

MONETARY POLICY COMMENTARY

4 October 2017

Romania's central bank narrowed the interest rate corridor, most likely, signalling the launch of a normalisation cycle

- On its Tuesday's meeting, Romania's central bank narrowed the interest rate corridor by 50 basis points and kept the policy rate at 1.75%. As a result, the deposit facility rate rose to 0.50%, up from 0.25% earlier and the interest rate on the NBR's lending facility decreased to 3.00% (versus 3.25%). At the same time, the Board of the central bank left the reserve requirement ratio for leu and foreign-currency denominated currencies unchanged at 8%, while it also decided to continue an 'adequate' liquidity management in the banking system.
- The decision to narrow the symmetrical corridor around the policy rate, implying a hike of the deposit facility rate, most likely put an end to the era of extra-low interest rates in Romania. This was confirmed by NBR governor Mr Isarescu too on his press conference, when he noted that ROBOR rates would not return to their earlier record lows. Lifting the deposit facility rate was probably the first move in a new policy cycle, aiming to shepherd interest rate back to levels supported by fundamentals. As we noted frequently in our earlier [reports](#), Romania is in the mature stage of the business cycle, with economic output already exceeding its potential. In addition, the definitely strong domestic demand, boosted by fiscal stimulus measures too, started to provide support for a gradual [reflationary](#) process, while fading base effects as well as the increases of administrative consumer prices are set to propel further the annual inflation in the months ahead. This context called for an exit from the period of ultra-loose [monetary](#) conditions.
- It is important to note that simultaneously with the Board meeting, the NBR also organized a repo operation, injecting almost RON 9.4 bn extra liquidity into the money market. This came after interbank interest rates registered a sudden jump in the latest period. The ROBOR 3M, the key reference rate for the majority of leu credits with variable interest rates, reached 1.8% on Tuesday, corresponding to almost 80 bps rally in just two weeks. Beyond fundamental factors, like the perspective of accelerating consumer price inflation, several transitory effects also contributed to the rapid advances. First of all, large payments into the government budget together with potential NBR interventions on the FX market soaked up the liquidity surplus. The excess liquidity of the banking sector stood at RON 4.9 bn in August, down from the peak of RON 13.6 bn in January, while October's data, due out this week, most likely will show another fall. The NBR's willingness to provide as much money as required (via repo operations, according to yesterday's guidance of Mr Isarescu) is set to ease significantly the negative effects coming from the liquidity squeeze.
- It appears that the normalisation process has started, with another narrowing of the corridor already in the pipeline (signalled by central bank chief Mr Isarescu too). However, we think that the new policy cycle will be quite gradual, as the NBR will pay special attention on what other central banks do, while a too large shock on ROBOR rates could trigger some pressure on the repayment ability of clients (on average, 100 bps rise of ROBOR translates into around 8% increase of the monthly instalment in the case of housing loans), an unwanted outcome. Therefore we expect only one policy rate hike in 2018, which could be made in H2.
- Under these circumstances, we expect that interbank lending rates are set to show a correction given the NBR's repo operations soon, while year-end payments from the government budget may further improve the liquidity conditions on the money market, helping ROBOR rates to ease. In 2018, we foresee interbank rates to inch up gradually, getting again close to the policy rate.

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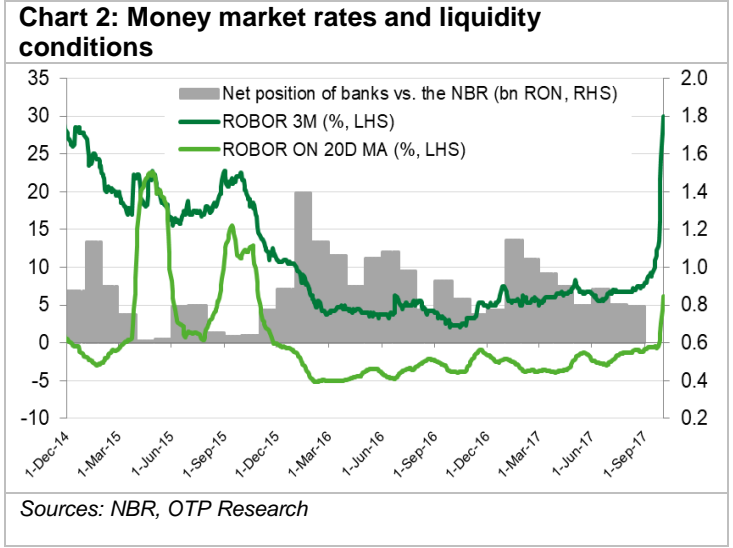
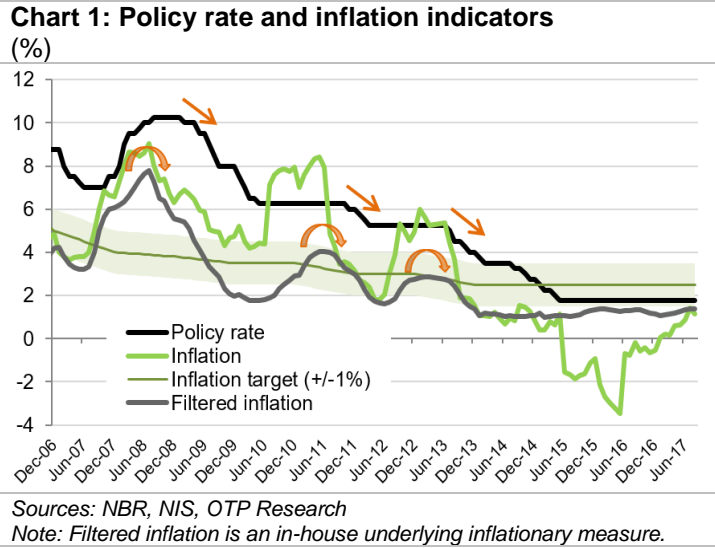
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Chart set:



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