
**STUDY ON THE MONETARY MARKET AND STATE SECURITIES DURING
2020-2022**

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***Abstract:** The onset of the COVID-19 pandemic led to an increase in uncertainty in the real economy and in the financial economy to record levels and at the end of the post-crisis economic cycle. In Romania, the ROBOR levels for the three-month and six-month maturities decreased by 30.7% to 2.03%, respectively by 31.4% to 2.10% between the end of February and the end of 2020, given that the National Bank of Romania (BNR) implemented a series of monetary easing measures: standard (including reduction of the reference interest rate from 2.50% to 1.50%) and unconventional (carrying out repo operations on a bilateral basis).*

***Key words:** real economy, financial economy, ROBOR levels, monetary easing measures*

INTRODUCTION

There are still many uncertainties about the COVID-19 pandemic: about the extent of its spread, its severity in different countries, the duration of the outbreak, and whether an initial decline could be followed by a recurrence. But some things are already certain. It is known that the economic impact of this pandemic is already immense, dwarfing anything we've experienced in living memory. The current shock to the global economy is certainly far greater than that of the 2008 global financial crisis and is likely to be more severe than The Great Depression. Even the two world wars of the 20th century, while disrupting supply chains and devastating physical infrastructure and populations, did not involve the restrictions on mobility and economic activity that are in place in most countries today. This is therefore an unprecedented global challenge and requires unprecedented responses.

MATERIALS AND METHODS

The articles are explaining how economy changed during the pandemic and what impacts it had over the ROBOR levels for three-month and six-month maturities, but also what monetary easing methods were needed.

RESEARCH RESULTS

The annual inflation rate was 3.8% in May and it increased to 3.9% in June. The rate was expected to reach 5.3% in December 2021 and to decrease to 4.4% in January 2022 [14]. Due to inflation the gas and electricity prices rose sharply in July. The first increase in the monetary policy interest rate took place in March and the public budget decreased in April and May.

Prices of consumer goods and services increased by 0.3% in June compared to May. This increase could be seen in the acceleration of the annual inflation rate from 3.8% in May to 3.9% in June. However, the annual inflation rate in June was above expectations (3.8%) and above those of other economic analysts (3.7%)

The monthly inflation rate was fueled again in June by rising liquid fuel prices (+1.9% compared to May) and because of rising oil price. The prices of fruits, vegetables,

and eggs increased in June (+1.8% compared to May) for the second consecutive month, after being on a continuous downward trajectory in the first 4 months of the year. Thus, according to seasonally adjusted data, the monthly CORE 3 inflation rate rose to 0.35% in June from 0.29% in May[5]. This is the highest level recorded in the first 6 months of the year and is close to the average monthly level (0.36%) recorded in the inflation episode of April-June 2020. The high level of CORE 3 inflation in June is largely explained by the rapid rise in processed food prices (+0.6% in June compared to May). In fact, growth of processed food prices began to accelerate in April. The annual inflation rate was on a continuous upward scale in the first 6 months of the year but didn't reach its highest level this year. Annual inflation rate was expected to increase substantially in July amid large additional increases in energy prices[9]. Thus, the annual inflation rate was expected to increase to 4.8% in July from 3.9% in June, assuming an increase in gas prices of 18%-20% and in electricity prices of 5%. It was expected that the annual inflation rate to decrease to 4.4% in January 2022, but to remain above the upper limit (3.5%) of the inflation target range for most of 2022.

At the meeting for monetary policy on July 7, the central bank (BNR) kept unchanged the monetary policy interest rate (at 1.25%) and the other alternative monetary policy instruments. This decision was in line with the expectations. The governor of the BNR specified that in a first phase the central bank will respond to inflationary pressures by tightening the control of liquidity in the money market using alternative monetary policy instruments, without rushing to increase the monetary policy interest rate [12]. Also, the Governor stated that as regards the calibration of the monetary policy, the central bank will adapt to the existing international and domestic situation and that "the period of low interest rates is coming to an end". In our scenario we assume that the first increase in the monetary policy interest rate will take place in March 2022 (at the 6th monetary policy meeting from this moment) [13]. However, we do not rule out that such a decision will materialize earlier given the very high levels of the annual inflation rate and the annual core CORE 3 inflation rate that we expect to materialize in the second half of this year and during 2022.

According to the preliminary estimates of the National Institute of Statistics (NIS), the real GDP registered a rapid growth of 1.8%. Also, real GDP registered a very high growth in 2021 compared to 2020 (13%), but an important part of this dynamic is explained by the statistical basis effect[10]. The monthly inflation rate in July was elevated (1%) due to the large increase in the prices of natural gas (+20.5%), electricity (+4.2%) and liquid fuels (+3.1%). As a result, the annual inflation rate quickly rose to 5% in July from 3.9% in June. The annual inflation rate in July exceeded our expectations (4.8%) and we therefore consider that there is a risk that the annual inflation rate will exceed at the end of the year to 5.3%.

At the monetary policy meeting held on August 6, the central bank (NBR) kept the monetary policy interest rate unchanged (at 1.25%), as well as the other alternative monetary policy instruments[11]. The NBR has substantially revised upwards the trajectory of the annual inflation rate predicted for 2021 and for the first half of 2022. The NBR foretold the annual inflation rate at 5.6% at the end of this year, well above the level of 4.1% that was predicted in May.

Real GDP grew by 1.6% in the second quarter compared to the first quarter, the advance being lower than the expectations of economic analysts (quarterly advance of 2.2%) [15].

According to seasonally adjusted data, both the deficit of foreign trade in goods and services and the current account deficit registered very high levels in June (although slightly lower than in May). It should be noted that the current account deficit values for

April and May have been substantially revised downwards. Even after this data revision, the current account deficit remained very high. Thus, the current account deficit represented 7.1% of GDP estimated by us for this period, the level being slightly higher than in first quarter when it represented 6.8% of GDP. This high level of the current account deficit in second quarter was fueled by the growing foreign trade deficit. According to our estimates, the deficit of foreign trade in goods and services in the second quarter accounted for 6.2% of GDP for this period, rising from a level of 5.3% of GDP [7].

The increase in the foreign trade deficit in second quarter was supported by the faster growth of imports of goods and services (+ 4.2% compared to Q1 in euro equivalent) compared to that of exports (2.4% in euro equivalent compared to Q1).

Export performance remained modest in second quarter with the quarterly advance in terms of volume probably only slightly positive. In fact, the seasonally adjusted data for us place the level of value of exports of goods and services in June close to that recorded in March[4]. The value of imports of goods and services showed signs of stagnation between March and June. Foreign trade performance continued to be adversely affected in quarter 2 by existing disruptions in global production and distribution chains.

According to the estimated values, the current account deficit in the first half of this year represented 6.9% of GDP estimated for this period. Our baseline scenario places the current account deficit at 6.5% of GDP in 2021, but does not rule out an even higher level. In fact the baseline scenario assumes a decrease in the current account deficit in the second half of the year amid a faster growth of exports than imports in the context of improving external demand.

The annual inflation rate rose very rapidly in July amid large increases for energy prices. The annual inflation rate jumped to 5.0% in July from 3.9% in June, above our expectations of 4.8% and above the expectations of 4.4% of other economic analysts. In monthly terms, the prices of consumer goods and services registered a substantial increase in July, of 1.0% compared to June [6]. The high level of the monthly inflation rate in July was fueled, first of all, by the increase of the natural gas price. The increase in natural gas tariffs paid by final consumers mainly reflects the substantial increase in the global price of this type of commodity that has materialized over the last year globally. In addition, electricity tariffs registered a significant increase again in July (+4.2% compared to June), after the major jump recorded in January (+18.4%)[8]. Also, the prices of liquid fuels (gasoline, diesel) continued to grow in July, respectively by 3.1% compared to June. The increases in energy prices in the last year had a cumulative contribution of 3% to the annual inflation rate of 5.0% in July.

The current scenario is that the annual inflation rate will be at 5.3% at the end of this year. At the same time is expected that the annual inflation rate will remain above the upper limit (3.5%) of the inflation target range for most of 2022 (3.5% in December 2022). It should be noted, however, that the uncertainty attached to inflation predictions remains high.

The annual inflation rate rose to 5.3% in August from 5.0% in July, exceeding the expectations (5.0%). The prices of goods and services increased by 0.2% in August compared to July, which represents a high monthly inflation rate. There were increases in fuel prices (+0.8% compared to July), the price of urban transport (+2.6% compared to July) and tobacco products (+0.7% compared to July). On the other hand, the high level of the monthly inflation rate in August was also supported by the basic inflationary pressures, which remained high. Thus, the seasonally adjusted data puts the monthly core inflation rate at 0.37% in August, close to the 0.39% level recorded in July. The annual dynamics of core inflation increased to 3.1% in August, from 2.9% in July.

The information taken into account by the INS when measuring inflation indicates an increase in electricity prices by 23.2% in the first 8 months of the year, respectively by 20.5% in natural gas prices. The information appearing in the press and the current offers of the suppliers for the competitive market, however, suggest substantially larger increases (50% or even more) in the prices already materialized from the beginning of the year until now or to be materialized from the beginning of the year until January 2022. In the scenario in which between October 2021 and January 2022 the INS would include in the calculation of the inflation rate a cumulative increase in the price of electricity of 20% and a cumulative increase in the price of natural gas of 40%, according to the assessments, the rate the annual rate of inflation could increase to 7.8% in December 2021 - January 2022. These increases can materialize if the introduction of heating aids and subsidies does not affect the calculation of the inflation rate and if prices are not capped at a historic level . For the moment, balancing, on the one hand, the possibility of incorporating large increases in electricity and natural gas prices in the calculation of the inflation rate from October 2021 - January 2022 and, on the other hand, the very high uncertainty related to the evolution of these prices, we decided to incorporate smaller price increases than those previously mentioned in a baseline scenario.

At the monetary policy meeting on October 5, the BNR increased the monetary policy interest rate to 1.5% from 1.25% and specified that it will continue to maintain firm control over liquidity on the money market. This decision was in line with expectations, but unexpected according to the Bloomberg survey which aggregated the opinions of economic analysts and which predicted the maintenance of the reference interest rate at 1.25%. Also, the BNR decided on the increase the interest rate on the deposit facility to 1.0% from 0.75%, respectively the increase of the interest rate on the credit facility to 2.0% from 1.75%. We believe that the main reason for the central bank's decision is the extensive deterioration of the inflation forecast [1].

The BNR specified in the press release published on October 5 that its current assessments "reveal the prospect of an increase in the annual inflation rate to significantly higher values in the short term than previously anticipated, under the impact of supply-side shocks." According to the BNR, the very large increases expected for the prices of energy products are likely to amplify and prolong the positive deviation of the annual inflation rate from the upper limit of the target range of 3.5%. Thus, is expected that BNR is to raise the reference interest rate again by 25 basis points at the monetary policy meeting on November 9. Moreover, it is believed that the BNR should continue the interest rate hike cycle in the first months of 2022, and the reference interest rate should reach 2.5% in the April-May 2022 period.

ROBOR 3M and 6M have continuously increased in 2022, reaching on October 26, the highest values in the last 12 years. Thus ROBOR 3M at 8.21%, and ROBOR 6M at 8.31% these values have not been reached since 2010.

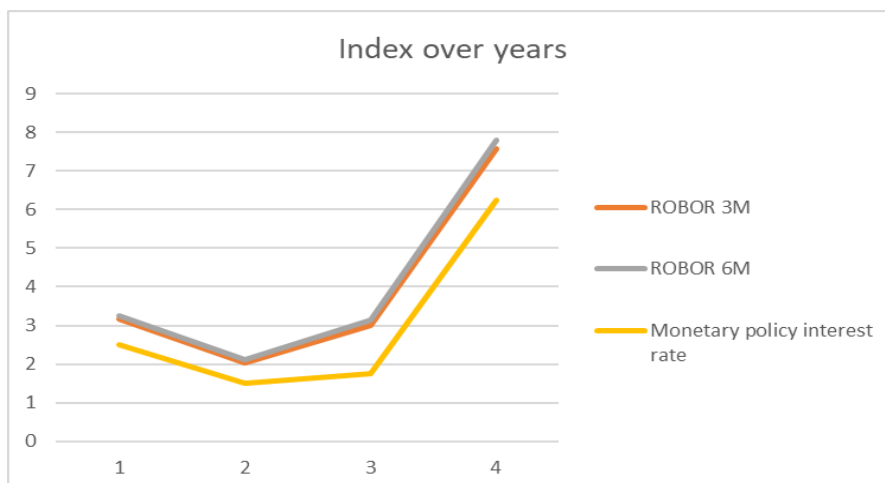


Figure 1. Monetary policy interest rate and robor rate

As a result of ROBOR's evolution in the last period on the banking market, the Competition Council announced on November 1st, 2022, that it has begun carrying out controls at the main banks in the country regarding the robor growth in the last period. The Competition Council is interested in whether the increase of ROBOR is the result of unclear agreements between the Banks. After the intervention of the Competition Council, even though the NBR increased the monetary policy interest rate to 6.75% per year, from 6.25%, the three-month ROBOR continues to decrease and registers the lowest values since July 2022 [3]. The recent conduct of the monetary policy of the BNR was configured in a prudent manner, in order to bring back and maintain in the medium term the annual rate of inflation in line with stationary target of 2.5 percent ± 1 percentage point, including by anchoring expectations inflationary in the medium term, as well as to stimulate domestic saving, in a way that contributes to the achievement of sustainable economic growth.

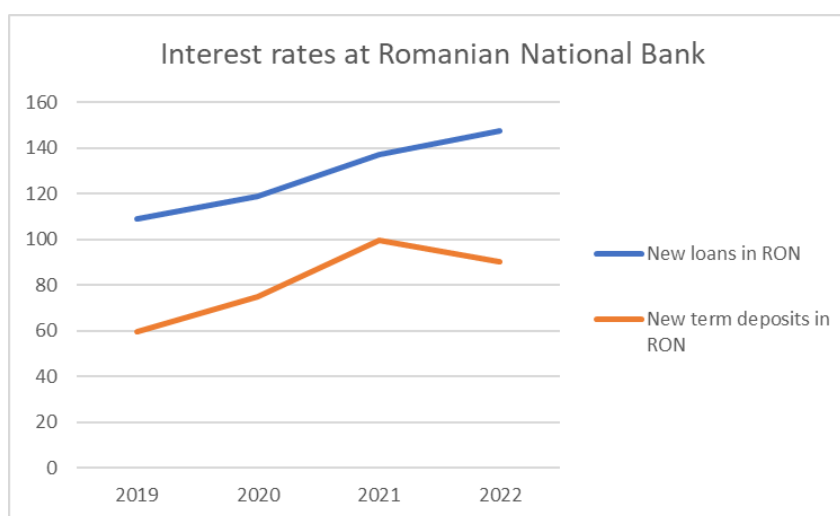


Figure 2. Interest rates in the banking system

In CFA Romania expectations, the average inflation for the next 12 months will be increasing and will reach 10.56%. The exchange rate will depreciate to an average of 5.06 lei per euro in the coming months [2]. CFA estimates economic growth at 1.6% in 2023. ROBOR 3M will increase from 8% to 8.39%, and interest rates on government securities rise above 9.52%. For the EUR/RON exchange rate, a depreciation of the leu is expected in

the next 12 months. Thus, the average value of expectations for the next 6 months is 5.0000 lei per euro, while for the 12-month period the average value of the anticipated exchange rate is 5.0652 lei per euro.

Annual inflation in the euro area reached a record high of 10.6% in October – well above the ECB's 2% target. "The inflation rate in the eurozone has not yet reached its peak and there is a risk that it will be even higher than we currently estimate," European central bank president Christine Lagarde warns Reuters.

Investors are speculating whether the ECB will raise the interest rate by 50 or 75 basis points at the December monetary policy meeting and to what level the cost of credit will be increased. Following decisions taken at the ECB meeting on 27 October, the interest rates on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility were increased to 2.00%, 2.25% and 1.50% respectively.

On the European front, the European Central Bank will make smaller key interest rate hikes in 2023 if further increases are needed, Reuters quoted governing council member Gabriel Makhlouf as saying on Sunday. While policymakers have been determined that interest rates need to rise further to help slow inflation, the minutes of their last meeting, published on Thursday, showed they could not fully agree on the destination or final pace of the increases.

The EU intends to finalise the transposition of the Basel III international agreements into EU law. The Basel III agreements were concluded by the EU and its G20 partners in the Basel Committee on Banking Supervision, with the aim of increasing banks' resilience to possible economic shocks. Basel III includes a series of measures aimed at strengthening prudential regulation standards, banking supervision and risk management in the banking sector in response to the global financial crisis of 2007-2008.

In Germany, where the Bundesbank expects recession next year, Deutsche Bank wants to increase future dividends by 50% as part of its plan to distribute eight billion euros by 2025, while Commerzbank is expected to pay its first dividends of 2020 next year. Next year could be more difficult, which is why we advise that the capital be maintained in banks so that it is available to compensate for any losses. The current situation, which is still good, should not lead to indolence. The Bundesbank "is not pleased" with the ECB's decision to postpone the implementation of the regulations Basel III until 2025, but said it was only "a temporary deviation" from globally agreed standards. Wuermeling considered that German banks have modestly increased the rewards for shareholders and the majority should manage the preservation of core capital, even after the increase in dividends. But the official warned that this year's profits should not lead to indolence.

Italian banking group UniCredit will reward shareholders this year with 3.75 billion euros and has pledged to maintain this level in 2023 as well, thus defying guidance from the ECB.

CONCLUSIONS

In conclusion, macroeconomic imbalances are high and continue to generate risks of depreciation of the RON in the coming period. Moreover, the current political crisis has the potential to be prolonged and it could be some time before a new cabinet is formed (after the dismissal of the cabinet led by Mr. Cîțu by motion of no confidence), which amplifies the risks of depreciation of the RON. There is a risk that the governance solution that will work in the next period, regardless of its configuration, will not demonstrate enough ambition to prioritize the process of fiscal consolidation and the implementation of reforms. Such developments should be negative for the RON. Also, Romania is now facing

the most severe wave of the COVID-19 pandemic. There are risks that the distancing measures will be tightened in the coming period to reduce the spread of the pandemic, this being likely to slow down economic growth. The downside risks to our economic growth forecasts of 7.5% in 2021 and 4.7% in 2022. On the other hand, the inflow of funds from the EU is expected to increase in the next period and the high level of internal interest rates are factors that should have a positive influence on the evolution of the EURRON exchange rate, limiting the depreciation pressures of the RON.

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