GDP REPORT

9 September 2013

Industry and agriculture were the main drivers of GDP growth in Q2

- Detailed GDP for Q1 pointed to a growth rate of 0.5% QoQ and 1.5% YoY, which were above markets' expectations, and higher than the flash estimate. The main contributors to the 1.5% Y oY GDP growth were agriculture (+0.6%) and industry (+1.4%). Without agriculture, growth would have been only 0.9% YoY. The dynamics of GDP excluding agriculture has been slowing in the past 3 quarters, a sign that core processes have still to recover.
- Looking at production side, the data is mixed: the advance witnessed by agriculture is merely due to a base effect, as 2012 has had the lowest production since 2007. The industrial production benefited from both the external and internal demand in Q2, unlike in Q1 and it weighs one third of the GDP, the most of all items. Among sectors, constructions had the most negative contribution (-0.5%): lower infrastructure works left their mark, as EU related funds were blocked in H1 2013.
- The expenditure side makes the growth picture clearer: households consumption barely moved (+0.2% YoY), investment decreased by 3.8% YoY and the single bright spot are the exports (+ 12.1% YoY). Moreover, imports declined generating an additional positive effect in the final result. All items are pointing to weak growth dynamics and lack of trust to spend and invest more. The exports' success lays in high value added goods such as the machinery and transport equipment which make up to 43% of Romanian exports.
- Prospects for future quarters are moderately optimistic: the agriculture is going to continue to support GDP growth in H2 2013. In industry, expectations are positive for July and August. Looking to the following quarters, given that a large part of industrial production goes to export and that the European economy shows signs of improvement, with ECB also pledging to keep the low rates for an extended period, chances for a sustained slow uptake exist. In constructions, the component that has been missing out is the public spending on infrastructure projects. Given that EU related funds have been unlocked at the end of H1, we expect improvement in this area starting in Q3. According to the Fiscal strategy for 2013-2015 and the one for 2014- 2016, the main infrastructure projects amount RON 6 bn in 2013 and they are ~ 50% higher in 2014. Moving further, to the retail trade, the disinflation process continues and this factor will not be biting into disposable income to the extent witnessed in H1. In the public services sector we expect to continue to see an increase in the number of employees, in line with the already started uptrend. So far, the fiscal adjustment imposed a policy of replacing public employees in a ratio of 7 to 1 but this will not be in place anymore after the restructuring of the public administration ends and the public wages law is enforced.

Treasury Sales Team

Alina Elena Vrabioiu
+4021 307 58 17
alina.vrabioiu@otpbank.ro

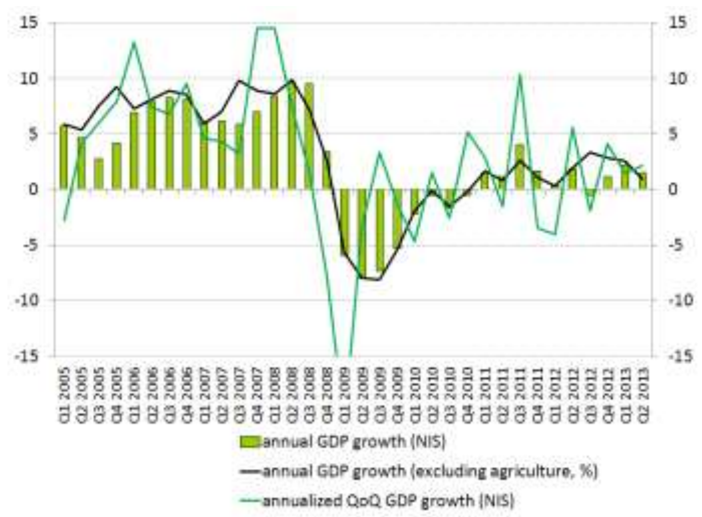
Irina Ananiesei
+4021 307 58 17
irina.ananiesei@otpbank.ro

Tania Fantana
+4021 307 58 17
tania.fantana@otpbank.ro

Analyst
Mihaela Neagu
+4021 307 58 64
mihaela.neagu@otpbank.ro

Chart 1: GDP growth summary charts (%)

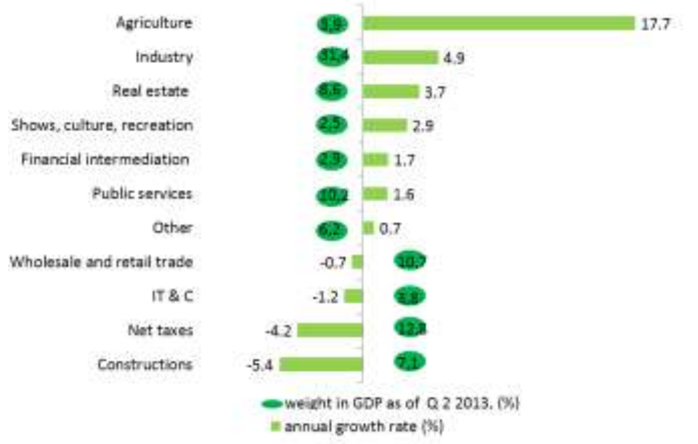
3 consecutive quarterly uptakes; excluding agriculture, the pace slowed down in the last 3 quarters



Source: NIS, OTP Research

Chart 2: Production approach: YoY growth rates, Q4

Agriculture and industry were top gainers and main drivers of GDP growth in Q2



Source: NIS, OTP Research

Note: "Other" refers to "Professional, scientific and technical activities; activities of administrative services and support services"

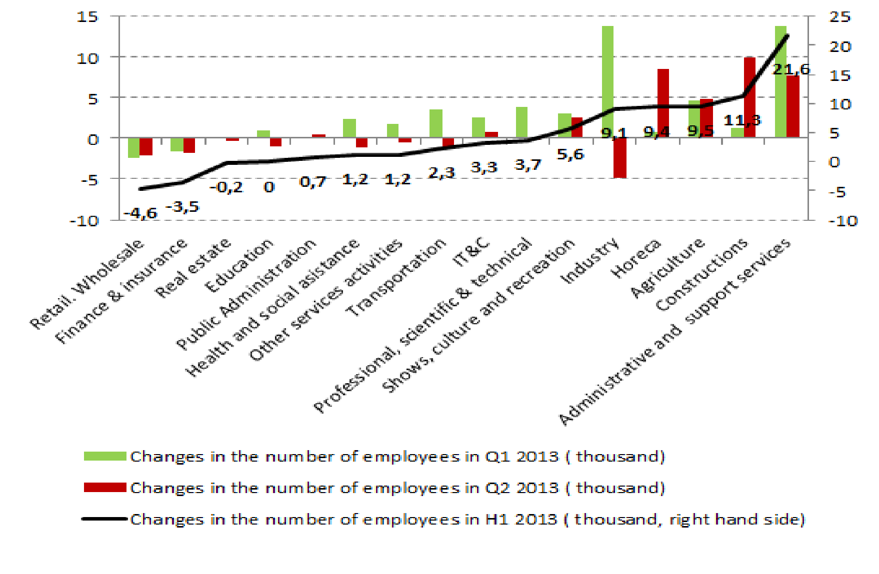
Detailed GDP data for Q1 came out better than the flash estimate: **the economy grew by 1.5% YoY (NSA) and 0.5% QoQ** (SA), compared to the flash estimate of 1.3% YoY (gross) and +0.3% QoQ. The **main contributor to the annual GDP growth were industry (+1.4%) and agriculture (+0.6%) (**see Chart 11). Without agriculture, growth would have been only 0.9% YoY. **The dynamics** of **GDP excluding agriculture has been slowing rhythm in the past 3 quarters, a sign that core processes have still to recover (Chart 1).** In fact, the only common denominator of each year in which we saw the economy grow post crisis are the services, the rest of the drivers have been different each year and therefore **we cannot clearly say that one sector or another has recovered sustainably**.

Looking at the production side, the dynamics is mixed among sectors (Chart 2). Industry was supported only by external demand in the first quarter but the sales data shows **that in Q2 2013, domestic industrial sales rose as well**, after two quarterly declines in Q4 2012 and Q1 2013 (see chart 6). **The advance** we saw of **agricultural value added is merely the result of a base effec**t, given that in 2012 agriculture was the worst year since 2007. The real estate and financial intermediation sectors, which were hardly hit during the recession also increased on an annual basis but they are among the few sectors were the number of employees dropped in H1 2013. **In the banking sector loan production did not increase in H1**. Restructuring continues and banks are still coping with complex issues: becoming cost effective, changing their business model to current customer needs and adapting to the new environment where external funding is not available. Moreover, banks have to repay their debt and the deleveraging process continues. The number of employees in the banking system dropped by 3% during the first 6M of 2013 and banks closed down 194 units during this period, reaching 5529 in June 2013. The value added in the **public services rose as wages were hiked twice last year** reaching 15% YoY in December 2012.

The segments where we saw declines were the wholesale and retail trade (-0.7% YoY), IT & C (-1.2% YoY) and constructions (-5.4% YoY, Chart 2). Trade was affected by weak business and consumer confidence: to enforce this view we notice that loans to companies contracted significantly on a yearly basis and banks saw poor demand from companies. Retail sales fell as disposable income has been affected by the high inflation rate (a high of 6% YoY in H1). The IT&C sector is only correcting the extraordinary advance witnessed last year (+29% YoY in 2012). There is a different story in constructions: aside from the fact that the private segment was probably down, public expenditures did not help either. In Chart 8 we see that infrastructure works (civil engineering) were down compared to the same period last year, as related EU funds were blocked in H1.

Chart 3: Evolution of the number of employees in H1 2013

Administrative and support services added one third of jobs in H1

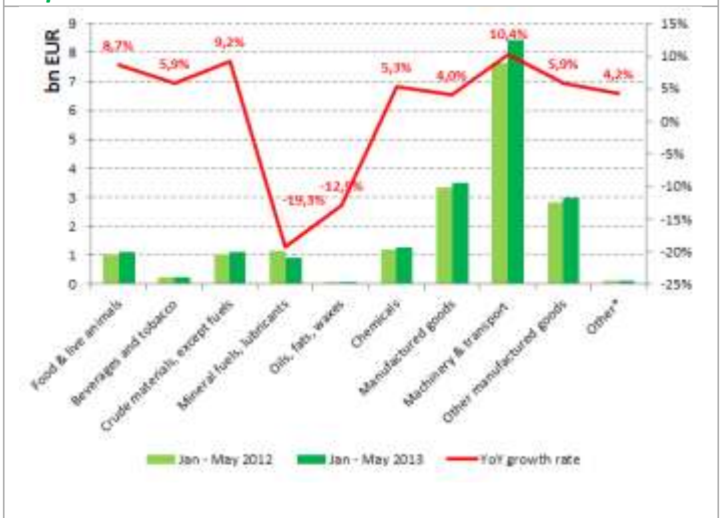


Source: NIS, OTP Research

Looking at the expenditure side (Chart 5) makes the growth picture clearer: consumption barely moved (+0.2% YoY), investment decreased by 3.8% YoY and the single bright spot are the exports (+ 12.1% YoY). Moreover, imports declined generating an additional positive effect in the final result. All items are pointing to a weak growth dynamics and lack of trust to spend and invest more. **The exports' success lays in high value added goods such as the machinery and transport equipment which make up to 43% of Romanian exports (Chart 4)**. Renault and Ford are the international car manufacturers present in Romania.

Chart 4: Exports' structure

Machinery and transport equipment drove up the exports in H1 2013

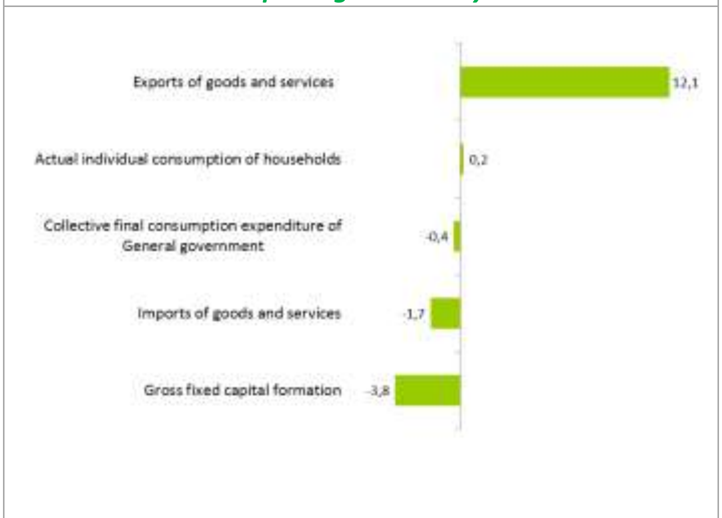


Source: Eurostat, OTP Research

Note: "Other": commodities and transactions not classified elsewhere

Chart 5: Expenditure approach: YoY growth rates, Q2

Exports supported GDP growth rate in Q2 and households' consumption gained a shy 0.2% YoY



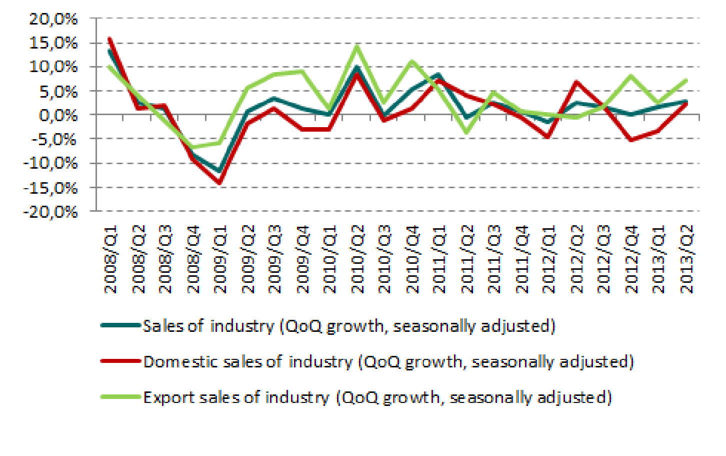
Source: NIS, OTP Research

Prospects for future quarters are moderately optimistic: first, the **agriculture** is going to continue to support GDP growth in H2 2013. Second, core business processes are still weak (Charts 12- 16). In **industry**, expectations are positive for July and August, but the rhythm is expected to slow down, according to the survey operated by the Central Bank. Also, Ford announced that it will close down production for a week in September so this will hurt September industrial production figures. However, looking to the following quarters, given that a large part of industrial production goes to export and that the European economy shows signs of improvement, with ECB also pledging to keep the low rates for an extended period, chances for a sustained slow uptake exist. In **constructions**, the component that has been missing out is the public spending on infrastructure projects. In H1 2013, the planned public investments were behind the plan (realization of 75% of the plan, cash basis) as absorption EU funds was significantly lower than the budgeted one (by 32%). Given that EU related funds have been unlocked at the end of H1, we expect improvement in this area starting in Q3. According to the Fiscal strategy for 2013-2015 and the one for 2014- 2016, the main infrastructure projects amount RON 6 bn in 2013 and they are ~ 50% higher in 2014 (please see the annex). They are mostly financed by EU post accession funds.

Moving further, to the **retail trade**, the disinflation process continues and this factor will not be biting into disposable income to the extent witnessed in H1. In addition to lower food prices resulted from the improved crop this year, the VAT for bread is decreased to 9% from 24% starting in September and this will likely have a positive effect on retail sales. Bread represents 6% of the consumer price basket. In the **public services** we expect to continue to see an increase in the number of employees, in line with the already started uptrend: according to the Fiscal Council, the number of public employees dropped by 15% in September 2012 since December 2008. However, in H1 2013 the number started to increase. The National Institute for Statistics reports 700 new jobs in the public administration (Chart 3) in H1, no addition in education and 1200 more in the health sector. So far, the fiscal adjustment imposed a policy of replacing public employees in a ratio of 7 to 1 but this will not be in place anymore after the restructuring of the public administration ends and the public wages law is enforced. For 2014, the public wages law is expected to be put in place in steps and once it is over, the 7 to 1 replacement of employees rule will not apply anymore.

Chart 6: Industrial sales evolution (%)

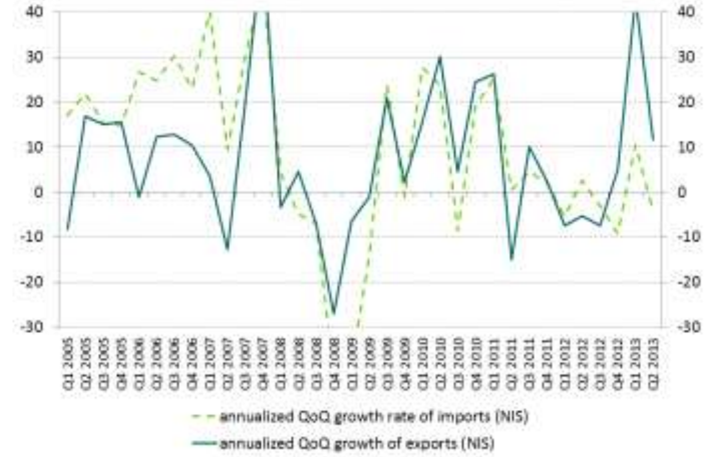
In Q2, domestic industrial sales have grown on a quarterly basis but they are lower on an annual basis



Source: NIS, OTP Research

Chart 7: Evolution of exports and imports (%)

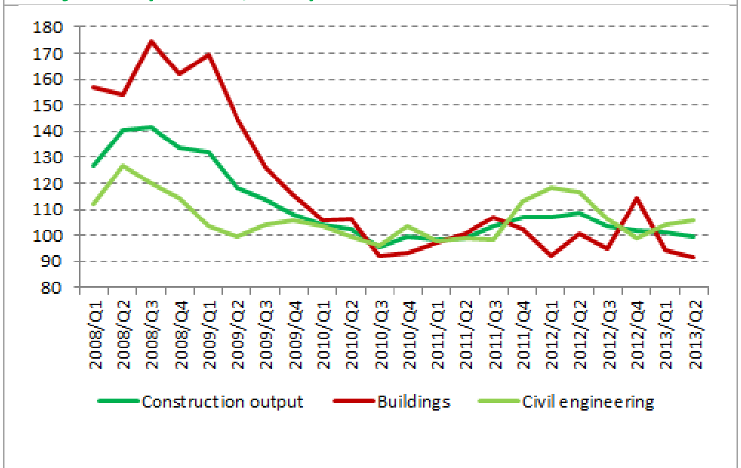
Exports rushed in the past 3 quarters



Source: NIS, OTP Research

Chart 8: Construction indices (2010=100, SA)

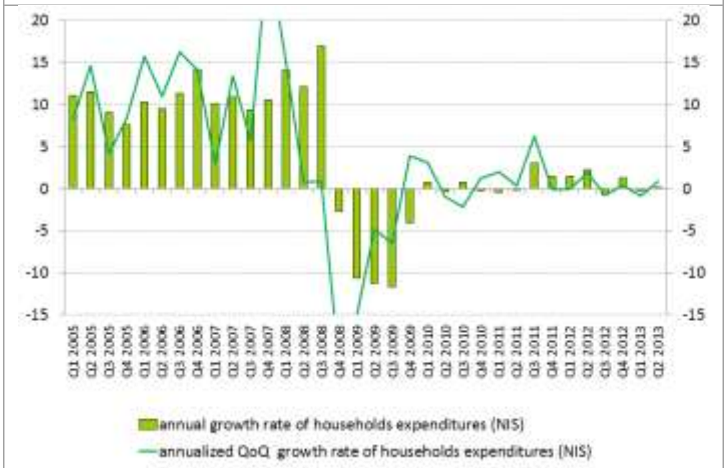
Civil engineering did not support construction activity in the first 2 quarters, compared to 2012 levels



Source: NIS, OTP Research

Chart 9: Households consumption expenditure (%)

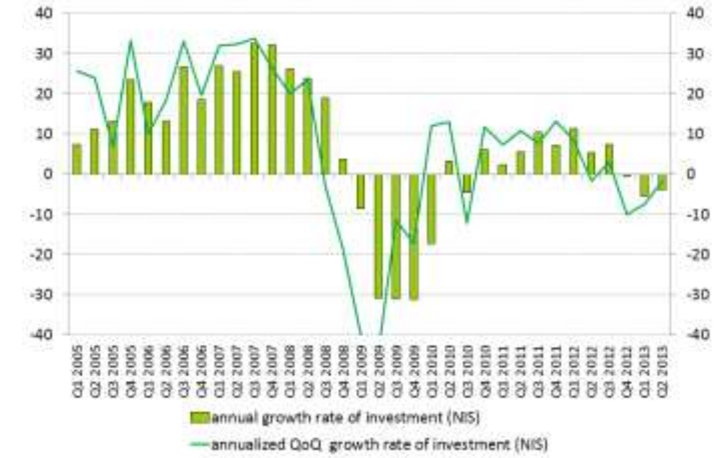
Private consumption is still feeble



Source: NIS, OTP Research

Chart 10: Gross fixed capital formation (%)

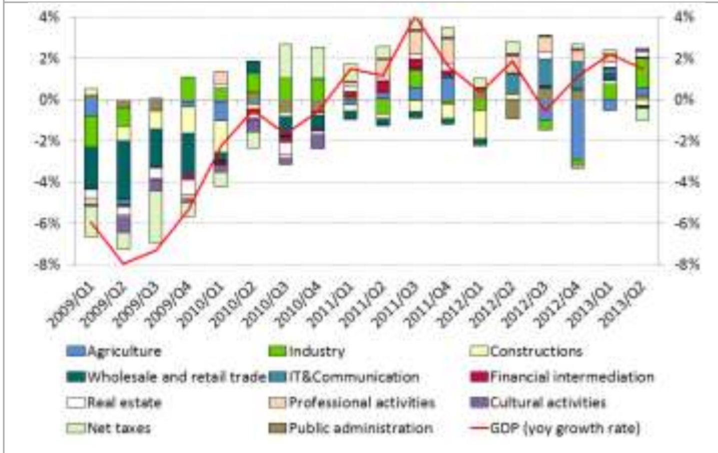
Investment dropped in the last 3 quarters (QoQ)



Source: NIS, OTP Research

Chart 11: Contribution to annual GDP growth rate (%)

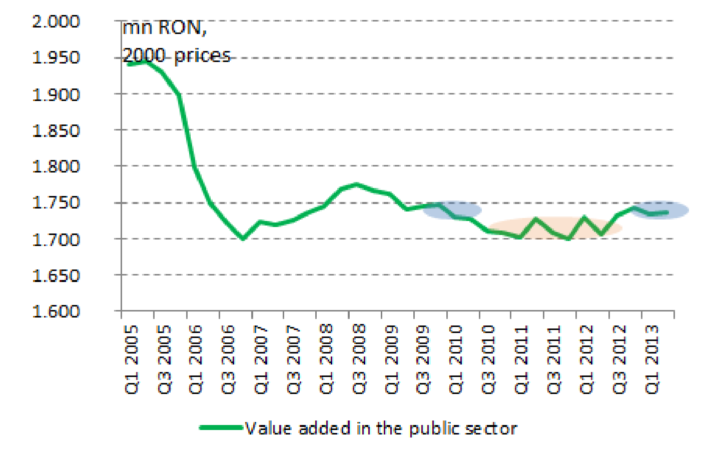
Industry had the biggest contribution in Q1 and Q2



Source: NIS, OTP Research

Chart 12: Value added in the public sector (RON mn)

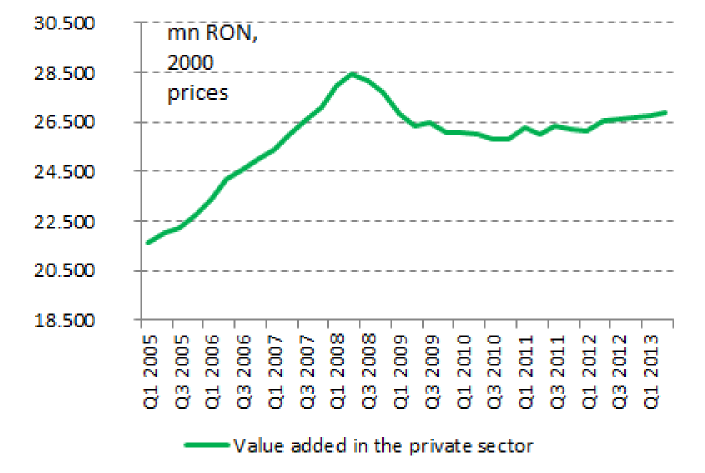
The public sector value added is recovering around the levels before the 25% wage cut of 2010



Source: NIS, OTP Research

Chart 13: Value added in the private sector (RON mn)

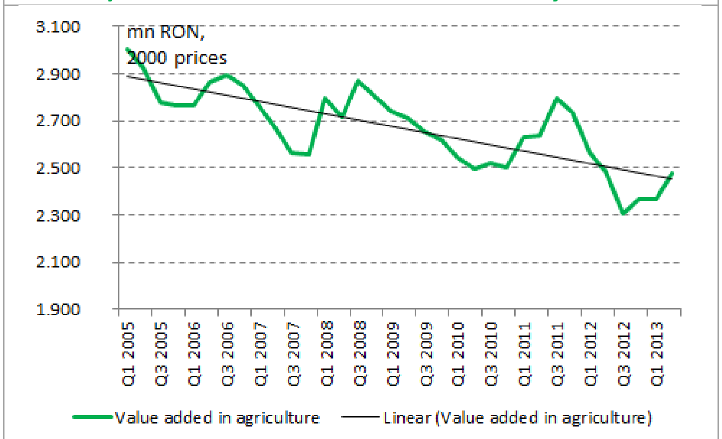
The private sector recovery is very slow



Source: NIS, OTP Research

Chart 14: Value added in agriculture

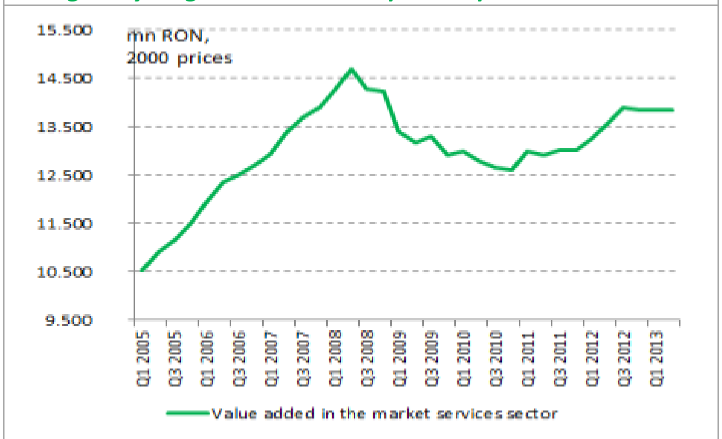
We saw an uptake in Q2, given the base effect; the overall picture shows a downtrend over the years



Source: NIS, OTP Research

Chart 15: Value added in the market services sector

After strong hike in Q1 – Q3 2012, market services have marginally edged lower in the past 3 quarters



Source: NIS, OTP Research

Annex 1:

Main infrastructure projects in 2013 RON thousand	2013	Funding
Rehabilitation of railway Brasov - Simeria, section Coslariu – Sighisoara	1.008.829	EU funds
Highway Orastie – Sibiu	699.069	EU funds
The project of rehabiliation of national roads, phase 6 (1112 KM):	546.704	EU funds
ELI project	519.719	EU funds
Highway Cernavoda – Constanta	435.448	EU funds
Highway Lugoj – Deva	430.091	EU funds
Rehabilitation of railway Border – Curtici - Simeria	413.414	EU funds
Highway Bucuresti – Brasov	369.078	state budget
Highway surrounding the cities Deva – Orastie	324.466	state budget
Rehabilitation of railway Brasov - Simeria,section Coslariu – Simeria	255.935	EU funds
Highway Arad – Timisoara and By-pass Arad	250.709	7,5% EU funds, the rest from reimbursable EU funds
Bypass Constanta	246.166	29% EU funds, the rest from reimbursable EU funds
Highway Brasov – Cluj – Bors	188.368	state budget
Highway Nadlac - Arad	170.003	EU funds
TOTAL	5.857.999	

Main infrastructure projects 2014 -2016 RON thousand	2014	2015-2016	Funding
Rehabilitation of railway Brasov - Simeria, section Coslariu – Simeria	1.713.133	1.348.960	EU funds
Rehabilitation of railway Brasov - Simeria, Coslariu – Sighisoara	1.548.926	1.772.463	EU funds
Highway Lugoj – Deva	1.380.135	4.010.990	EU funds
Rehabilitation of railway (Border – Curtici - Simeria)	880.102		EU funds
ELI project	316.999	132.685	EU funds
Enlargement to 4 lanes of the Bucharest South bypass	312.426	477.362	state budget
Modernization of the bypass of Bucharest between A1 -DN 7 and DN2 -A2	266.804	220.343	state budget
Highway Timisoara - Lugoj	263.507	650.493	EU funds
Highway Bucuresti – Brasov	250.000	500.000	state budget
The V th artery of the subway (Drumul Taberei - Pantelimon, Universitate – Pantelimon)	205.755		EU funds
Finalization of the Dam in the Port of Constanta	200.000	269.000	EU funds
Bypass of Bacau on DN 2 - stage I:	175.644	483.809	EU funds
The project of rehabiliation of roads, phase 5	170.369	320.252	EU funds
The project of rehabiliation of national roads, phase 6 (1112 KM):	165.895	616.126	EU funds
Bypass of Craiova city, South, DN 56 - DN 55 - DN 6	128.014		state budget
Highway Orastie – Sibiu	119.823	1.183.528	EU funds
Modernization of national road: DN 73 Pitesti - Câmpulung - Brasov	107.629	225.000	state budget
Enlargement to 4 lanes on national road DN 7, Baldana - Titu	100.000	94.214	state budget
The V th artery of the subway (Drumul Taberei – Universitate)	92.564	622.337	EU funds
The National Theathre (Bucharest) I. L. Caragiale	85.543	19.203	EU funds
Artery IV of the subway:	65.076	132.804	state budget
Bypass of Brasov, on DN 1:	61.457	207.975	EU funds
Highway Nadlac - Arad	50.014	517.149	EU funds
TOTAL	8.659.815	13.804.693	

Source: The Ministry of Finance, the Fiscal strategy 2013 – 2015, the Fiscal Strategy 2014 -2016

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