreciation pressures are (...) an additional argument to tighten the monetary policy' ***NBR governor Isarescu****, ING translation of the testimony to the Economic Commission of the Senate*
15-Feb-17	'The NBR aims to discourage carry trade.' ***NBR governor Isarescu****, ING translation*	'The inflation forecast is consistent with non-accommodative monetary policy stance.' ***NBR governor Isarescu****, ING translation*
07-Feb-17	'There is a 'quasi-general' view within the NBR Board for keeping some flexibility for interest rate volatility within ±1ppt standing facilities corridor. ' ***NBR governor Isarescu****, ING translation*	
16-Jan-18	'We will decide in the coming weeks and months, first of all if, and then how many, and the frequency of increases'. (...) It will depend on the data. ***NBR deputy governor Voinea****, quoted by Bloomberg*	'We've shown determination to contain inflation and anchor inflation expectations.' ***NBR deputy governor Voinea****, quoted by Bloomberg*
08-Jan-18	'Narrowing the standing facilities corridor led to (...) firmer liquidity management (...) and the liquidity absorption at the deposit facility level of 1.00% seems sufficient.' ***NBR governor Isarescu****, ING translation of the press briefing from YouTube*	'The NBR Board discussed intervening via operations at the key rate level to keep the interest rates near its level and a decision on this would probably be taken at the February meeting.' ***NBR governor Isarescu****, ING translation of the press briefing from YouTube*

Source: Bloomberg, Reuters, NBR, YouTube, zf.ro, privesc.eu, hotnews.ro, ING translation

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