GDP REPORT

14 March 2017

In 2016, GDP expansion hit new post-crisis high of 4.8%; the peak seems to be over but economic growth pace could remain robust in this year too

- Romania's GDP grew by 4.7% YoY in the last quarter of 2016, up from Q3's 4.3% YoY advance (gross data, see Chart 1), broadly in line with expectations. In the same period, the country's economy added 1.3% in QoQ comparison, after a disappointing 0.5% rise a quarter earlier (seasonally and working day adjusted data). The non-farm private sector GDP, our preferred measure for underlying dynamics, painted an even brighter picture, pointing to 5.3% YoY and 1.5% QoQ increases. It is also worth mentioning that in the whole year 2016, GDP growth reached a new post-crisis high, at 4.8%, following 3.9% in 2015. As a result, Romania was positioned again among the top performing countries of the European Union.
- On the production side, Q4 data largely reflected our anticipations, with market services remaining the number one driver of the economic advance, while industry conveyed a thin contribution to growth (Chart 4). At the same time, constructions' value added was somewhat higher than we had assumed, with no impact on the annual growth. To some extent, this was in contrast with high-frequency indicators, which had suggested a more subdued perspective for Q4. Nonetheless, the expenditure side was quite soft, with inventories masking weaker domestic demand (Chart 3). In annual terms, consumption slowed further, primarily owing to the fading base effects of the fiscal easing measures (Chart 5) and also due to households' stronger propensity to save (Chart 6). Retail deposit flows (measured as FX-adjusted increase in the stock of deposits) showed an upward trend in the past few quarters, helping to reach around 2% of GDP in 2016, after 2015's 1%. Meanwhile, struggling government expenses for investments left their heavy mark on gross fixed capital formation (Chart 7).
- Despite the softer than expected expenditure side in Q4, we think that the big picture did not change remarkably compared to our previous report. As we noted earlier, Romania is in the mature stage of the economic cycle, with robust growth driven primarily by households' consumption, which was fuelled by fiscal stimulus actions and loose monetary conditions as well.
- It is also important to point out the perspective of a moderately slowing growth pace in 2017 and 2018. As we said previously too, this could happen owing to the vanishing effect of earlier fiscal and monetary stimulus, while there is limited room for further easing actions. We recall that after the latest actions of the government there is a significant risk of missing the 3% deficit target (Chart 9). In addition, monetary policy most likely will become less supportive as inflation started to revive (for further details on monetary policy outlook please read our latest MPC report). Nevertheless, GDP growth pace may remain robust: we expect for 4.1% in 2017 and 3.5% next year. Significant gains in salaries are set to prevail due to the tightening labour market. Moreover, another minimum wage hike in February, coupled with further public wage increases in the pipeline, could provide additional support to consumption this year. Regarding investments, we think that improvement may come this year, after 2016's disappointment, but the stretched government budget and quite cautious corporate sector limits the upside potential. EU funds could also help gross fixed capital formation in 2017. We suspect that absorption will show a moderate pick-up compared to last year. Historical evidence shows that Romania lags behind other countries of the CEE region in terms of the absorption pace, especially in the early years of the EU budget period. This could be the case this year too, despite the experiences gained in the previous budgeting cycle. Net exports most likely will have a negative impact on GDP advance as robust domestic demand continues to fuel imports.
- In relation to the main economic sectors, we deem that similarly to 2016, market services could be the primary driver of growth, sustained by industries, like wholesale and retail trade, which can take advantage of the healthy domestic demand. We also expect that the success story of IT&C may continue in 2017, even though after last year's exceptional performance (+14.2%) a slower growth pace seems quite likely. Shared services centres and software development companies played an important role in last year's quick advance. It is worth noting that IT&C's value added reached 5.6% share in total GDP last year, exceeding by a wide margin the output of agriculture (3.9%).

Headquarter Treasury Sales

Alexandru Tibuleac
+40372 31 85 85
alexandru.tibuleac@otpbank.ro

Ionut Constandache
+40372 31 85 86
ionut.constandache@otpbank.ro

Corina Bejan
+40372 31 85 84
corina.bejan@otpbank.ro

Andreea Nica
+40755 000 106
andreea.nica@otpbank.ro

Regional Treasury Sales

Szilamer Kozma - Cluj
+40755 000 400
szilamer.kozma@otpbank.ro

Tudor Zaman - Bucuresti
+40755 000 199
tudor.zaman@otpbank.ro

Alexandru Sabin - Arad
+40730 577 959
alexandru.sabin@otpbank.ro

Chief Economist

Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

Analyst

Csaba Bálint
+4021 307 58 96
csaba.balint@otpbank.ro

- On the other hand, industry was rather disappointing in 2016, recording only a modest advance (1.7%). It seems that the sector was not able to fully benefit from the rebounding domestic demand (Charts 10 & 11), probably as the fiscal stimulus was too large and came too rapidly, making it difficult for companies to adapt to the new conditions. Looking ahead, the deliberate recovery of the EU and the swiftly rising unit labour costs may limit the sector's growth pace, together with an old hardship, namely the lack of adequate infrastructure. The low coverage of motorways continues to be an important restraint in accessing the common European market, and also limiting inward FDI flows into several regions of the country.

- Constructions' advance was also relatively modest (+1.8%), mainly on shrinking civil engineering works, which reflected moderate public investment activity. At the same time, uncertainties around the regulatory environment (e.g. debt-to-asset law and planned loan conversions) probably also weighed on the sector in 2016. However, the residential segment got momentum in the latest period (Chart 12), while building permits statistics indicate a bright outlook for this year (Chart 13). It may be worth mentioning that Romania has the largest overcrowding rate of dwellings in the EU (Chart 14), suggesting that there is need for new homes. Meanwhile, rising wages together with improved mortgage lending activity could result in healthy demand for residential buildings.

- Agriculture barely increased in 2016 (less than 0.1%), reflecting mixed weather conditions. The sector still struggles with fragmented land ownership structure, obsoleted equipment in numerous cases as well as underdeveloped infrastructure (e.g. only 1.3% of utilized agriculture area has irrigation system, versus the EU's average of 6.2%). As a result, crop yields are far from EU standards (Chart 15), while they show high volatility too.

- Summing it up, we deem that the outlook is favourable for 2017: somewhat slower but still strong growth may come. On the back of the latest fiscal loosening measures we even revised slightly upward our real GDP projection, to 4.1% (versus 3.8% earlier). The short-term perspective appears to be a bit softer than we had previously expected, as cold weather conditions, high precipitations as well as the political uncertainties could have left their mark on economic activity in Q1 2017, but the impact of these factors is transitory.

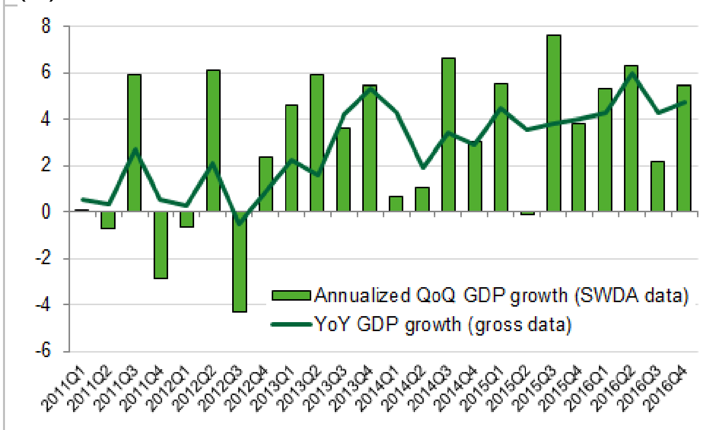
- In a final remark, we aim to highlight the regional discrepancies inside the country. In our previous report, we underscored the geographical disparities in free workforce. Not surprisingly, counties' contribution to Romania's total GDP shows similarly high differences. The top seven economic hubs (Bucharest-Ilfov, Constanta, Timis, Cluj, Prahova, Brasov and Iasi counties – see Chart 17) provide more than half of the country's total value added. Moreover, these centres even increased their weight in the last decade (Chart 16), while in terms of GDP/capita their advantage also rose compared to the other counties. Therefore, well-designed policies would be necessary in order to alleviate these gaps. Improvement in infrastructure should be one of the targeted tools, unlocking the potential in the free workforce of the lagging areas (of course, skill mismatches remain the other main challenge).

Key economic indicators		**2013**	**2014**	**2015**	**2016**	**2017F**	**2018F**
Real GDP	%	3.5%	3.1%	3.9%	4.8%	4.1%	3.5%
Final consumption of households	%	-2.4%	4.4%	5.5%	6.7%	5.7%	3.3%
Cons. expenditure of housh.	%	2.6%	4.2%	5.9%	7.4%	6.1%	3.6%
Public consumption	%	-4.6%	0.8%	0.1%	2.5%	2.3%	0.0%
Investment	%	-5.4%	3.2%	8.3%	0.0%	7.1%	5.8%
Exports	%	19.7%	8.0%	5.4%	7.6%	4.8%	6.0%
Imports	%	8.8%	8.7%	9.2%	9.3%	7.5%	6.5%
Consumer prices	% annual avg	4.0%	1.1%	-0.6%	-1.5%	1.1%	2.9%
Government sector balance	in % of GDP	-2.1%	-0.8%	-0.8%	-2.6%	-3.4%	-2.8%
Public debt	in % of GDP	37.8%	39.4%	37.9%	38.1%	39.2%	39.6%
Current account	in % of GDP	-1.1%	-0.7%	-1.2%	-2.4%	-3.4%	-3.6%
Key interest rate	% annual avg	4.8%	3.3%	1.9%	1.8%	1.8%	2.5%
Key interest rate	% end of period	4.00%	2.75%	1.75%	1.75%	2.00%	2.75%
EUR/RON	annual avg	4.42	4.44	4.44	4.49	4.50	4.44
EUR/RON	end of period	4.48	4.48	4.52	4.54	4.46	4.42
Nominal GDP	RON bn.	637.5	668.1	711.1	759.2	807.3	859.7
Unemployment	%	7.1%	6.8%	6.8%	6.0%	5.4%	5.3%
Nominal wage growth	%	4.8%	7.6%	9.8%	12.8%	9.8%	6.2%
Real wage growth	%	0.8%	6.5%	10.4%	14.6%	8.5%	3.3%
Nominal GDP	EUR bn.	144.3	150.3	160.0	169.1	179.4	193.6

Sources: NIS, NBR, Eurostat, OTP Research

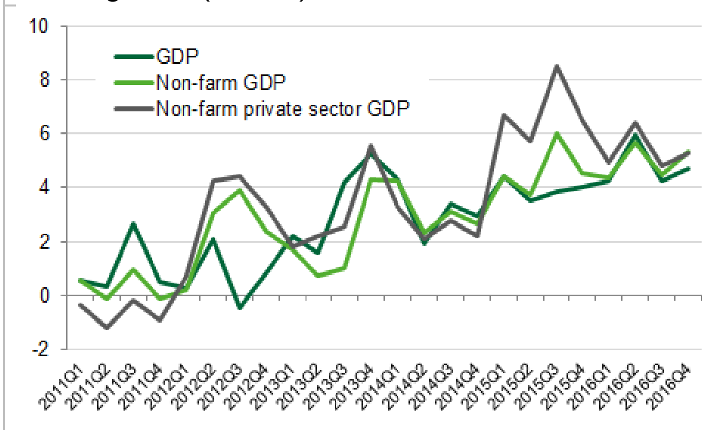
Chart set:

Chart 1: Summary chart of GDP growth (%)



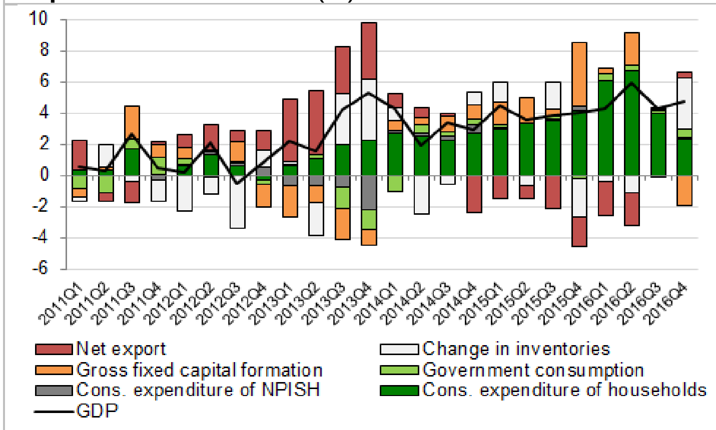
Sources: NIS, OTP Research

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



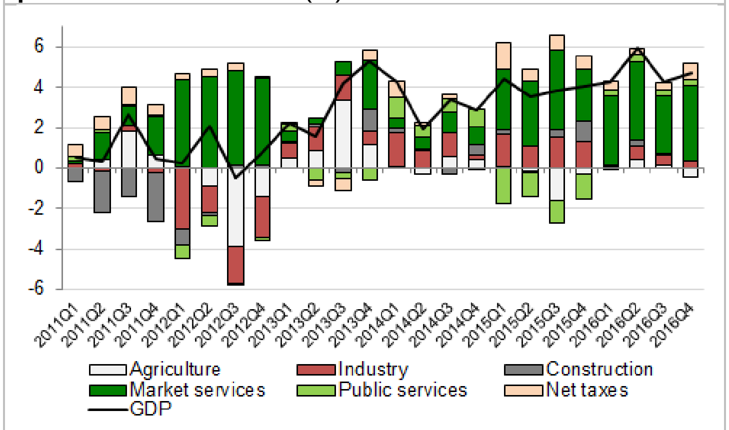
Sources: NIS, OTP Research

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



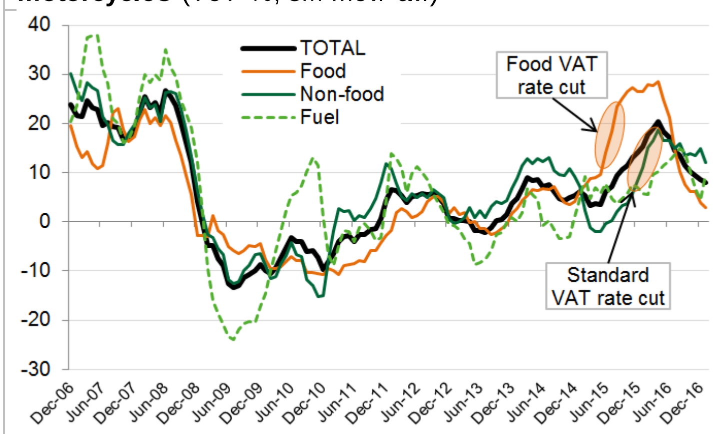
Sources: NIS, OTP Research

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



Sources: NIS, OTP Research

Chart 5: Retail sale, except motor vehicles and motorcycles (YoY %, 3M mov. av.)

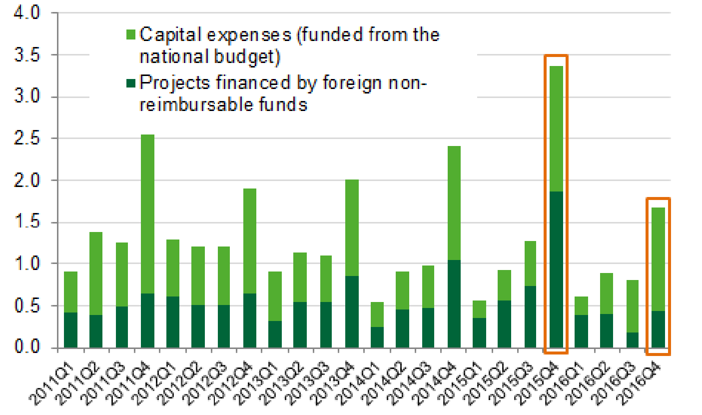


Sources: NIS, OTP Research

Chart 6: Deposit flow in the case of households (as % of GDP, SA, 3M mov. av.)

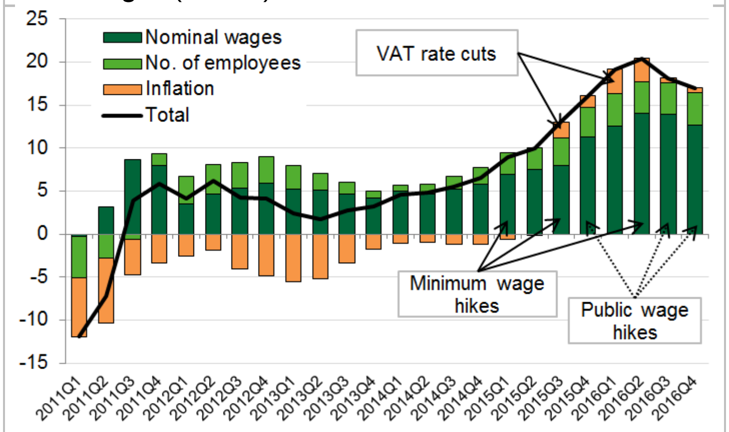
Sources: NBR, NIS, OTP Research

Chart 7: Government expenses for investments (as % of GDP)



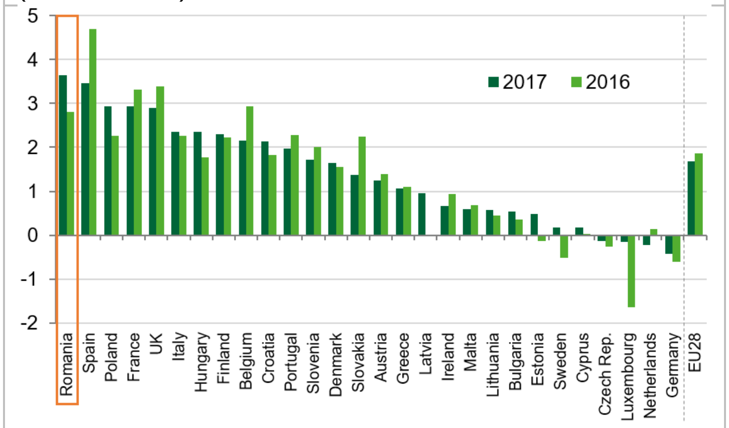
Sources: Ministry of Finance, NIS, OTP Research

Chart 8: Decomposition of households' real income from wages (YoY %)



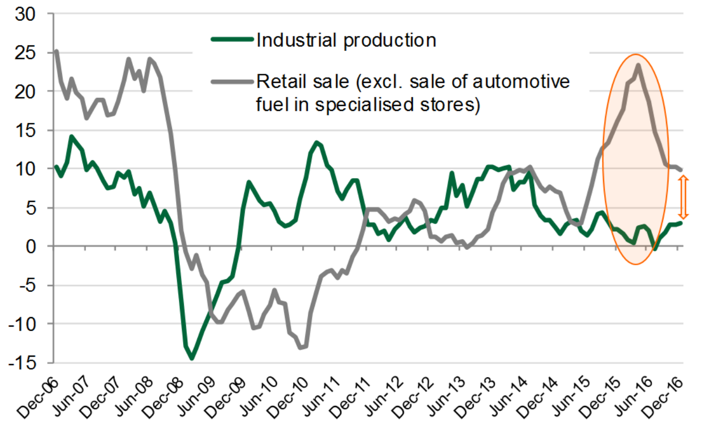
Sources: NIS, OTP Research

Chart 9: Government budget deficit (as % of GDP)



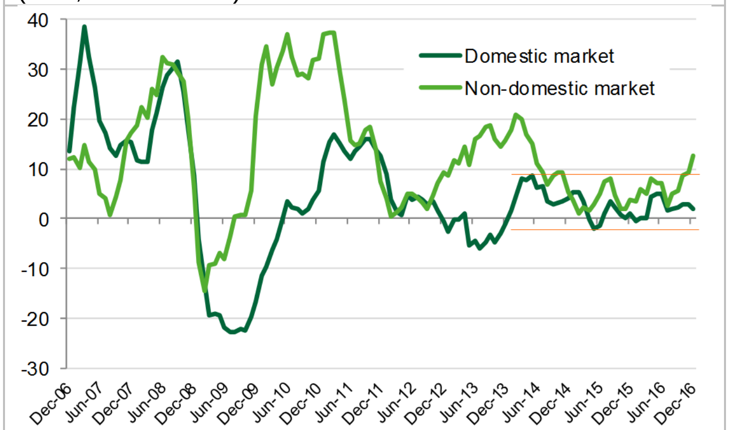
Sources: EC, OTP Research

Chart 10: Volume index of industrial production vs. retail sales (YoY, 3M mov. av.)



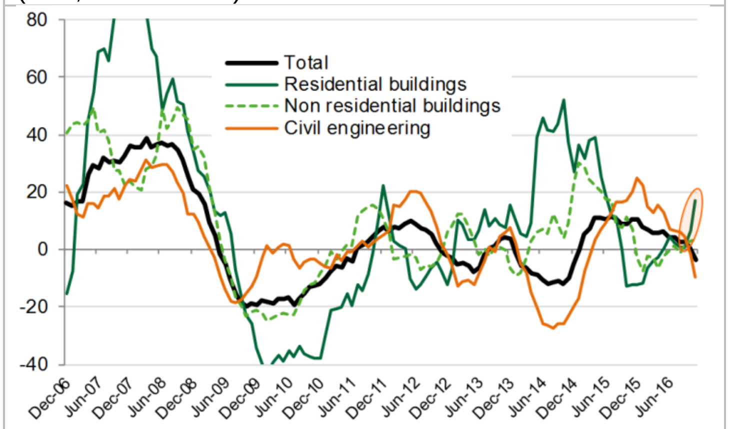
Sources: NIS, OTP Research

Chart 11: Turnover value indices in industry (YoY, 3M mov. av.)



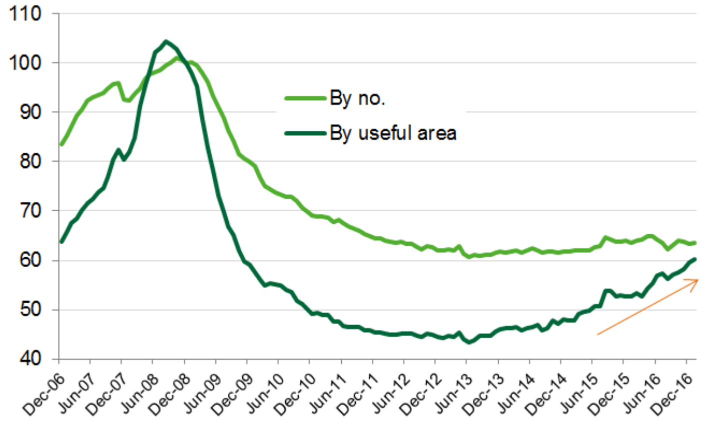
Sources: NIS, OTP Research

Chart 12: Construction works (YoY, 6M mov. av.)



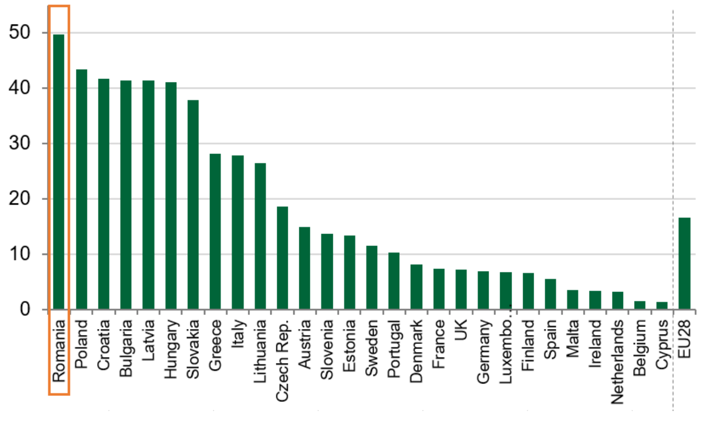
Sources: NIS, OTP Research

Chart 13: Building permits
(2008 av. = 100)



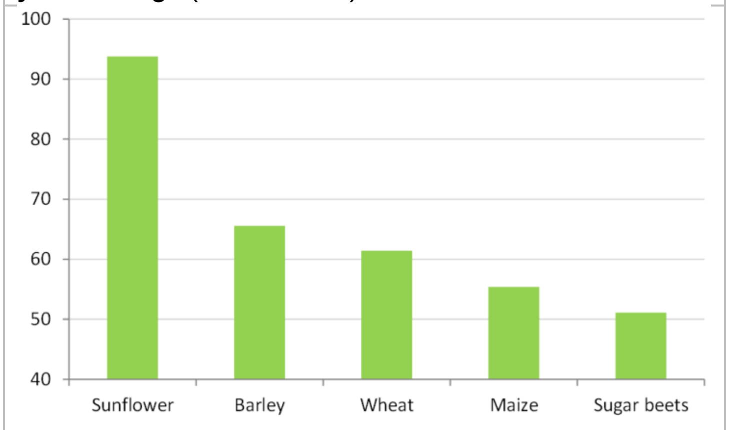
Sources: NIS, OTP Research

Chart 14: Proportion of people living in an overcrowded dwelling (% of total population)



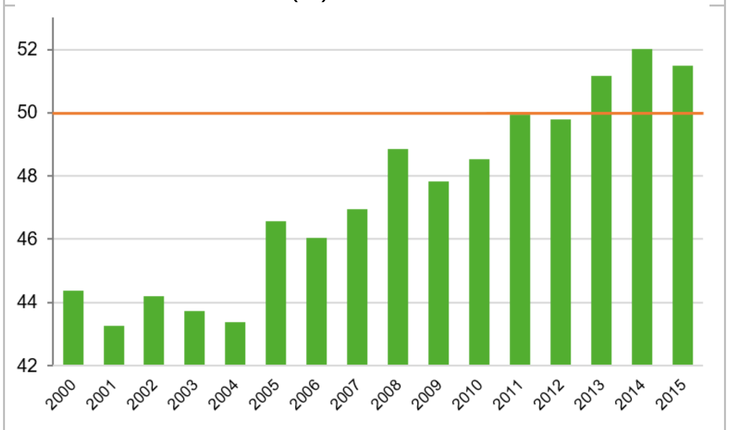
Sources: Eurostat, OTP Research
Note: defined by the number of rooms available to the household

Chart 15: Crop yields in Romania vs. the EU, five year average (EU av. = 100)



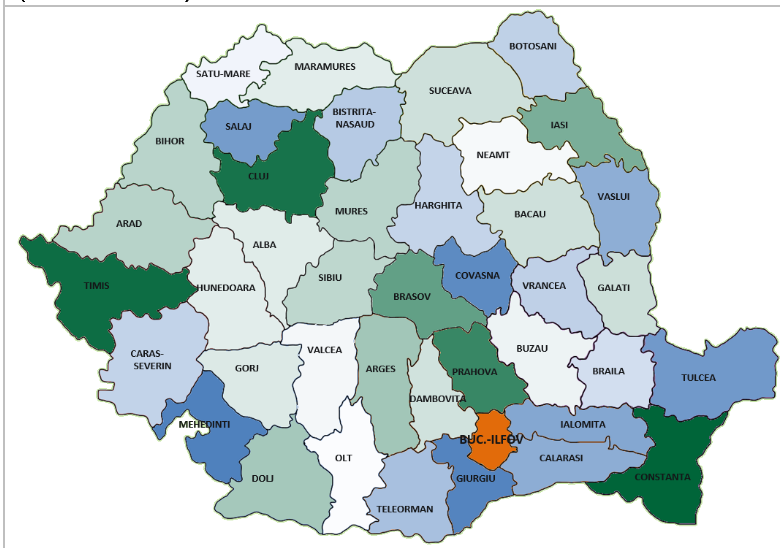
Sources: EC, OTP Research

Chart 16: Share of the largest economic centres in Romania's total GDP (%)



Sources: NIS, CNP, OTP Research
Note: it includes Bucharest-Ilfov, Constanta, Timis, Cluj, Prahova, Brasov and Iasi counties

Chart 17: Counties' share in Romania's GDP
(%, as of 2015)



1	BUC.-ILFOV	27.0
2	CONSTANTA	4.8
3	TIMIS	4.6
4	CLUJ	4.5
5	PRAHOVA	4.0
6	BRASOV	3.4
7	IASI	3.1
8	ARGES	2.5
9	DOLJ	2.5
10	ARAD	2.2
11	MURES	2.2
12	BIHOR	2.2
13	SIBIU	2.1
14	GALATI	1.9
15	SUCEAVA	1.9
16	BACAU	1.9
17	DAMBOVITA	1.9
18	GORJ	1.7
19	ALBA	1.6
20	HUNEDOARA	1.6
21	MARAMURES	1.6
22	BUZAU	1.5
23	VALCEA	1.4
24	NEAMT	1.3
25	OLT	1.3
26	SATU MARE	1.2
27	BRAILA	1.1
28	HARGHITA	1.1
29	CARAS-SEVERIN	1.1
30	BOTOSANI	1.1
31	VRANCEA	1.1
32	BISTRITA-NASAUD	1.0
33	TELEORMAN	1.0
34	VASLUI	0.9
35	CALARASI	0.9
36	IALOMITA	0.9
37	SALAJ	0.8
38	TULCEA	0.8
39	COVASNA	0.7
40	GIURGIU	0.7
41	MEHEDINTI	0.7

Sources: CNP, OTP Research

Disclaimer

OTP Bank Romania S.A. does not intend to present this document as an objective or independent explanation of the matters contained therein. This document a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.
This communication does not contain a comprehensive analysis of the described issues. This report is issued for information purposes only and should not be interpreted as a suggestion, an invitation or an offer to enter into any transaction, as an investment advice, and it does not constitute legal, tax or accounting advice. Also it is not and should not be considered a recommendation for investment in financial instruments according to NSC Regulations no. 32/2006 and 15/2006.
Information herein reflects current market practices. Additional information may be available on request. This document is intended only for the direct and sole use of the selected customers of OTP Bank Romania S.A. Any form of reproduction or redistribution to any other person that the intended recipients, including publication in w hole or in part for any purpose, must not be made w ithout the express w ritten agreement of OTP Bank Romania S.A. Although the information in this document has been prepared in good faith from sources which OTP Bank Romania S.A. believes to be reliable, w e do not represent or w arrant its accuracy and such information may be incomplete or condensed. The issuer of this report does not claim that the information presented herein is perfectly accurate or complete. How ever it is based on sources available to the public and w idely believed to be reliable. Also the opinions and estimates presented herein reflect a professional subjective judgment at the original date of publication and are therefore subject to change thereafter w ithout notice. Furthermore there can be no guarantees that any market developments w ill unfold as forecasted. Opinions and estimates constitute our judgment and are subject to change w ithout notice.
OTP Bank Romania S.A. may have issued reports that are different or inconsistent w ith the information expressed w ithin this report and is under no obligation to update or keep current the information contained herein.
OTP Bank Romania S.A. may hold a position or act as market maker in the financial instrument of any issuer discussed herein or act as advisor or lender to such issuer. This document is not intended to provide the basis for any evaluation of the financial instruments discussed herein. In particular, information in this document regarding any issue of new financial instruments should be regarded as indicative, preliminary and for illustrative purposes only, and evaluation of any such financial instruments should be made solely on the basis of information contained in the relevant offering circular and pricing supplement w hen available. OTP Bank Romania S.A. does not act as a fiduciary for or an advisor to any prospective purchaser of the financial instruments discussed herein and is not responsible for determining the legality or suitability of an investment in the financial instruments by any prospective purchaser.
This report is not intended to influence in any w ay or to be considered a substitute to research and advice centred on the specific investment objectives and constraints of the recipient (including tax concerns) therefore investors should obtain individual financial advice. Before purchasing or selling financial instruments or engaging investment services, please examine the prospectuses, regulations, terms, agreements, notices, fee letters, and any other relevant documents regarding financial instruments or investment services described herein in order to be capable of making a w ell-advised investment decision. Please refer to your competent adviser for advice on the risks, fees, taxes, potential losses and any other relevant conditions before you make your investment decision regarding financial instruments or investment services described herein. OTP Bank Romania S.A. in compliance w ith the applicable law , assumes no responsibility, obligation, w arranty or guarantee whatsoever for any direct or indirect damage (including losses arising from investments), or for the costs or expenses, detrimental legal consequences or other sanctions (including punitive and consequential damage) sustained by any natural or legal person as a result of the purchase or sale of financial instruments or engaging investment services described herein, even if OTP Bank Romania S.A. w as w arned of the possibility of such occurrences.
Figures described herein refer to the past and past performance is not a reliable indicator of future results. Investments in financial instruments carry a certain degree of risk (fluctuation of share prices, uncertainty of dividend, yields and / or profits, exchange rate fluctuations, etc.). The capital invested is not guaranteed, investment gains, usually assumed proportionate to risk, and past performance of financial instruments is not a guarantee for future performance.
Please note that the Internet is not a secure environment and OTP Bank Romania S.A. does not accept any liability for any loss caused by the result of using this report in a form altered or delayed by the w ilful or accidental interception, corruption or virus infection.

This document has been provided to the recipients upon their prior request. Your abovementioned permission may be w ithdraw n by an e-mail addressed to csaba.balint@otpbank.ro or a w ritten mail addressed to OTP Bank Romania S.A , Buzesti Street, no. 66-68, 1st district, Bucharest, Romania. Please refer to your name and e-mail address in both cases.