

NBR increased the monetary policy rate by 100 bp and the minimum reserve requirements for FCY to 40%

The National Bank of Romania decided in the Board meeting of 8 February 2006 to increase the monetary policy rate – the interest rate paid on 1-month deposits taken by NBR from commercial banks – by 100 bp, from 7.5% annually to 8.5% annually. Also the NBR decided to increase the rate of minimum reserve requirements for foreign currencies liabilities to 40% from 35% (previous increase was in December from 30% to 35%). The inflation target for 2006 is maintained to 5%, while the target for 2007 was set at 4%.

We find the new measures of NBR as a strong signal that it is decided to fight against inflation, after it missed his first ever target in 2005 (end-2005 inflation rate was 8.6%, a slight above the upper limit of the target band of 6.5%-8.5%) and the inflation target for 2006 is very ambitious mainly given large planned increases in administrative prices.

Regarding the impact of the interest rate hike and the increase in FCY minimum reserve requirements on lending rates, we think that these measures could be reflected partially in the lending rates. We think that the banks that were very aggressive in cutting rates on LCY lending even below 10% in the last period would have to increase the interest rate of LCY lending. On foreign currency lending, we think that the effect could be marginal, depending on the banking competition.

As regarding deposit interest rates, we think that normally these should increase but their developments are highly related to the effective interest rate at which the NBR will drain the liquidity from the market.

The more important becomes now the developments in the exchange rates. If the NBR drains the liquidity from the market at the new higher interest rate, strong pressures for RON appreciation will come in place (in last two days the exchange rate has already started to appreciate sharply). Given the last year current account deficit and the signals of a slowdown in the economic growth, the NBR is not very comfortable with a strong appreciation of RON. Based on these facts, we think that the NBR will increase only steadily the effective interest rate at which the sterilization of liquidity is made and it will be ready to go again in the FX market to curb any pressures for a strong RON nominal appreciation.

Kind regards,
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