GDP REPORT

7 December 2015

Much better than it seems: underlying, broad-based acceleration is hidden by agriculture.

- In the third quarter of 2015, Romania's economy could pick up, as we expected in our previous GDP report too. Nonetheless, the pace of growth exceeded both our and the market's forecast with a 1.4% QoQ advance (SWDA data), leading to the annual gain of 3.6% (gross data; see Chart 1). The recent detailed statistics were in line with the NIS's flash estimate, released three weeks earlier.
- Simultaneously, both the non-farm and the non-farm private sector GDP (in our opinion, these may offer a clearer picture over the underlying evolutions) recorded above 5% rises: 5.5% YoY and 5.2% YoY respectively (see Chart 2), the highest since Q3 2008. As it was also suggested by the high-frequency indicators, all of the main economic sectors were in the positive territory irrespectively of the base period (previous quarter or Q3 2014) with a single exception, namely agriculture, which was heavily dragged down by a severe drought, especially in late summer. As a result, agriculture's output sharply dropped, pointing to a 14.8% YoY fall. Nevertheless, the weakness of the sector during 2015 could translate into a positive base effect in 2016, which – together with the large fiscal loosing package – represents notable upside potential.
- Taking a more exhaustive view on the production side items, the recent statistics outline that market services remained the foundation-stone of GDP growth, providing the largest contribution, based on the good performance of several sub-sectors such as: IT&C (+11.7% YoY), trade, hotels and restaurants (+8.9 YoY), other private services (+7.9% YoY), while financial intermediation and real estate activities were relatively subdued (+2.3% and +2.4%). Nevertheless, the favourable trends registered by the economy were broad-based, with construction adding 5.4% YoY and industry inching up 1.8% YoY too. Overall, this structure seems to confirm that the country's economy entered into a new expansion cycle, raising the chance of reaching a mature phase in the not too distant future.
- Turning to the expenditure side, the big picture did not change very significantly, after households' consumption continued to be the main driver, similarly to the previous quarters since Q1 2014 (Chart 4). Moreover, it could even accelerate, reaching 6.6% annual growth in the period of July-September, after 5.5% in Q2. Households' spending might be supported first of all by strongly increasing real disposable incomes, after the foods' VAT rate cut in June, which resulted in much lower inflation. In addition, raising nominal wages and further improving labour market conditions also helped households' real wages to advance (Charts 5).
- Net exports had again a negative impact on GDP dynamics, lowering the overall growth by 0.9% percentage points in Q3, after domestic-demand-driven imports advanced faster than exports (3.1% YoY vs. 0.9% YoY). Romanian exports lost further steam recently, despite the relatively favourable stance of the European economy underscored by the EC's sentiment indicator (Chart 6), as extra-EU demand shrank significantly, according to the monthly trade statistics. It may be worth noting that the balance of the current account seemingly marks a turning point (Chart 7). We think that the CA deficit should gradually widen in the following period on the back of the domestic-factors-led GDP growth.
- Gross fixed capital formation also registered a positive contribution to the annual GDP growth, but it was a smaller one compared to Q2, as investments slightly declined on QoQ basis recently (-0.6%, SWDA), after robust gain in April-June. On the other hand, they still could record 4.2% year-on-year gain in the third quarter of 2015. Regarding the public sector, the somewhat higher use of EU funds might also bolster investments during 2015, while the government's capital expenditures from own sources partially offset these increases (Chart 8). At the same time, private investments also could rise.
- Regarding the last quarter of 2015, the early data suggest that the economy might continue the upward trend: retail trade's increase remained high (Chart 11); employment expectations (Chart 12) and economic sentiment indicator (Chart 13) are still favourable. On the other hand, due to the coming VAT rate reduction in January, households may postpone some of their expenditures. Thus the last quarter of the year should be less impressive than Q3, causing us to maintain our 2015 growth forecast at 3.7%.
- Looking ahead, year 2016 may start on a strong note, boosted by a large fiscal stimulus (see Chart 9), which should bolster consumption even further. Nevertheless, the absorption of EU funds may weigh on investments in the light of the new 2014-2020 budgeting period.
- At the same time, we see positive signs in the case of credit dynamics. Our broad estimate about the evolution of performing loans underscores favourable changes (Chart 14). But indeed, these partially may be clouded by the lowered limit of the so called "First Home" state guarantee scheme (to RON 1.5 bn in 2016, from RON 2.8 bn this year) and the disputed mortgage default legislation.

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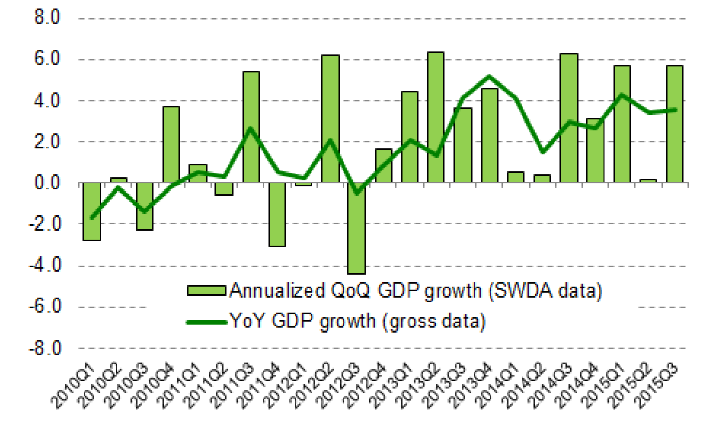
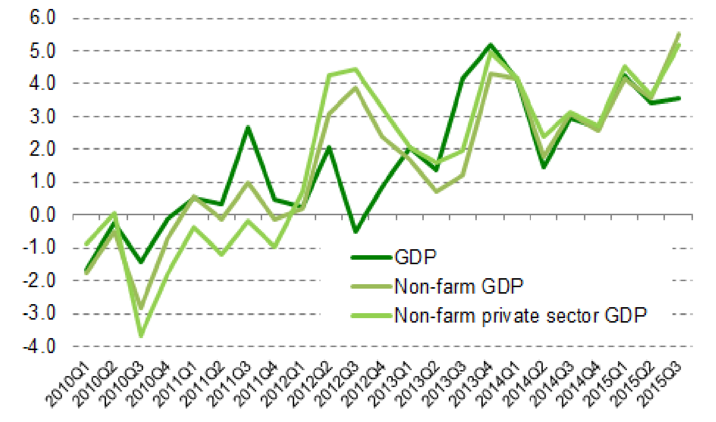
Chart set:

Chart 1: Summary chart of GDP growth (%)



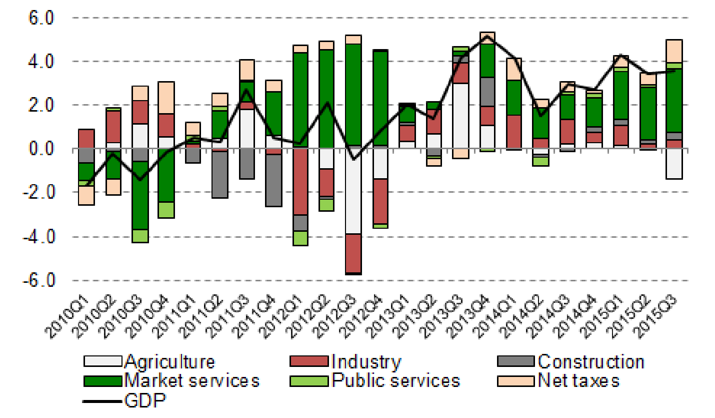
Sources: NIS, OTP Research

Chart 2: GDP vs. non-farm and non-farm private sector growth (YoY%)



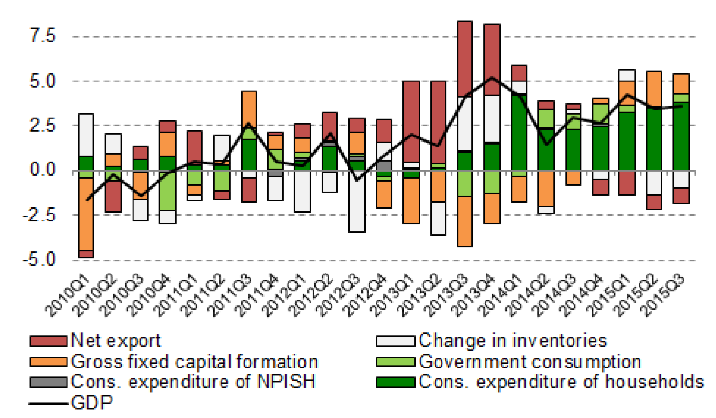
Sources: NIS, OTP Research

Chart 3: Decomposition of GDP growth by production-side items



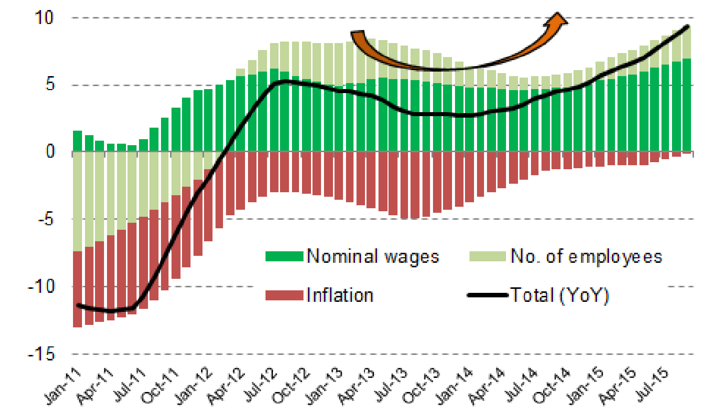
Sources: NIS, OTP Research

Chart 4: Decomposition of GDP growth by expenditure-side items



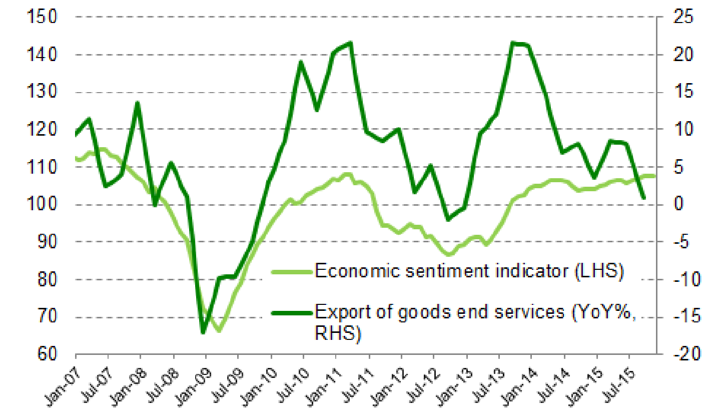
Sources: NIS, OTP Research

Chart 5: Decomposition of households' real income from wages (%, 12M moving average)



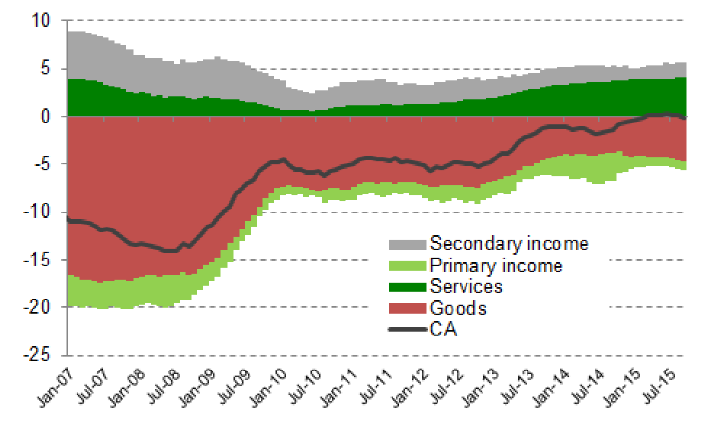
Sources: NIS, OTP Research
*Note: households' real income from wages is calculated as the number of employees * Net real wages on 2000's constant prices*

Chart 6: Romanian exports and EU level economic sentiment indicator



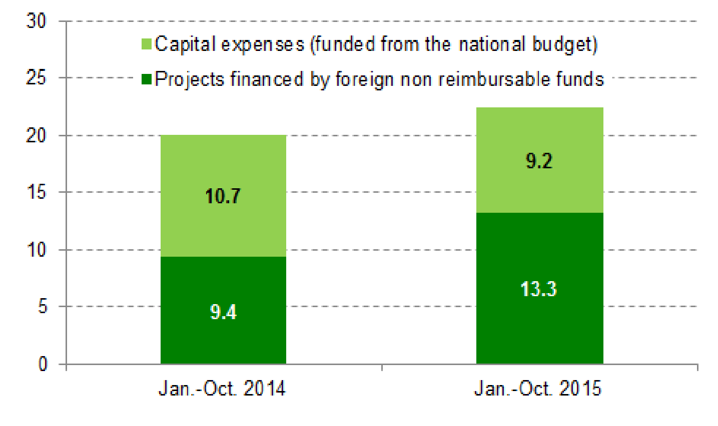
Sources: NIS, EC, OTP Research

Chart 7: Current account by its main components
(12M rolling, as % of GDP)



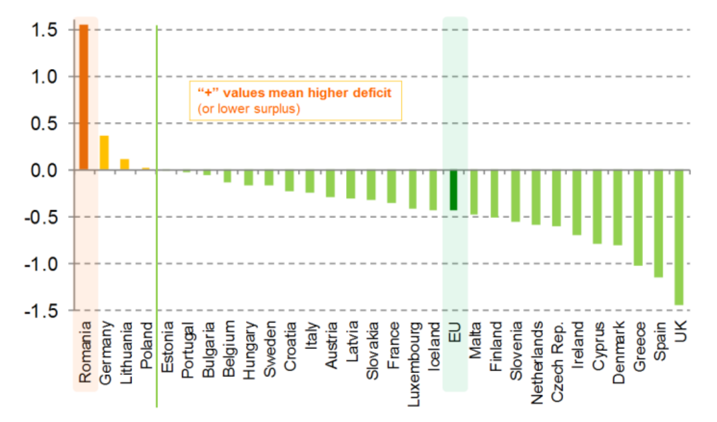
Sources: NBR, NIS, OTP Research

Chart 8: Public investments
(RON bn)



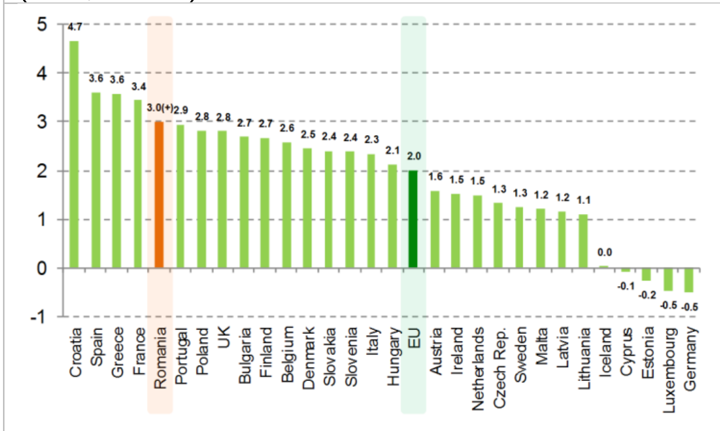
Sources: Ministry of Finance, OTP Research

Chart 9: Change in general government balance
(2016 vs. 2015, percentage-points)



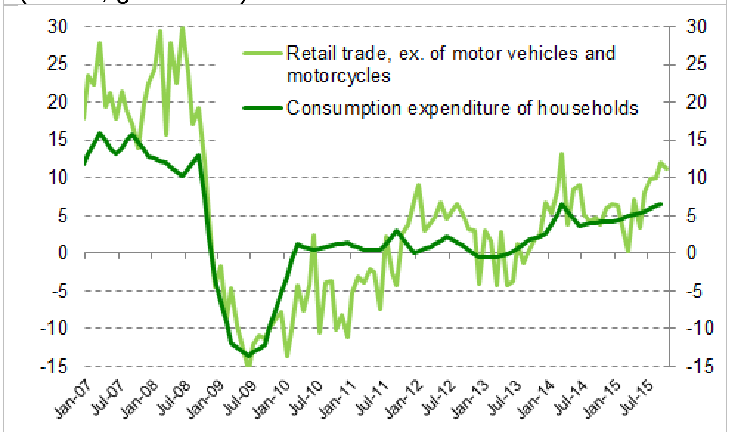
Sources: EC autumn forecast, OTP Research

Chart 10: Forecasted general government deficit
(2016, GDP %)



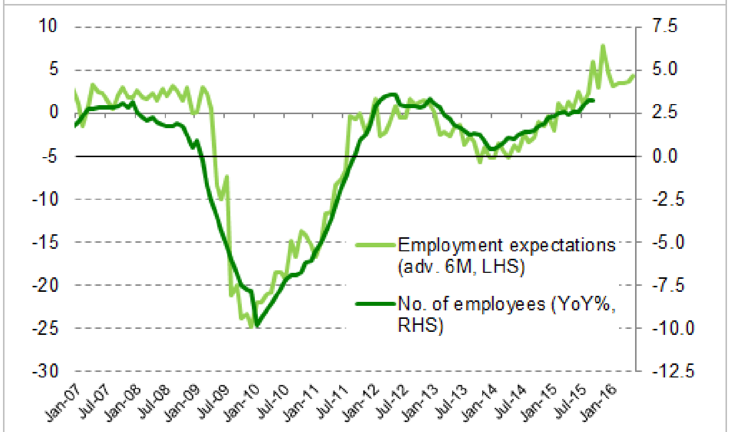
Sources: EC autumn forecast, Ministry of Finance, OTP Research

Chart 11: Consumption vs. retail trade growth
(YoY%, gross data)



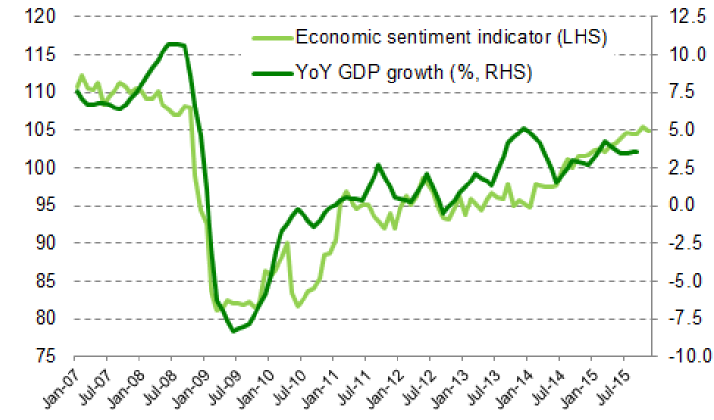
Sources: NIS, OTP Research

Chart 12: Employment



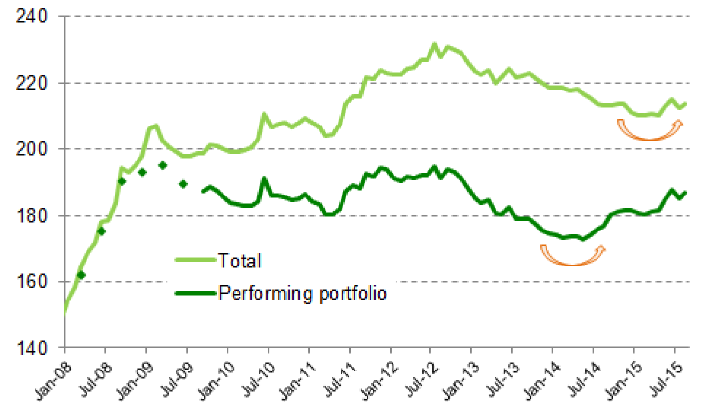
Sources: NIS, EC, OTP Research
Note: employment expectations are calculated as a weighted average of sectorial expectations

Chart 13: GDP growth vs. economic sentiment indicator



Sources: NIS, EC, OTP Research

Chart 14: Non-government loans (RON bn)



Sources: NBR, OTP Research

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