MACROECONOMIC review

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Evolution of BNR FX reserves in November

As of End of November, National Bank of Romania's foreign exchange reserves stood at EUR 31,744 million, compared to EUR 32,198 million last month.

During the month, the following flows have taken place:

- EUR 1,103 million inflows, representing inflows into the European Commission's account, changes in the foreign exchange reserve requirements of the credit institutions, inflows into the Ministry of Public Finances' accounts, income from the management of foreign exchange reserves a.s.o.;
- EUR 1,557 million outflows, representing interest and principal payments on foreign currency public debt, changes in the foreign exchange reserve requirements of the credit institutions a.s.o. .

The gold stock has held steady at 103.7 tonnes. However, following the change in the international price of gold, its value amounted to EUR 4,276 million.

The international reserves of Romania (foreign currencies and gold) on November 30th 2011 stood at EUR 36,020 million, compared to EUR 36,290 million on October 31st 2011.

During the month of December 2011, the payments due on public and publicly guaranteed foreign currency denominated debt amount to EUR 108.3 million.

Romanian 2011 inflation may be below Central Bank forecast

Romania's inflation rate may end the year at less than the central bank's forecast, bolstering expectations that policy makers will continue to lower interest rates to spur economic growth.
The rate might fall below the 3.3 percent forecast for this year from 3.55 percent in October, Governor Mugur Isarescu said in a speech at a seminar in Bucharest, in early December. The bank targets an inflation of 3 percent, plus or minus 1 percentage point, for this year and next.
"The December annual rate might be lower than our latest forecast, which was deemed optimistic," Isarescu said. "The exchange rate has been relatively stable considering the obvious tensions from the euro area which led to stronger declines of eastern European currencies."
The inflation rate, which has fallen near two-decade lows since July, prompted the central bank to cut the key rate last month and will probably enter the central bank's target for the first time in five years, after the impact of a 5 percentage point government tax increase last year dissipated.

Romanian policy makers resumed cutting rates on Nov. 2, bringing borrowing costs to a record-low 6 percent for the first time in 18 months to spur a weak economic recovery after a two- year recession.
An inflation slowdown isn't enough to warrant faster interest-rate changes, Deputy Governor Cristian Popa also said. Any future rate reduction must be carefully weighted, he said.
The central bank may act to curb "excessive" volatility of the leu stemming from pressure generated by Europe's debt crisis, Popa told to press reporters in Bucharest. Growth may be slower in 2012 than the bank's current forecast of 2.3 percent, he said.

Central bankers left rates unchanged after a July 2010 increase in the value-added tax rate to meet international bailout pledges boosted inflation to the fastest in two years. Before that, the bank lowered borrowing costs four times to combat the worst recession in two decades.

Romania's inflation rate unexpectedly rose in October to for the first time in five months 3.55 percent from 3.45 percent in September on higher heating bills and food costs, the National Statistics Institute said on Nov. 10.
"Vegetable and fruit prices are rebounding after a bumper harvest in the autumn triggered decreases, while administered prices will continue their adjustment," Isarescu also said.

Romania posts highest Q3, 2011 quarterly economic growth rate in EU

Romania reported the highest quarterly economic growth rate (+1.9%) among the EU member states in the third quarter of 2011, according to preliminary estimates released by the Eurostat official statistics office of the EU. In the same quarter, GDP increased by 0.2% in the euro area (EA17) and by 0.3% in the EU27. In the second quarter of 2011, growth rates were +0.2% in both zones. Compared with the same quarter of the previous year, Romania's Q3, 2011 growth rate was third in the EU, at 4.4 percent, behind Estonia's 7.9% and Lithuania's 7.3%. Both the Eurozone and the European Union overall recorded a Q3, 2011 year-over-year rise in the GDP of 1.4%.

Swiss prices, GDP vs. SNB exchange rate policy

Swiss prices fell more than expected in November, adding impetus to the central bank to do more to weaken the Swiss franc to shield the economy from the risk of deflation and recession. Swiss consumer prices for November fell 0.2 from a month earlier compared with average analyst forecasts for a rise of 0.1 percent. They were down 0.5 compared with the previous year compared and with forecasts for a fall of 0.3 percent. Deflation would reinforce the conclusion markets drew about Switzerland's growth outlook after last week's weak KOF and GDP data.

The Swiss National Bank set a cap on the red-hot franc at 1.20 per euro on Sept. 6, citing an increasing threat of lower prices and of a contracting economy.

The new data could be the shock the country's central bank needs to raise the EUR/CHF minimum level at 1.25 or 1.30 from 1.20.

SNB policymakers, who hold their next policy review on Dec. 15, have said they are prepared to take additional steps to keep the currency in check, should the economic outlook and deflationary trends make that necessary, but expectations are it will wait to see what happens in the euro zone, the root of franc strength.

In September, the SNB forecast inflation of just 0.4 percent for this year and a 0.3 percent fall in prices in 2012, based on the franc weakening further.

Comments by Swiss National Bank (SNB) policymakers since early November, related to EUR/CHF cap

The central bank set a cap on the franc at 1.20 per euro on Sept. 6.

Chairman Philip Hildebrand, November 28th:
"The franc will continue to exist for a long time. However, it is highly valued. We assume that it will weaken further…The Swiss economy is currently going into in a difficult phase with a low or possibly event slightly negative rate of growth. The franc is still at a high level….But I wish to remind that since Sept. 6 we've said that we're prepared to take fresh measures if the economic outlook and deflationary risks should so require."

Vice chairman Thomas Jordan, November 27th:
"The Swiss economy is now entering into a difficult phase with low or possibly slightly negative growth rates. The franc is still at an elevated level. On top of this, the world economy is also slowing down".
In response to a question about politicians and industry groups calling for a shift in the cap, Jordan said: "I have a certain understanding for it."

Vice chairman Thomas Jordan, November 14th:
"The national bank must not take instructions from business groups, nor from politicians. We haven't done that in the past, nor will we do so in future. We are constantly watching the situation. We are watching global economic developments and the impact on Switzerland. If we see that due to the economic outlook, due to deflationary risks there is a need to act then we will take measures". "We are worried. The global economy has become weaker. The franc is still very strong despite the minimum exchange rate." Jordan said. "These both lead to the economic development in Switzerland being dampened. We assume that we will see a significant weakening of the economic development here at home."

Board Member Jean-Pierre Danthine, November 11th:
"We are continually observing developments and are ready, if that is necessary, to take further measures. Of course we hope that Europe will work towards a solution of the problems sufficiently quickly so that we don't fall into a recession."
"If the risk of an economic downturn increases due to a strong decline of foreign demand and the strong franc then there is a risk that must be taken seriously of a deflationary development given already falling consumer prices,"

Chairman Philip Hildebrand, November 8th: on limits of inflation-targeting monetary policy

"A clear lesson, one of the most powerful lessons from the crisis is that monetary policy that ensures price stability is a key ingredient for macroeconomic stability but it does not excesses in the economies... it does not guarantee financial stability. The most prominent area of regulation that we have in mind is that it should be the SNB's responsibility to mandate a counter cyclical capital buffer as it has been set up in Basel III. We feel that we should have a more formal role to play on deciding on regulation that clearly impacts on financial stability. We are not suggesting that we have to have a voice in all regulation, but in the regulation that will have a direct bearing on financial stability."

Vice chairman Thomas Jordan, November 8th:

"It would be incorrect to simply conduct a policy that simply results in a competitive devaluation," SNB vice chairman Thomas Jordan told a conference in the central city of Lucerne. "It's a big difference if you weaken the currency so that you get a price advantage over someone else or if you limit the appreciation," he also said.

Asked how far the SNB would take its policy of weakening the franc, Jordan said: "If the state of affairs were suddenly to develop that we had enormous deflationary pressures and we had to take certain steps, then we would. The instruments available are well known."

Jordan said the cap on the currency could involve high costs and expand, but added: "Nevertheless the central bank is fully committed to enforcing this minimum exchange rate, so as to fulfill its mandate."

Vice chairman Thomas Jordan, November 7th:

"If the franc suffers an appreciation that's no longer tolerable, then we take steps to push deflationary risks out of the way. And we did that". "We're always looking at the situation," he said. "If there's need for action...then we're prepared to take further steps."

Chairman Philip Hildebrand, November 6th:

"The franc is still highly valued versus the euro at the current exchange rate. We expect it to weaken further over time,… If that was not the case, it could lead to deflationary trends and weigh strongly on the economy. If the economic outlook and the deflationary development make it necessary, we are ready to take further measures," he said.

"We see that our crystal clear policy when introducing the minimum exchange rate is seen as very credible," said Hildebrand, adding broad support for the measure had added to its credibility.

Asked whether the SNB could lift the minimum exchange rate to 1.30, Philip Hildebrand, who was appointed vice chairman of the Financial Stability Board in early November, said: "We monitor the data and will take further measures if needed."

Political changes in euro zone governments: Greece, Italy and Spain

November has come with several changes on the euro zone political level, together with increased fears related to the spread of Europe debt crisis.

In early November, after losing its support, Greek Prime Minister Georgios Papandreou has resigned, opening the way for a new government, managed by a technocrat Lucas Papademos, former vice president of ECB.
Later, market focus has changed to Italy, approaching (or even overrunning) the yield of Italian 2Y, 5Y and 10Y bonds to 7%, the figure considered to generate significant problems to any government. The Berlusconi government has resigned, immediately after getting the Parliament approval of his austerity package. The technocrat Mario Monti has been appointed as Prime Minister. The first significant step of the new government was announced during the last weekend of November and mainly involved budget cuts.
In the same month, following general elections in Spain, socialists have lost the power and a new government has been formed by Mariano Rajoy, former leader of the opposition Popular Party.

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