

MONETARY POLICY COMMENT

1 July 2016

"Vigilance" and "uncertainty" were the key words of yesterday's policy meeting; monetary policy outlook became hazier after Brexit.

- **Romania's central bank kept the benchmark interest rate at 1.75%.** Its other key instruments, such as the minimum reserve requirement ratios for leu- and foreign currency-denominated liabilities were left unchanged too. As it was unanimously foreseen by analysts in a Bloomberg/Reuters survey, and as we also noted in our earlier [reports](#) that the policy rate could remain flat during this year, yesterday's decision of the central bank's Board did not cause any surprise. Moreover, the recent events on the external front probably enhanced the conviction of Board members that **the NBR should continue its vigilant wait-and-see position** in the short term.
- Beyond vigilance, uncertainty was the other key word at the press conference, where Mr Isarescu also underscored that **the NBR still has room to act and it also "stands ready to use all its available tools"**. These statements were made in the light of last week's referendum in the United Kingdom, which caused large waves on global financial markets, after the results showed that the majority of Briton voters want the UK to leave the community of the European Union.
- **On the domestic front, the shock caused by Brexit worries had a fairly mild impact.** Indeed, the EUR/RON spiked sharper in the first morning following the historical vote, but it came back close to normal levels relatively soon. Similarly, money market rates and the benchmark yields on government securities seemed to be quite resistant as well. ROBOR rates are not too far from their pre-vote levels, while the yields on the medium and long-term bonds are staying lower than a week ago, following a short-lived increase.
- **Regarding the direct effects of the UK's decision to exit from the EU on Romania's real economy, we reckon that those are rather limited in the short term.** It is worth mentioning that Britain is the fifth largest trade partner of Romania, based on the value of exported goods with a 4.4% share in total exports in 2015, but this level corresponds to only about 1.5% of GDP. Under these conditions, even in the case of a significant fall of UK demand for Romanian products, the negative impact would be manageable. The other channel, through which the Romanian economy could be affected is related to EU funds. A potential adjustment of the EU budget may not be a too distant scenario, given that Brexit should take place in the following period. Therefore a revision of the available development funds cannot be fully excluded some time in the future. EU funds played an important role in Romania's economic growth and the UK usually was a net contributor to the common budget of the European Union. Nevertheless, the UK's contribution was quite modest compared to its own economic capacity and was far lower than that of Germany. Hence, we deem that the risk of losing financial resources may have limited influence on the overall position of the economy, similarly to the negative effects coming from tighter regulations of UK's labour market.
- **On the other hand, it is important to note that Britain's unprecedented move induced a series of unknown factors in the system,** and last week's shock on financial markets could be followed by other waves depending on how the situation evolves and what new information becomes available. In the light of increased uncertainties, the main central banks of the world may implement a softer than previously thought policy, with secondary impacts on the stance of monetary conditions in the CEE region, including Romania.
- In relation to inflation, we underline that the **expectations on short-term price dynamics were scaled back** (for further details, please see our latest inflation [report](#)), even though domestic developments, such as surging household's consumption expenditures (+10% YoY in [Q1 2016](#)) and the double-digit growth rate of average wages continue to point to significant inflationary risks in the medium term.
- **Previously, we expected that Romania's central bank could narrow the interest rate corridor already in 2016, but the latest external events, together with less vigorous price dynamics in the short term make the outlook hazier, with pressure for delaying such measures.**

Headquarter Treasury Sales

Alexandru Tibuleac
+40372 31 85 85
alexandru.tibuleac@otpbank.ro

Cristian Ilie
+40372 31 85 86
ilie.cristian@otpbank.ro

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

Andreea Nica
+40755 000 106
andreea.nica@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

Chief Economist

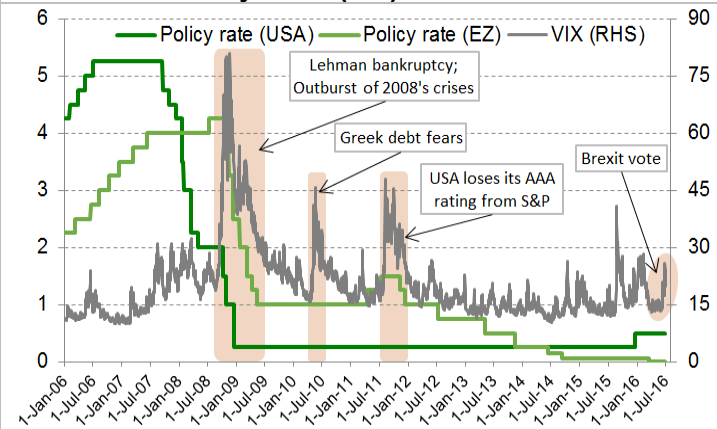
Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

Analyst

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

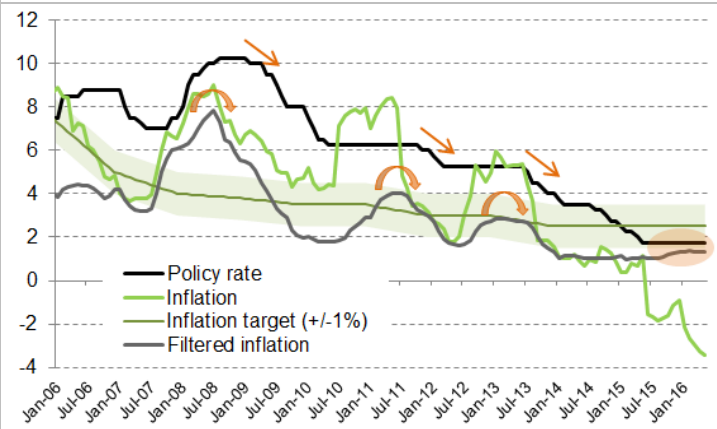
Chart set:

Chart 1: Policy rates in the USA and in the eurozone vs. CBOE Volatility Index (VIX)



Sources: Reuters, OTP Research
 Note: the VIX is a measure of implied volatility on S&P 500 index options.

Chart 2: Policy rate and inflation dynamics



Sources: NBR, NIS, OTP Research
 Note: filtered inflation is an in-house measure of underlying inflation dynamics, which among others excludes the impact of VAT changes.

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.