

GDP REPORT

09 June 2016

Skyrocketing consumption drove fast growth in Q1 2016

- The National Institute of Statistics revealed the detailed Q1 2016 GDP report, leaving economic expansion at 4.3% YoY (gross data, see Chart 1) and 1.6% QoQ (SA data), in line with its flash estimates released in May. These growth paces exceeded both our and market expectations, after high-frequency indicators suggested a more mixed evolution. Compared to the previous few quarters, the big picture did not change fundamentally, as domestic demand remained the main driver (Chart 3), while on the production side market services recorded the largest contribution to growth (Chart 4). Non-farm private GDP, our preferred underlying indicator, pointed to an almost 5% YoY gain at the beginning of 2016, similarly to the period of October-December 2015 (Chart 2).
- It was expected that households' consumption probably accelerated further in the first quarter of the year, and indeed the fresh data of the NIS did not cause any disappointment on this front. Households' consumption expenditures surged by 10.0% YoY in the period of January-March, reaching double-digit territory for the first time in eight years. Meanwhile, they expanded by 3.5% in quarter-on-quarter comparison, which pace would have been envied even before the outburst of the financial crisis. The main factors behind the rattling growth figures remained broadly the same: incomes from wages increased rapidly (Chart 6), driven by the tightening labour market, while minimum and public sector wage hikes as well as record low inflation on the back of VAT reductions gave additional boost to real disposable incomes.
- On the short term, we deem that consumption growth could maintain its momentum, getting a newer boost from the 19% increase of the minimum wage in May, which roughly affects one in five employees (for a more detailed picture about the structure of wages, please see Chart 7). In addition, inflation may be more sluggish this year than previously thought (we recently revised our average inflation expectation for 2016 to -1.2%, from -0.3%), supporting households' purchasing power. On the other hand, Q1's elevated 2008-like gain in consumption seems to be unsustainable in the medium term. As the stimulating factors such as the positive impact of the lower VAT and the supportive effects coming from the minimum and public wage hikes gradually fade out, households' expenditures most likely will lose some steam, but indeed their advance could still remain impressive in regional comparison even in 2017 and later. In addition, companies may scale back their plans to open new jobs, in response to the higher minimum wage. We also recall that productivity gains were not able to offset the increasing labour costs in the latest period, while the market appears to become increasingly tighter (Romania's unemployment rate is already much lower than the EU's average). These conditions limit the upside potential of job creation, which may be reflected by the reversal of the employment expectations (Chart 8).
- Remaining at the demand side, the NIS' data reveal that investments represented by gross capital formation continued to rise in Q1 2016 (7.0% YoY and 2.3% QoQ), even if at a slower pace than a quarter earlier. The positive dynamics presumably were still helped by the massive government spending in the last few months of 2015. Despite to the upturn showed in the latest period, there is still large room for investments in order to catch up with their pre-crisis levels (Chart 9). Nevertheless, in the light of the 2014-2020 budget period, lower access to EU funds may be a drag on investments this year.
- However, Q1's GDP report has less favourable points too. As it was expected, the growth rate of imports (8.0% YoY and 2.8% QoQ), which was boosted by the definitely strong domestic demand, outpaced again the advance of exports (1.2% YoY, 0.5% QoQ), putting the gap between them on a clearly widening trend, after a long period of healthy corrections (Chart 10). It may be worth mentioning that even though the current level of the deficit should not raise concerns at the moment, Romania has one of the weakest positions in terms of the current account deficit in the CEE region, and further deterioration is likely to come, as the output gap turns positive and the strengthening domestic demand causes the import of pro-cyclical items to increase exponentially. The import of goods increased almost unanimously among the main product groups in the first two months of the year (Chart 11), but exports continued to mark a relatively weak evolution despite the rather favourable economic sentiment in the EU (Chart 12), as they were pulled back by trades with extra-EU countries.
- Turning to the production side, the fresh statistics showed that market services remained the most important driver of growth (Chart 4), accelerating to a 7.4% YoY expansion, after 4.8% rise in Q4. Not surprisingly, the more detailed breakdown (Chart 13) reveals that the segments that usually exhibit higher sensitivity to changes in households' consumption propensity performed relatively better. On the other hand, the industrial sector was not able to convincingly benefit from the cheering domestic demand (Chart 14). This causes us to worry to some extent, as it may point to weaknesses in competitiveness. Accordingly, it also signals that further strengthening in domestic demand could be met by even larger imports, impairing the country's external position and limiting economic growth outlook in the medium and long terms. In Q1, constructions' output ran out of steam as well, but it came after a very strong year-end in 2015, while licenses for residential buildings continued to climb higher, even though credit standards on housing loans tightened due to the newly implemented debt discharge law (Chart 16).

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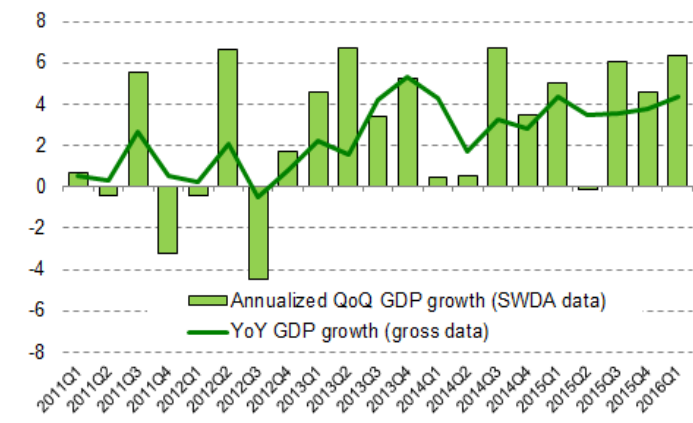
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- The strong dynamics should continue in Q2 too, which view is supported by the early indicators as well. Regarding the entire year of 2016, we continue to expect a very strong performance. Moreover, taking into account the better-than-anticipated dynamics in the first quarter and the promising outlook on agriculture production, we revised upward our projection by 0.1% percentage point to 4.3%. At the same time, we foresee a milder increase in 2017 (3.7%) because of the fading effect of stimulus measures.

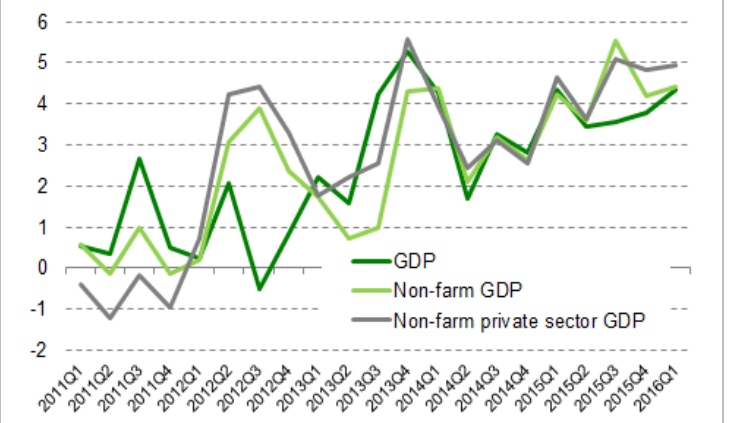
Chart set:

Chart 1: Summary chart of GDP growth (%)



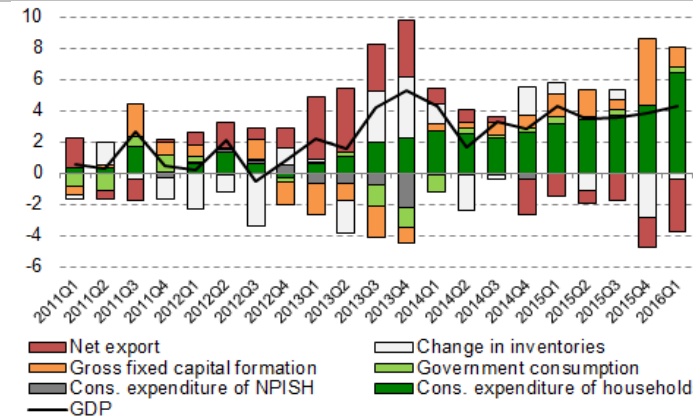
Sources: NIS, OTP Research

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



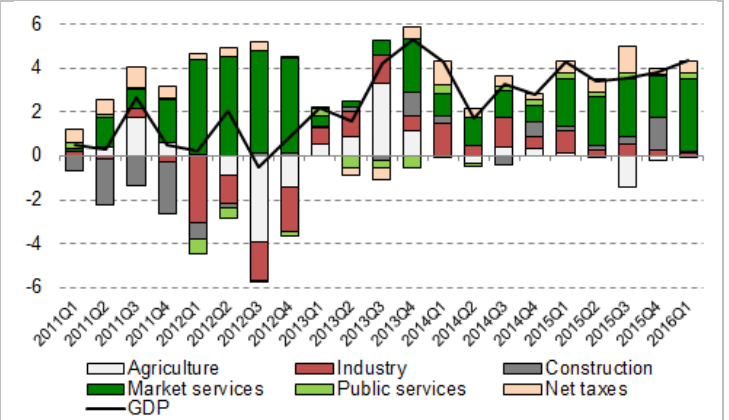
Sources: NIS, OTP Research

Chart 3: Decomposition of GDP growth by expenditure-side items (%)



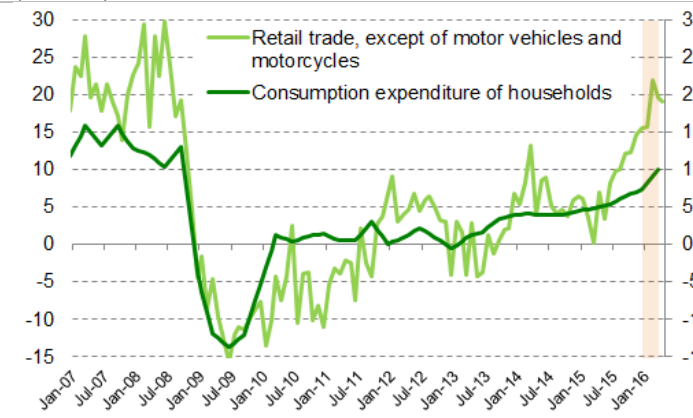
Sources: NIS, OTP Research

Chart 4: Decomposition of GDP growth by production-side items (%)



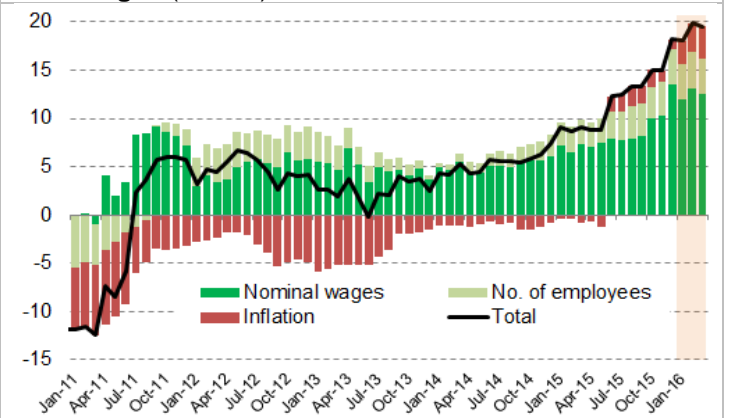
Sources: NIS, OTP Research

Chart 5: Consumption vs. retail trade growth (YoY %)



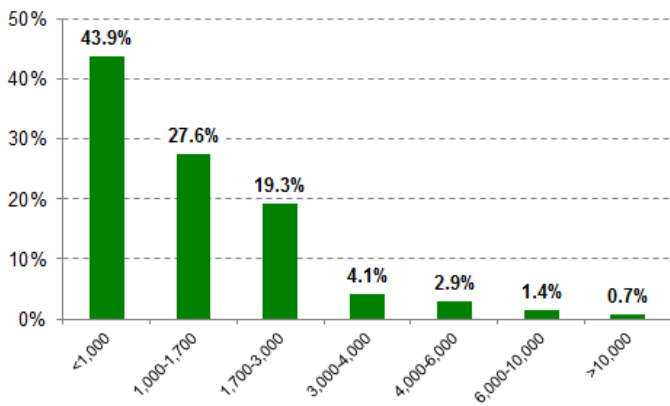
Sources: NIS, OTP Research

Chart 6: Decomposition of households' real income from wages (YoY %)



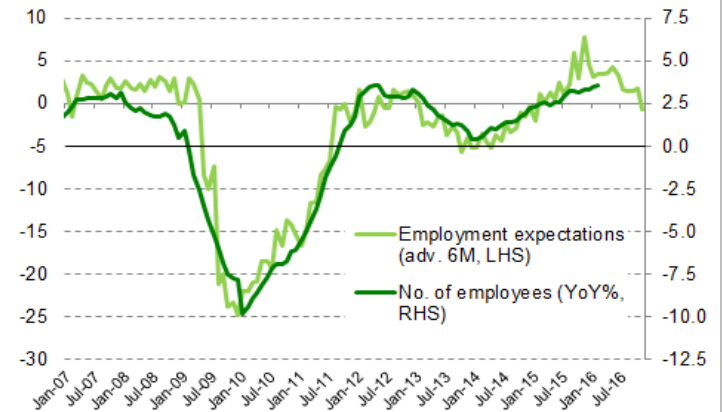
Sources: NIS, OTP Research

Chart 7: Structure of net wages
(%, RON)



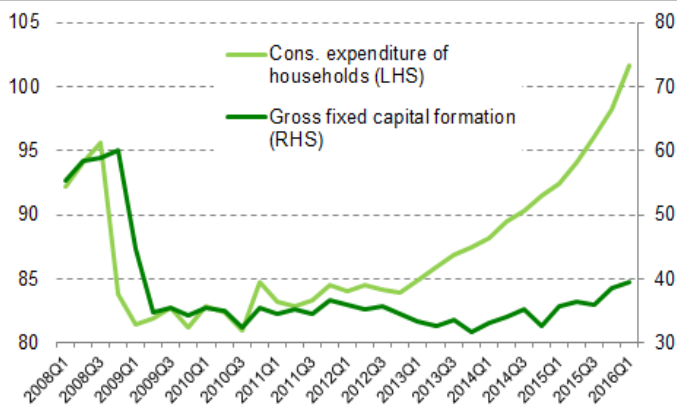
Sources: Ministry of Labour, ZF, OTP Research

Chart 8: Employment



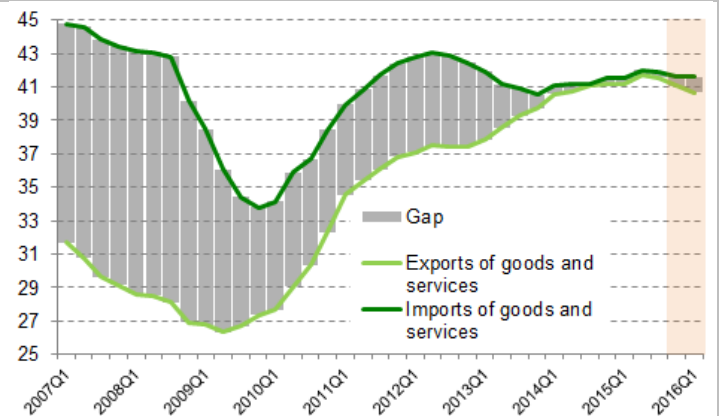
Sources: NIS, EC, OTP Research
Note: employment expectations measured as balance of opinions are calculated as a weighted average of sectorial expectations

Chart 9: GFCF vs. consumption expenditures of households
(RON bn, average prices of 2010, SA)



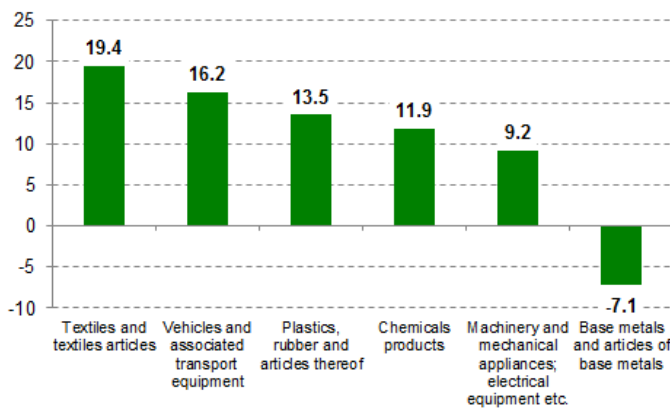
Sources: NIS, OTP Research

Chart 10: Export & import of goods and services
(as % of GDP, 4Q rolling)



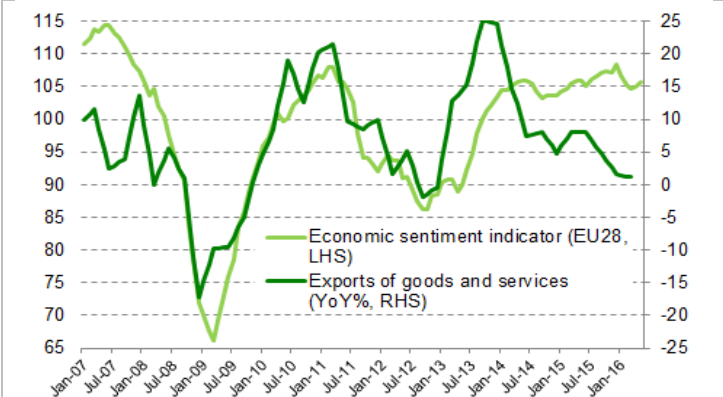
Sources: NIS, OTP Research

Chart 11: Import of goods by its main product groups in Jan.-Feb. 2016
(CIF, YoY %)

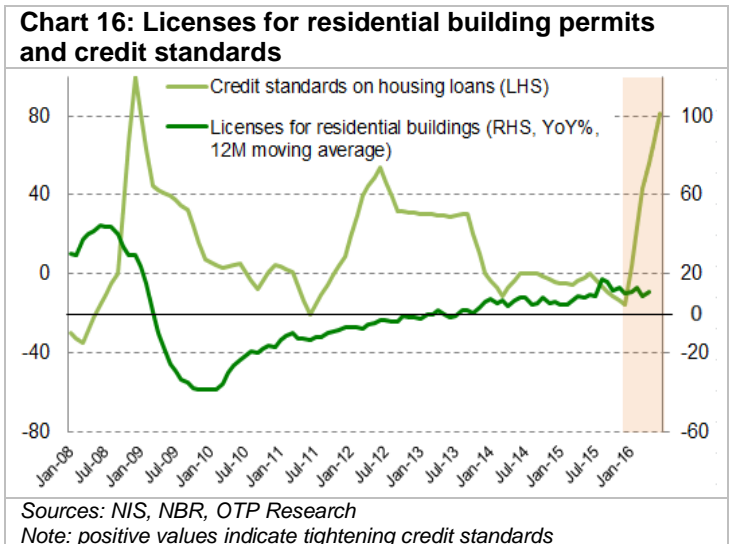
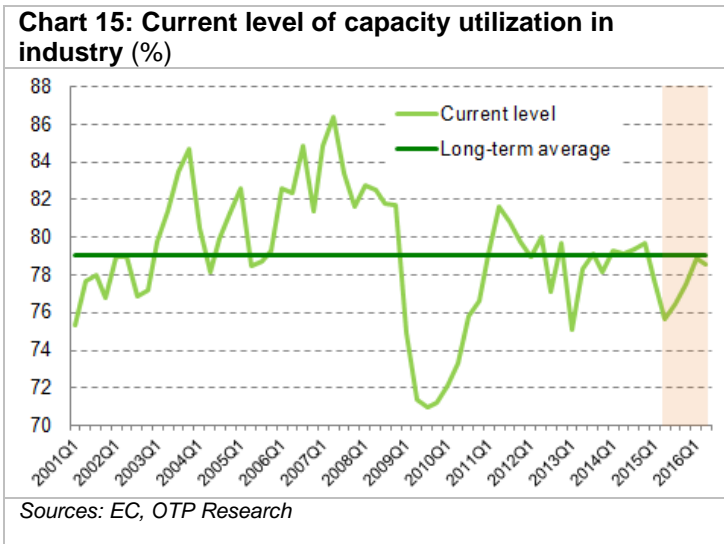
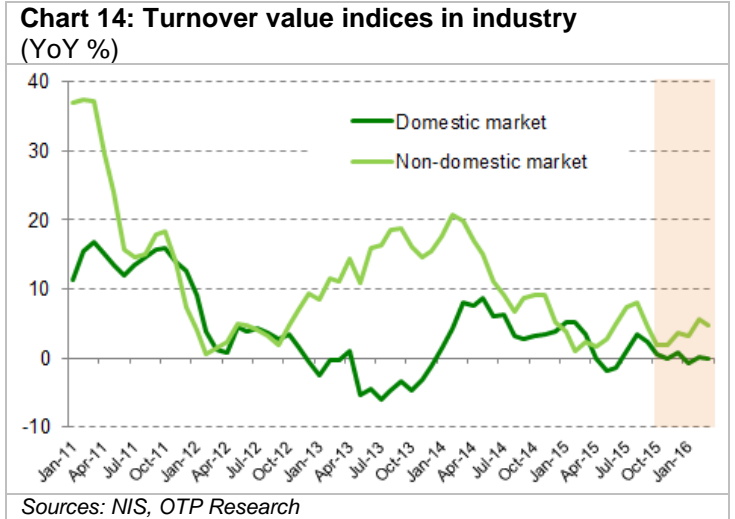
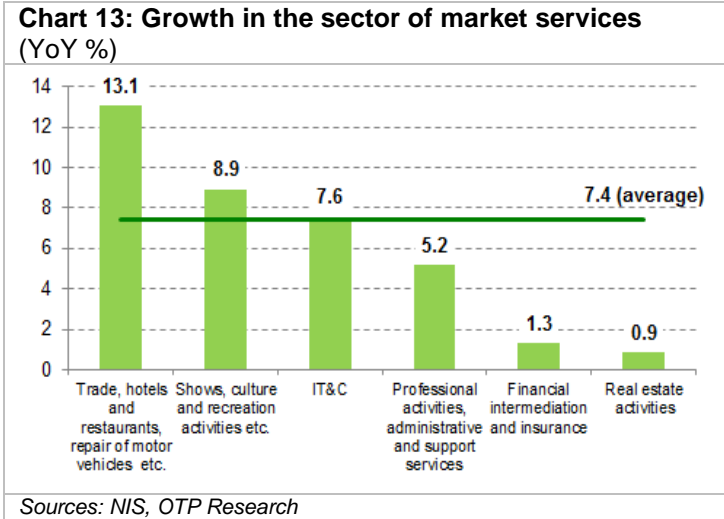


Sources: NIS, OTP Research

Chart 12: Romanian exports and EU level economic sentiment indicator



Sources: NIS, EC, OTP Research



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