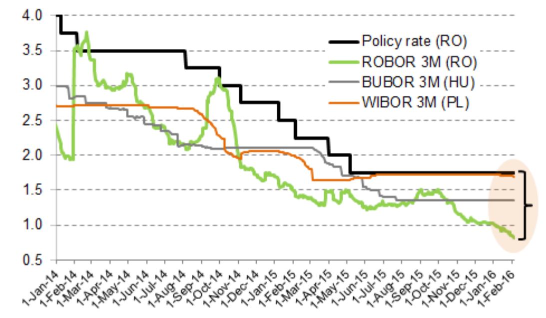
MONETARY POLICY COMMENT

8 February 2016

The benchmark interest rates were left untouched. Overall, monetary conditions are looser than the key rate would suggest.

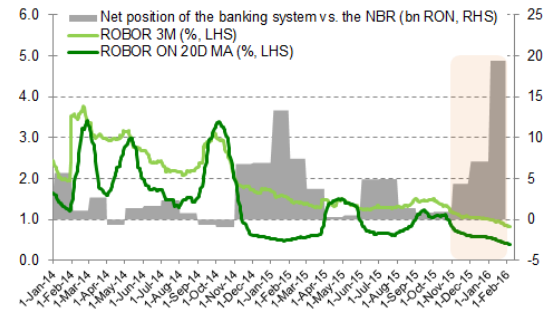
- **On Friday's rate-setting meeting of the central bank, the Board held the key rate at 1.75%**, causing no surprise, as the decision was foreseen by the large majority of analysts, including us. At the same time, policy makers maintained the mandatory reserve ratios at their previous levels (8% for RON and 12% for FX liabilities), while the decision also notes that the NBR will further pursue 'adequate' liquidity management in the banking system. Following the Board meeting, there were no significant movements on financial markets; the recent rally of the RON versus the EUR can be associated with supportive external factors.
- The press release of the CB remarks the evolution of the inflation rate, which ended the year in the negative territory at -0.9% YoY. Nevertheless, it also underscores that this outcome was primarily due to June's VAT reduction. **Excluding the impact of the tax change, consumer prices would have increased by near *'2% at year-end, standing inside the ±1 percentage point variation band of the 2.5 percent target'***, the experts of the NBR said. This development regarding recent CPI dynamics was also noted in our January's inflation report.
- Little detail was revealed about the NBR's new forecast in the policy statement, but it confirmed that the headline inflation could re-enter the target band at the beginning of 2017 on the fading base effect of the standard VAT rate cut, loose fiscal policy as well as rising unit wage costs. The full report will be presented by Governor Isarescu in a press conference on Tuesday.
- The press release also warned that the risks to the forecast are coming primary from the domestic environment, among others pointing to the fiscal developments and the implementation of structural reforms, but it recalls that external uncertainties are high too, in the light of fears about global economic outlook and diverging monetary policies. At the same time, as it did several times earlier, the statement underscored the importance of a balanced policy mix in achieving macroeconomic stability and sustainable long-term growth.
- Turning back to monetary policy issues, we did not change considerably our overall view since the previous rate-setting meeting. **The stance of monetary conditions could remain loose, especially in the presence of easing biases in the eurozone and in the CEE region**. It may be worth noting too that **monetary conditions are even more relaxed than the key rate would suggest**. Romania's benchmark rate (1.75%) is relatively high compared to that of Poland (1.50%) and Hungary (1.35%), but interbank lending rates stay at lower levels (see Chart 1) due to the abundant liquidity that characterizes the market (see Chart 2) and to the wider interest rate corridor (0.25%-3.25%). We think this **corridor could be narrowed slowly, as it was also suggested by the NBR's chief Mr. Isarescu in Friday's conference**, and this could result in less volatility in interbank rates. Nevertheless, the policy rate may be left unchanged until the end of the year at 1.75%, and could be raised to 2.75% in 2017, while gradual minimum reserve ratio cuts may also come. The next policy meeting is scheduled for 31 March.

Chart 1: Policy rate and interbank lending rates (%)



Sources: NBR, Reuters, OTP Research

Chart 2: Money market rates and liquidity conditions



Sources: NBR, OTP Research

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