MACROECONOMIC review

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NBR Board decisions of September 29th (official statement)

In its meeting of September 29, 2011, the Board of the National Bank of Romania decided the following:

• to keep unchanged the monetary policy rate at 6.25% per annum;

• to ensure adequate management of liquidity in the banking system;

• to maintain the existing levels of minimum reserve requirement ratios on both leu-denominated and foreign currency-denominated liabilities of credit institutions.

The NBR will further monitor domestic and global economic developments so as, by accordingly adjusting its available instruments, to ensure the fulfillment of its objectives of achieving and maintaining price stability in the medium term as well as financial stability.

The analysis of developments in macroeconomic indicators shows a faster disinflation, in line with the central bank's expectations. The annual inflation rate slid for the third consecutive month to reach 4.25% in August versus 7.93% in June, amid a steep reduction in volatile food prices and the gradual fading-out of the first-round effect of the VAT hike in July 2010. Moreover, the annual adjusted CORE2 inflation fell to 2.92% in August against 4.74% in June. Disinflation is expected to continue in the period ahead, so that annual inflation rate will near the target. The faster disinflation while keeping the monetary policy rate unchanged and amid a moderate leu exchange rate volatility translates into a tightening of real broad monetary conditions aimed at supporting the convergence of inflation towards the medium-term objectives.

The resumption of economic growth continued, at a slower pace, amid a worsening of global risk appetite and of the outlook for growth worldwide, as well as amid increased uncertainties regarding the euro zone sovereign debt crisis. The slower pace of the Romanian economy is expected to be temporarily countered by the good agricultural output in the second half of this year.The prospects reveal a consolidation of disinflation, but also persistent uncertainties related to developments in the external environment, capital flows, as well as administered and some volatile prices. Therefore, the central bank will gradually adjust the monetary policy stance, in line with these developments and in the context of fulfilling the Romanian authorities' commitments under the external financing arrangements with international institutions.

Ensuring price stability, together with maintaining financial stability, paves the way for a sustainable cut in the costs of leu-denominated loans, a process fostered by the NBR. The resumption of lasting economic growth should also consider a boost of leu-denominated saving, which would secure sustainability of the external deficit and gradually reduce reliance on external financing.

August inflation rate declines to lowest in 17 months

Romania's inflation rate fell more than economists expected in August to the lowest in 17 months as a bumper harvest boosted food stocks and the effect of a government tax increase faded.
The rate fell to 4.25% from 4.85% in July, the lowest since March 2010, the National Statistics Institute in Bucharest said. August inflation was estimated at 4.6%, according to the median forecast of nine economists surveyed by Bloomberg. Consumer prices fell 0.35%, on the month.
Eastern European central banks including Romania have left borrowing costs unchanged in the past quarter amid concern about the economic impact of the debt crises in Europe and U.S. Romania's central bank lowered the inflation forecast for this year and next on Aug. 8.

Romania's central bank targets an inflation rate of 3%, plus or minus 1%, for this year and next and expects the rate at 4.6% at the end of the year. The International Monetary Fund forecasts a 5.5% rate for the year, the lender's mission chief to Romania, Jeffrey Franks, said on Aug. 1.
Food-price growth slowed to 3.8% in August from a year earlier, compared with 5.7% in July, on falling vegetable and fruit prices, the institute said.
Non-food costs fell to 4.9% in August from 5% the previous month, while price growth for services accelerated to 3.5% from 3.1% in July on increased public transport costs and rising water bills, the institute said

Public budget deficit

Budget deficit for January-August extended to 2.4% of GDP from the previous 2.1% of GDP recorded in the first seven months of the year. The fact that the deficit target agreed with the IMF for 3Q11 stands at 3.2% of projected GDP gives the government room for September. It is not very likely that the September gap will turn out to be this wide but it will probably be significantly larger than the shortfall seen in August.
Since the debt issued in August and September barely covered maturing instruments, it's likely the deficit was funded from outside the market.

USD liquidity provided by Central banks

On September, the 15th, in an effort to relief some market tensions; ECB announced additional US dollar liquidity-providing operations over year-end. The Governing Council of the European Central Bank (ECB) has decided, in coordination with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, to conduct three US dollar liquidity-providing operations with a maturity of approximately three months covering the end of the year. These operations will be conducted in addition to the ongoing weekly seven-day operations announced on 10 May 2010. The schedule for these additional operations is October, 12th, November, the 9th and December, the 7th.
These will all take the form of repurchase operations against eligible collateral and will be carried out as fixed rate tender procedures with full allotment.
The action was well received by financial markets, providing a short moment , but long awaited, of respite market, heavily strained by negative news to come from the negotiations on resolving the situation in Greece.

Jürgen Stark quits ECB Board of Directors

On September, the 9th, Jürgen Stark, Member of the Executive Board and Governing Council of the European Central Bank (ECB), informed President Jean-Claude Trichet that, for personal reasons, he will resign from his position prior to the end of his term of office on 31 May 2014. Mr. Stark will stay on in his current position until a successor is appointed, which, according to the appointment procedure, will be by the end of this year. He has been a Member of the Executive Board and Governing Council since 1 June 2006.

Having been informed by Jürgen Stark of his decision to resign for personal reasons, President Jean-Claude Trichet thanks him wholeheartedly for his outstanding contribution to European unity over many years. Having worked with Jürgen Stark for almost 20 years, he expresses particular gratitude for his exceptional and unwavering dedication as a member of the Executive Board and Governing Council for more than five years.

EU's Barroso unveils transactions tax proposal

European Commission President Jose Manuel Barroso proposed a tax on financial transactions in his annual State of the Union speech before European parliamentarians in Strasbourg.

"If all the sectors of the economy from industry to agriculture to services, if they all pay a contribution to the society also the banking sector should make a contribution to the society," Barroso said, stressing the role financial companies played in the current economic crisis and describing them as "under-taxed" in comparison with other sectors.

The tax would be levied on all transactions on financial instruments between financial institutions when at least one party is located in the EU, the commission said in a news release. Transactions involving shares and bonds would be taxed at a rate of 0.1%, while derivative contracts would be taxed at a rate of 0.01% beginning January 2014. The tax could raise 57 billion euros a year, the commission said.

The tax can only be introduced unanimously, meaning that any EU member state can veto the proposal. So far Britain, the Netherlands and Sweden have indicated they staunchly oppose the proposal.

A spokesperson for the UK Treasury told the BBC that it would "absolutely resist" any tax that was not introduced globally. "We would not do anything that is not in the UK's interests," the British broadcaster quoted him as saying.

The UK is home to the EU's biggest financial services industry. Experts estimate that some 80 percent of the revenues of any Europe-wide financial tax would come from London.

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