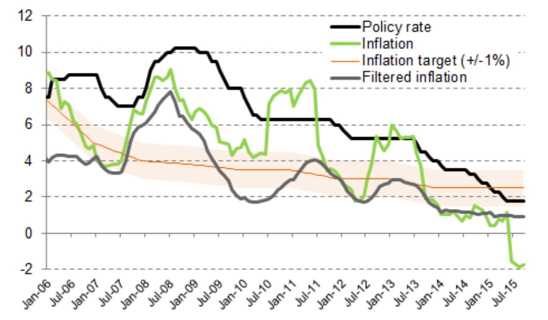
# MONETARY POLICY COMMENT

*6 November 2015*

## *The NBR kept its monetary policy on hold amid increased political uncertainties*

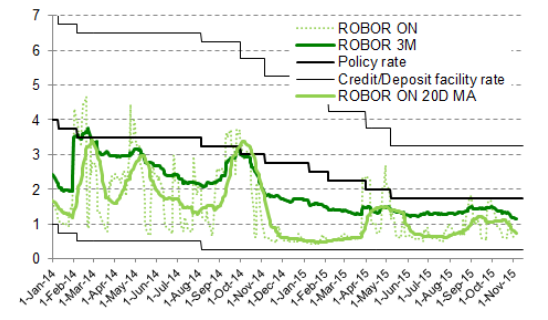
- In its Thursday meeting, **the Board of Romania's central bank kept the benchmark interest rate at 1.75%** for the fourth consecutive time, while it left the minimum reserve requirement ratios (MRR) at the previous levels as well, namely 8% for RON and 14% for FX liabilities. At the same time, the NBR also decided to continue an *"adequate"* liquidity management in the banking system. **The outcome of the NBR rate-setting meeting caused no surprise** on the market, after it was highly anticipated by analysts, including us.
- Furthermore, the Board members of the CB examined and approved the new Inflation Report, which is set to be presented by Governor Isarescu through a press conference next Monday. Even though the details of the report have not been revealed yet, the press release of the NBR broadly pencils in the expected path of consumer prices, noting that **the annual inflation rate may stay in the negative territory in the following three quarters. Then the growth rate of consumer prices should turn positive, but it will remain below the lower bound of the variation band (1.5%) until the beginning of 2017**. This evolution is roughly in line with our forecast of 1.4% YoY at the end of 2016, while we see the inflation rate getting near the mid-point target (2.5%) in January 2017, as the impact of next year's VAT reduction will fade out.
- The NBR's press release also underscores the developments in the case of RON-denominated loans, which showed a sharp upward trend in the latest period. As a result, **the weight of domestic currency credit rose slightly above 50%** in September for the first time since the middle of 2007. **This leads to a more efficient monetary policy transmission mechanism** and lower risks to financial stability, according to the NBR. In our view, **the revival of the RON-based lending activity may urge the central bank to favour an interest rate environment that gradually becomes more stable and predictable**. On the other hand, less volatile interest rates could result in higher pressure on the EUR/RON exchange rate in the case of external or internal shocks.
- In our opinion, the big picture did not change significantly since our previous MPC report. **We still expect the NBR to keep its benchmark interest rate at a record low this year and in 2016 too**. Nonetheless, the policy making task of the NBR became more difficult in the light of recent uncertainties on the political scene. This may require more cautiousness from the CB until the situation is resolved. Nonetheless, the chance of an expanded ECB QE increased in the last few weeks, suggesting even looser monetary conditions in the eurozone in the following period. Such developments could support further easing measures of Romanian policymakers too.
- **Regarding inflation, we still see little price pressure in both headline and core figures** (Chart 1), but rapidly increasing wages and the vanishing negative output gap may raise some concern over the medium term.
- Following the previous monetary decision, NBR Governor Isarescu confirmed that the central bank plans a gradual reduction of reserve requirement ratios over the next two years. We believe that this plan did not change, but such a movement was not opportune at this time amid raising political instability and already improved liquidity conditions.

**Chart 1: Policy rate and inflation indicators** (%)




*Sources: NIS, OTP Research*

**Chart 2: Policy rates and interbank MM rates** (%)




*Sources: NBR, OTP Research*

[1] *Filtered inflation is an in-house measure of underlying inflation dynamics, which in its structure is relatively similar to the NBR's preferred adjusted CORE2 indicator, but among other differences it excludes additional items, which are strongly connected to the EUR/RON exchange rate. Furthermore, it filters out indirect tax changes too.*

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