

GDP REPORT

8 September 2016

Going ballistic on fiscal fuel: growth can reach 5% this year

- Romania's statistical office confirmed that the country's GDP growth rate accelerated to 6.0% YoY in Q2 (gross data, see Chart 1), up from 4.3% a quarter before, while in QoQ comparison the economy expanded by 1.5% QoQ (SWDA data), pointing for the fourth very strong gain in a row. The performance showed in Q2 caused a significant positive surprise, beating the earlier expectations by a large margin (Reuters' consensus/OTP: 4.1%/4.5% YoY). At the same time, the non-farm private sector GDP, a useful gauge in assessing underlying economic dynamics, surged even more rapidly, adding 6.3% YoY (Chart 2), as it was not pulled back by the less robust advance of public services (4.4% YoY) or net taxes (3.1% YoY). In the latest quarter, both the overall and the non-farm private sector GDP recorded the fastest expansions since Q3 2008.
- Generally speaking, the big picture remained the same. Romania entered into the mature stage of the business cycle, with robust growth driven by the reviving domestic demand, which was boosted even further by aggressive fiscal stimulus (Chart 6). Meanwhile, the labour market got tighter and real disposable incomes were also helped by low commodity prices.
- The soaring real wages (Chart 5) pushed households' consumption expenditures to another post-crisis high of 11.2% YoY in Q2, up from Q1's already spectacular 9.5% YoY rise, registering an even larger contribution to the overall growth (Chart 3). In QoQ terms, expenditures soared 3.2% in the period of April-June, similarly to the first quarter of the year. Simultaneously, gross fixed capital formation also accelerated significantly in the most recent quarter. We have suspected that a pick up may come in the second quarter, after a rather disappointing Q1, but the recently revealed data (10.6% YoY) outpaced our expectations. As the latest updates on the monthly budget execution indicated relatively modest public investment activity, after higher capital expenses from own sources were offset by lower EU fund absorption, we suspect that private investments performed reasonably well. Nonetheless, the deteriorating external balance left its mark on Q2 statistics, shaving off 3.4 percentage points from the annual growth, as the domestic-demand-fuelled imports continued to expand much faster than exports.
- The picture painted by the breakdown of the Q2 2016 GDP statistics was broadly in line with our expectations. On the production side, market services continued to deliver the largest contribution to the growth (Chart 4), after a stellar growth of 8.3% YoY/2.2% QoQ, getting a boost from IT&C (17.3%YoY/7.3% QoQ) as well as the segment of trade, hotels and restaurants, repair of motor vehicles and motorcycles (12.1% YoY/2.7% QoQ). As regards the IT&C sector, it seems that the success story continued, providing the most impressive evolution among the main components of market services compared to 2013 (Chart 7). With these advances, the weight of IT&C in total nominal GDP reached an all-time high of 7.2% in Q2 2016. The favourable trend was reflected in the rapidly rising number of computer programmers (Chart 8) as well as in their surging wages (Chart 9). Beyond market services, construction output also rose nicely on both annual (6.9%) and quarter-on-quarter (1.9%) basis, helped by a rebound in civil engineering works. On the other hand, value added in industry barely expanded (2.6% YoY/0.1% QoQ) as high-frequency indicators had already suggested earlier. The underperformance most likely was the result of the quickly falling mining and quarrying sector. Nonetheless, it appears that producers for the domestic market still struggle to gain strong momentum from the very robust demand, with the monthly turnover value indicators starting to show some signs of improvement only in the latest period (Chart 10). Agricultural output added some extra support to the economy in Q2, given its 17.9% YoY jump, as weather conditions were quite favourable.
- Looking ahead, we think that the strong momentum could be maintained. Romania's economic sentiment indicator slightly improved in the period of July-August (Chart 11), pointing to healthy business activity in Q3. In addition, weather conditions in the third quarter were apparently more supportive than a year earlier, which helped to keep grain yield forecasts at relatively high levels (Chart 12). On the expenditure side, domestic demand could be fuelled further by rapid wage dynamics (we note here that the government raised the wages of numerous public workers in August again). Moreover, in the light of the general elections set to be held on 11 December, rising government spending is very likely in the second half of the year. Taking into account the significantly better performance of the economy in H1 as well as the rather positive outlook for the coming quarters, we revised our 2016 GDP growth projection to around 5%, up from 4.3% in our [previous](#) report.
- But we also suspect that this cheering growth rate may not occur again soon in the years ahead, as several one-off factors bolstered expansion in 2016, such as the sharp VAT reductions and significant hikes in minimum and public wages. The impact of these measures could gradually fade out, while there does not seem to be room for another, similarly large-scale easing in the forthcoming years (assuming that policy makers will be more or less prudent, keeping the budget deficit at sustainable levels). In addition, monetary policy was quite supportive too, with ROBOR interest rates falling to record lows. As inflation may climb higher, we do not expect even looser monetary conditions in the medium term in Romania. Meanwhile, there is no guarantee that good agricultural harvest will recur persistently. In such conditions, economic advance may slow, closer to the country's potential.

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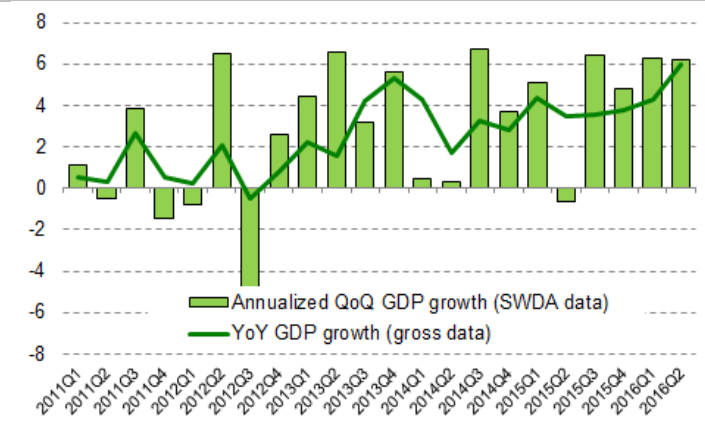
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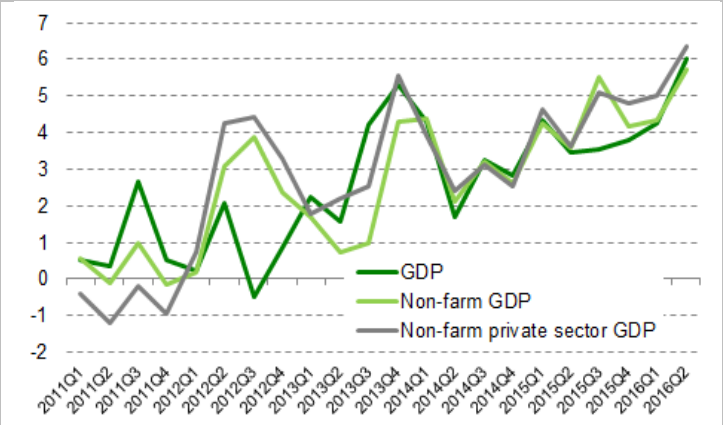
Chart set:

Chart 1: Summary chart of GDP growth (%)



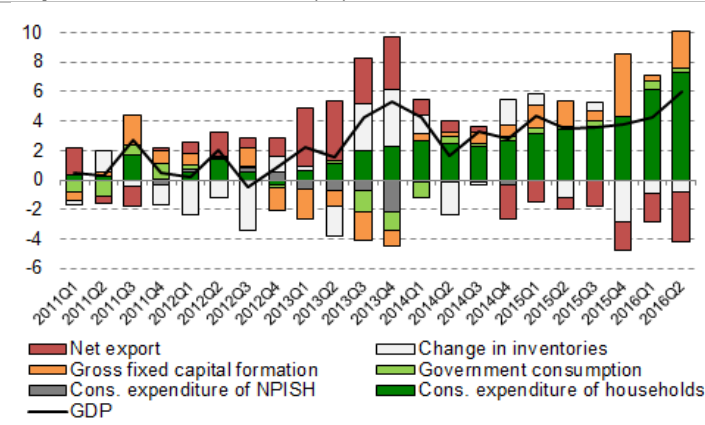
Sources: NIS, OTP Research

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



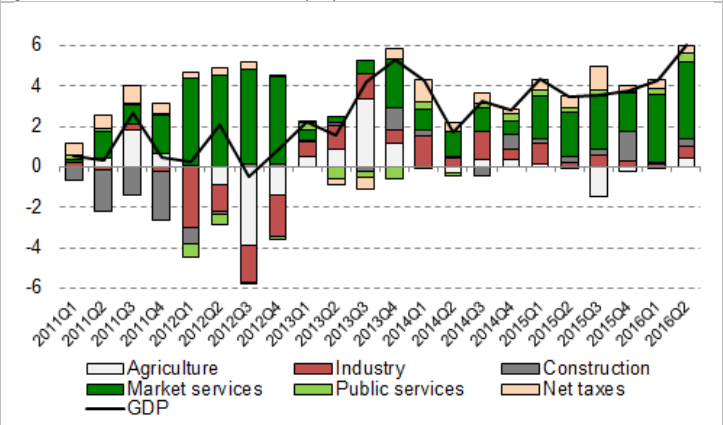
Sources: NIS, OTP Research

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



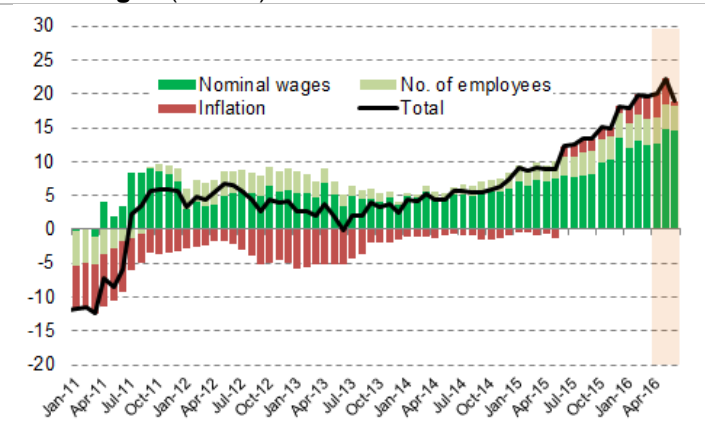
Sources: NIS, OTP Research

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



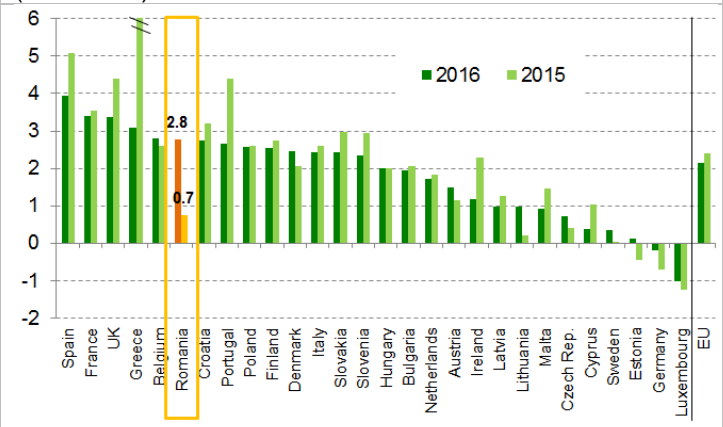
Sources: NIS, OTP Research

Chart 5: Decomposition of households' real income from wages (YoY %)



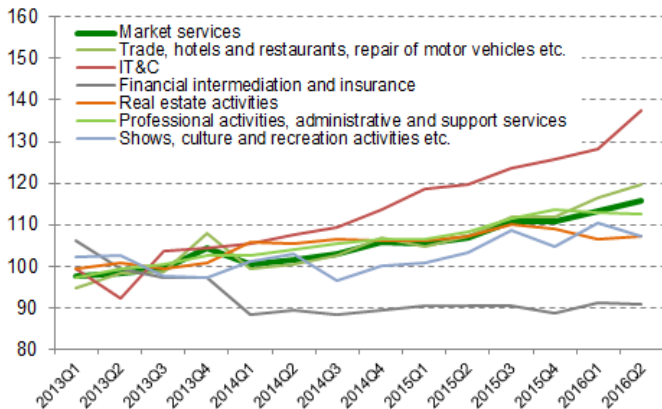
Sources: NIS, OTP Research

Chart 6: General government deficit (% of GDP)



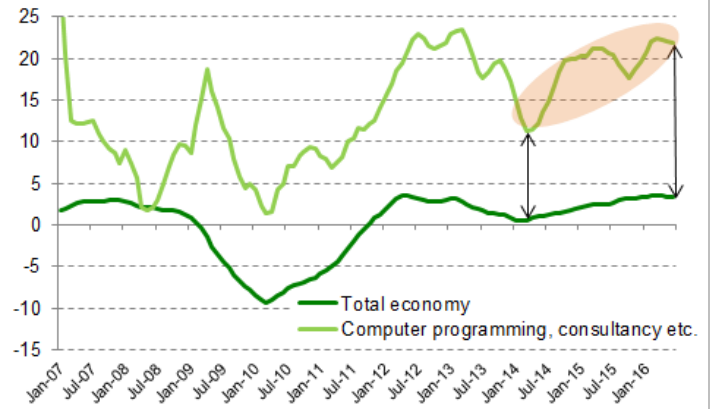
Sources: EC (Spring 2016 Economic Forecast), OTP Research

Chart 7: Value added in the sector of market services by its main segments (2013 av. = 100, SA)



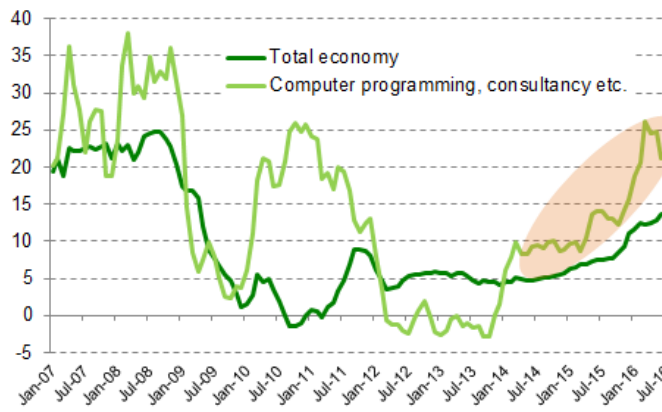
Sources: NIS, OTP Research

Chart 8: No. of employees (YoY %, 3M mov. av.)



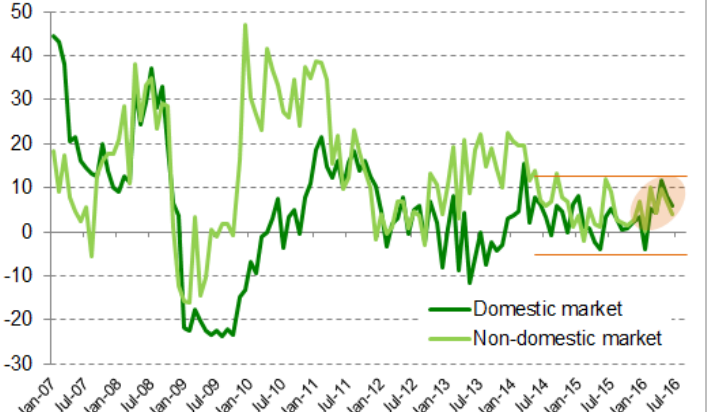
Sources: NIS, OTP Research
Note: enterprises with four employees or more

Chart 9: Average net wages (YoY %, 3M mov. av.)



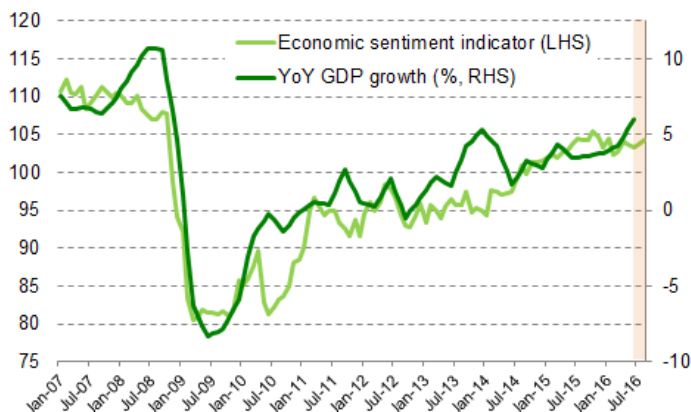
Sources: NIS, OTP Research
Note: enterprises with 4 employees and over

Chart 10: Turnover value indices in industry (YoY %)



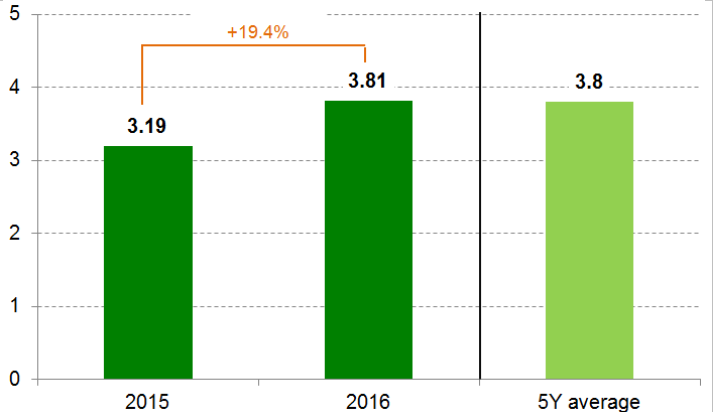
Sources: NIS, OTP Research

Chart 11: GDP growth vs. economic sentiment indicator



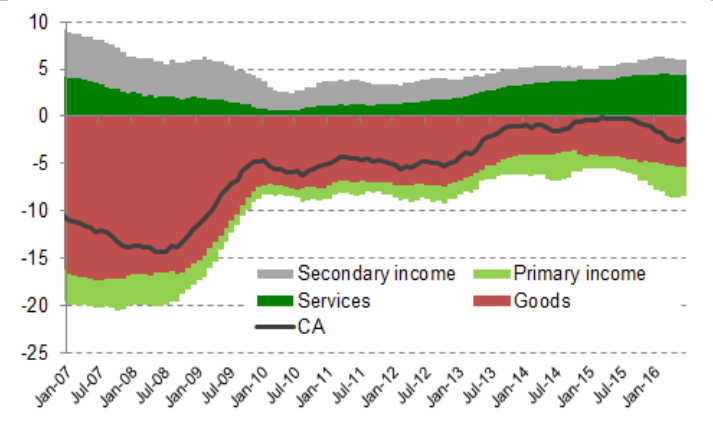
Sources: NIS, EC, OTP Research

Chart 12: Maize production, 2015 vs. 2016's expectation (t/ha)



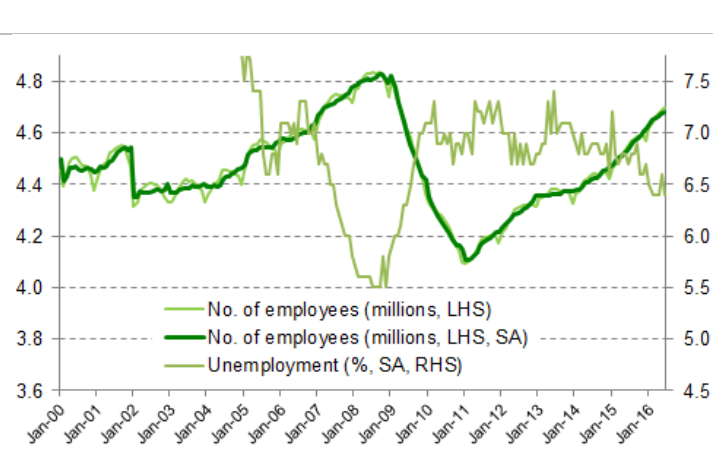
Sources: EC, OTP Research

Chart 13: Current account balance
(% of GDP, 12M rolling)



Sources: NIS, NBR, OTP Research

Chart 14: Labour market indicators



Sources: NIS, OTP Research

Note: no. of employees at enterprises with 4 employees and over

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