Governor Mugur Isărescu: speech at ”The 43rd Meeting of the Central Banks Governors' Club of the Central Asia, Black Sea region and Balkan countries”

Dear Governor Uysal,

Dear colleagues,

It is my pleasure to meet with you virtually today and, at the same time, I am grateful that even during this unprecedented times, we are able to carry on the work within our forum. I would like to thank our hosts for making this virtual meeting possible and I sincerely look forward to meeting you all again in person.

The Romanian experience with the COVID-19 pandemic; challenges for monetary policy

Before Covid-19 context, the Romanian economy had rather overall good performance, with an annual growth rate of 4.1 percent although the pace had stared to decelerate slightly, starting in Q3 2019. The beginning of this year, it seemed that the positive outlook would remain in place during the period ahead. Indeed, the latest statistical data point to a 2.7 percent GDP increase in the first three months of this year compared to the same period in 2019, which represents the largest GDP growth in the EU in Q1 2020.

However, I have to note that during the previous four years, growth has been mainly driven by wage increase and rapid growth rate of consumption, while fiscal and external imbalances widened and the annual inflation rate remaining around 4 percent the highest among peer countries/in the EU. In such a context, of a pronounced procyclical fiscal policy, the NBR maintained a fairly restrictive monetary policy; we kept policy rate at 2.5 percent and a relative high level of reserve requirements (8 percent, both in local currency and forex).

Against this background, the initial impact of the crisis was forceful, deepening existing unbalance, and marked by increasing pressures arising from temporary supply-side frictions, particularly of food products, depreciation of the national currency and rising liquidity needs. As such, due to the sharp decline of the economic activity experienced in April, official quarterly GDP growth estimates indicate a 14 percent contraction for the second quarter of this year.

It is also important to note that rising unemployment and the response measures to alleviate the damage of the crisis (such as the initiative of "technical unemployment", repatriation of Romanian citizens stranded abroad, or quarantine and isolation measures) have also increased budgetary pressures.

I will now turn to NBR's policy actions in response to the crisis. Starting with March 16th, the President of Romania declared the state of national emergency, with an initial duration of one month, later extended for one more. The priority was to protect the public health and to ensure the availability of essential goods and services. As a consequence, the immediate objective of our central bank was to secure the necessary stability and the liquidity of the banking system, for the proper functioning of public finances and the real economy. For this and consistent with its mandate and statutory independence, we have taken several key measures at speed to support the economy. We have also secured a positive relationship with the Government and made sure that our measures do not come into conflict with the fiscal ones, given the exceptional situation.

Particularly for Romania, the exchange rate plays an important role as a public indicator of the stability and overall economic situation. We kept the managed floating framework, but in this context, we decided to provide liquidity mainly on bilateral base, in order to avoid an overshooting (which is difficult to explain to the public) and to prevent an unnecessary depreciation of our currency. Also distinct from some trends in the region, we have not pursued drastic cuts of interest rates. The decrease of policy rate on March 20th was from 2.5 percent to 2.0 percent, together with the halving of the corridor around the policy rate from 1 percentage point to ±0.5 percentage point; on Friday, last week, we further decreased the policy rate to 1.75 percent. These seem to have been effective measures as the results were quick to follow*; since the first part of April* budgetary public needs were properly financed and we saw considerable decline in the three-month interbank market rate, as well as in the sovereign debt financing costs. Over the past two months the exchange rate has remained relatively stable, and CPI inflation is running now at around 2.5 percent.

Regarding the purchase of government securities denominated in domestic currency on the secondary market – a common measure among the central banks in this context – I would like to stress that NBR decided to start the purchases in March this year only after a shift occurred in its market position, from net debtor to net creditor to the commercial banks. From this perspective, the measure, fully aligned with the NBR's status as lender of last resort, was taken with the objective of securing adequate liquidity to the system and is not qualified as QE.

In addition to these monetary policy measures, the NBR Board has taken actions that will help affected individuals and companies with outstanding loans by providing lenders with increased flexibility in the fulfilment of certain requirements. Other policy actions include changes to resolution measures that allow for delays in reporting obligations for banks or the postponement of contributions to the bank resolution fund. Last but not least, the NBR has taken systematic action at operational level to ensure continuity and smooth functioning of payment and settlement systems and by providing banks with necessary liquidity for all operations.

Policy priorities for the future

Going forward, the evolution will mostly be dependent on the public health developments and their timing. That is why we will continue to monitor and update our assessment of the economy and the public health situation, and we will focus our measures on providing the necessary liquidity support, ensuring the financial stability, as well as securing a sustainable decreasing path of interest rates.

As the cooperation with the Government is important, we intend to continue working together to ensure a quick bounce back of the economy from the current situation. Also, the EU Coronavirus recovery package will undoubtedly play an essential part in our recovery efforts.

While expressing unceasing gratitude to those on the front line of the fight against the Covid-19, we underline that NBR stands ready to play its part. However, in the long-run, the only viable option is the return to a normal monetary policy stance, but we are aware that the new normal will be rather different from the past. That is why we intend to take gradual measures, constantly adapting to the rapid changing environment, while following the legal requirements.

Dear colleagues,

As the General Manager of the BIS, Mr. Carstens has recently said, ‘central bankers must work to get monetary policy back to normal and create an exit strategy from aggressive measures as soon as possible(…)at this very early stage, we have to start thinking about how to implement and make possible an exit strategy’. He has also pointed out that ‘At some point, central banks should start sending signals that this will not last forever.’

I am sure we are all facing significant challenges at this moment and that sharing specific solutions and their outcomes within this forum is of real help and useful for each of us. I am looking forward to having your input.

Please receive, on behalf of the National Bank of Romania, all the best wishes for you and your colleagues in each of your esteemed institutions. May we see each other again in good health and optimistic!

Thank you!