otp Research

MONETARY POLICY COMMENTARY

10 January 2018

The tightening cycle has further to run

- On the first monetary policy meeting of the year, the Board of the central bank lifted its key rate to 2.00%, up from the all-time low of 1.75%, which lasted for almost three years. The decision came after the NBR had started a policy normalisation cycle in the second half of 2017, by narrowing the interest rate corridor. In line with the policy rate, the symmetrical corridor also shifted 25 basis points higher, with the interest rate on the NBR's deposit facility going up to 1.00% and with the Lombard rate reaching 3.00%. At the same time, the Board maintained the mandatory reserve ratios at 8% for both leu-denominated liabilities and foreign currency-denominated ones. Admittedly, there was no doubt about the necessity of the tightening cycle, but the timing of the first base rate hike surprised the market, as most analysts had expected rates to remain on hold, at least in the January meeting. We had also assumed a slightly later date for the first policy rate increase.
- Initially, the leu had firmed against the euro on the news, but later the cross finished the trading session higher, also bolstered by the dovish tone of Mr Isarescu's press conference. The ROBOR fixing rates moved 9-21 basis points higher up to the 1M maturity, while interbank interest rates on the 3M-12M changed modestly (by one to four bps). At the same time, the yield curve on government securities shifted up by eight basis points on average.
- Regarding the big picture, after a prolonged period of extra-low inflation rates, consumer prices pointed to a noticeable rebound most recently and they are set to march even higher in the months ahead (see Chart 1), propelled by both fundamental and one-off factors. Moreover, the reassuring revival of the economy, supported by aggressive pro-cyclical fiscal policies, resulted in overheating fears. Owing to the stimulus measures, Romania's government deficit increased, while the excess domestic demand put pressure on the balance of the current account. In this context, the NBR started a normalisation process last year, by narrowing the interest rate corridor in the first step, and by lifting the key rate now.
- We interpret the NBR's slightly earlier-than-expected first rate hike as a tool to enhance confidence on the domestic and the external front regarding the central bank's commitment to achieve its medium-term inflation target, despite the increasing concerns about an overheating economy. This step is designed to dampen expectations before headline inflation peaks near 5%. Nonetheless, through the dovish tone of the press conference, policy makers tried to prevent adverse market reactions in order to avoid a too rapid jump in the burden of borrowers. The strategy seems to have worked out quite well for now.
- On the press conference following the rate-setting meeting, NBR governor Mr Isarescu reiterated his earlier messages, underscoring that the central bank will put more emphasis on ROBOR stability, while it plans to allow somewhat higher flexibility to the exchange rate, in line with the transition process from managed floating FX regime toward full-fledged inflation targeting. Mr Isarescu hinted that the Board of the central bank may approve a tighter control over liquidity on the money market, starting from its February meeting. Meanwhile, the governor also added that the EUR/RON could fluctuate in a 5-6% range, but without mentioning the lower and the upper bounds of this range. Regarding potential lending restrictions in the case of households, Mr Isarescu noted that macro-prudential measures (if any, as there is no consensus among Board members on this subject) may be implemented this spring at the earliest.
- Given the slightly earlier-than-expected first rate hike, now we expect three more increases in 2018, roughly 25 bps per quarter, with the risk of frontloading them owing to the particular shape of the headline inflation (see Chart 1). We reiterate that the pace of 25 bps per quarter may appear still slow at first sight, but it is worth keeping in mind that the ROBOR 3M (the key benchmark for borrowers) has increased by 110-120 bps since August 2017 and it may rise by additional 80 bps until the end of this year, in our view. Overall, this would translate into 10%-25% increase in monthly instalments in the case of mortgage loans (depending on the maturity of loans, see Chart 2), an important burden for borrowers.

Headquarter Treasury Sales

Ionut Constandache
+40372 31 85 86
ionut.constandache@otpbank.ro

Corina Bejan
+40372 31 85 84
corina.bejan@otpbank.ro

Anamaria Toma
+40372 31 85 85
anamaria.toma@otpbank.ro

Cristian Bodirca
+40372 31 85 88
cristian.bodirca@otpbank.ro

Regional Treasury Sales

Szilamer Kozma - Cluj
+40755 000 400
szilamer.kozma@otpbank.ro

Tudor Zaman - Bucuresti
+40755 000 199
tudor.zaman@otpbank.ro

Alexandru Sabin - Arad
+40730 577 959
alexandru.sabin@otpbank.ro

Andrei Sala – Brasov
+40755 000 015
andrei.sala@otpbank.ro

Chief Economist

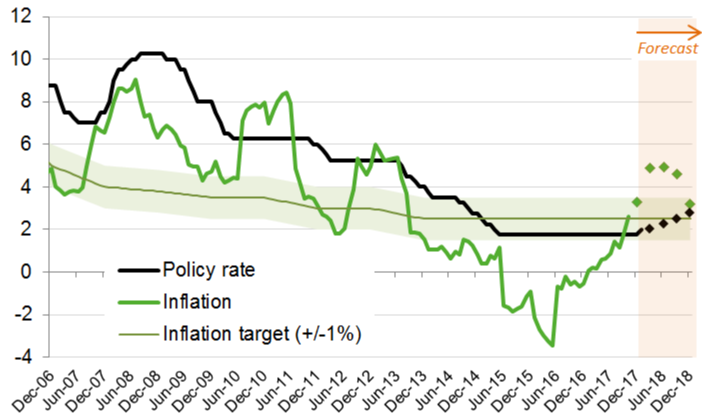
Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

Analyst

Csaba Bálint
+4021 307 58 96
csaba.balint@otpbank.ro

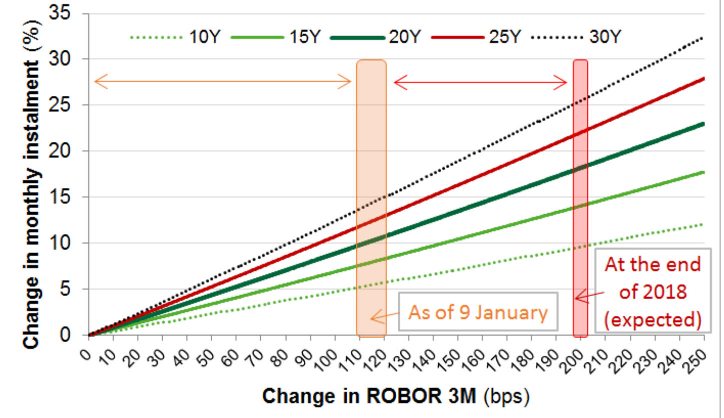
Chart set:

Chart 1: Policy rate and inflation (%)



Sources: NBR, NIS, OTP Research

Chart 2: Simulated impact of ROBOR 3M hike on the monthly payment of borrowers (housing loans)



Sources: NBR, OTP Research
Note: the simulation was calibrated on a housing loan with 4.0% interest rate (initial ROBOR 3M = 0.89%, in line with August 2017 average)

Disclaimer

OTP Bank Romania S.A. does not intend to present this document as an objective or independent explanation of the matters contained therein. This document a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This communication does not contain a comprehensive analysis of the described issues. This report is issued for information purposes only and should not be interpreted as a suggestion, an invitation or an offer to enter into any transaction, as an investment advice, and it does not constitute legal, tax or accounting advice. Also it is not and should not be considered a recommendation for investment in financial instruments according to NSC Regulations no. 32/2006 and 15/2006.

Information herein reflects current market practices. Additional information may be available on request. This document is intended only for the direct and sole use of the selected customers of OTP Bank Romania S.A. Any form of reproduction or redistribution to any other person that the intended recipients, including publication in whole or in part for any purpose, must not be made without the express written agreement of OTP Bank Romania S.A. Although the information in this document has been prepared in good faith from sources which OTP Bank Romania S.A. believes to be reliable, we do not represent or warrant its accuracy and such information may be incomplete or condensed. The issuer of this report does not claim that the information presented herein is perfectly accurate or complete. However it is based on sources available to the public and widely believed to be reliable. Also the opinions and estimates presented herein reflect a professional subjective judgment at the original date of publication and are therefore subject to change thereafter without notice. Furthermore there can be no guarantees that any market developments will unfold as forecasted. Opinions and estimates constitute our judgment and are subject to change without notice.

OTP Bank Romania S.A. may have issued reports that are different or inconsistent with the information expressed within this report and is under no obligation to update or keep current the information contained herein.

OTP Bank Romania S.A. may hold a position or act as market maker in the financial instrument of any issuer discussed herein or act as advisor or lender to such issuer. This document is not intended to provide the basis for any evaluation of the financial instruments discussed herein. In particular, information in this document regarding any issue of new financial instruments should be regarded as indicative, preliminary and for illustrative purposes only, and evaluation of any such financial instruments should be made solely on the basis of information contained in the relevant offering circular and pricing supplement when available. OTP Bank Romania S.A. does not act as a fiduciary for or an advisor to any prospective purchaser of the financial instruments discussed herein and is not responsible for determining the legality or suitability of an investment in the financial instruments by any prospective purchaser.

This report is not intended to influence in any way or to be considered a substitute to research and advice centred on the specific investment objectives and constraints of the recipient (including tax concerns) therefore investors should obtain individual financial advice. Before purchasing or selling financial instruments or engaging investment services, please examine the prospectuses, regulations, terms, agreements, notices, fee letters, and any other relevant documents regarding financial instruments or investment services described herein in order to be capable of making a well-advised investment decision. Please refer to your competent adviser for advice on the risks, fees, taxes, potential losses and any other relevant conditions before you make your investment decision regarding financial instruments or investment services described herein. OTP Bank Romania S.A. in compliance with the applicable law, assumes no responsibility, obligation, warranty or guarantee whatsoever for any direct or indirect damage (including losses arising from investments), or for the costs or expenses, detrimental legal consequences or other sanctions (including punitive and consequential damage) sustained by any natural or legal person as a result of the purchase or sale of financial instruments or engaging investment services described herein, even if OTP Bank Romania S.A. was warned of the possibility of such occurrences.

Figures described herein refer to the past and past performance is not a reliable indicator of future results. Investments in financial instruments carry a certain degree of risk (fluctuation of share prices, uncertainty of dividend, yields and / or profits, exchange rate fluctuations, etc.). The capital invested is not guaranteed, investment gains, usually assumed proportionate to risk, and past performance of financial instruments is not a guarantee for future performance.

Please note that the Internet is not a secure environment and OTP Bank Romania S.A. does not accept any liability for any loss caused by the result of using this report in a form altered or delayed by the wilful or accidental interception, corruption or virus infection.

All rights reserved – OTP Bank Romania S.A. (registered seat: Street Buzesti, no. 66-68, 1st district Bucharest, Romania; company registration number: 01-10-041585; NBR registration no RB-PJR-40-028/1999; for further information please refer to: https://www.otpbank.ro/en).

This document has been provided to the recipients upon their prior request. Your abovementioned permission may be withdrawn by an e-mail addressed to csaba.balint@otpbank.ro or a written mail addressed to OTP Bank Romania S.A , Buzesti Street, no. 66-68, 1st district, Bucharest, Romania. Please refer to your name and e-mail address in both cases.