

GDP REPORT

09 June 2017

Households' consumption boosted growth in Q1, while industry revived given the EU's strong recovery; 2017's economic advance could be faster than previously thought

- Economic growth picked up sharply in the first quarter of the year, posting 5.7% YoY advance, after 4.8% in the previous quarter (gross data, see Chart 1), the detailed data of the National Institute of Statistics showed. Seasonally adjusted figures also pointed to strong momentum, with the growth rate reaching 1.7% QoQ. The data was in line with the flash estimates of the NIS, published a few weeks earlier. The economy's performance in Q1 was a positive surprise, as the market, including us, had expected a more modest increase (Reuters survey: 4.4% YoY). Non-farm private sector GDP, which captures the underlying dynamics of the economy probably more accurately, registered 6.4% YoY rise, up from 5.5% YoY in Q4 (Chart 2).
- The detailed GDP statistics correspond to our view on the more general economic picture: Romania is in the maturity stage of the economic cycle with rapid growth, propelled further by loose fiscal and monetary policies.
- On the expenditures side, rebounding consumption was the main reason behind the stellar growth in Q1 (Chart 3). After the weaker-than-expected performance in H2 2016, households' expenditures sharply accelerated in the first quarter, lifting the annual growth pace to 7.4% YoY, following Q4's 4.5% YoY gain. The strong uptick was supported by the even faster increase in real disposable incomes on the back of government actions (Chart 5). In Q1, both minimum and public wages were raised significantly. Moreover, pensions went up too, while the standard VAT rate decreased by one percentage point, to 19% starting from 1 January.
- On the other hand, gross fixed capital formation remained rather weak, pointing to 0.7% annual drop, even though it was able to expand on QoQ basis. Sectorial data indicate that only investments in new constructions increased in the first quarter (Chart 6), apparently helped by the recovery of the residential segment. To a lesser extent, significant government spending at the end of 2016 might have had some positive secondary impacts in Q1 too. Exports got a boost from the reviving economy in the EU, sending the annual growth rate of exports to 11.7%. However, this was not enough to overtake imports, as the latter got even stronger momentum given households' soaring consumption.
- Turning to the production side, it is important to underscore that market services continued to register the largest contribution to growth (Chart 4), despite the slip in QoQ comparison (actually, our in-house seasonally adjusted data point to a modest increase). Among the sub-sectors of market services, the IT&C segment posted the most spectacular advance again, climbing 15.3% higher in annual terms. At the same time, industry showed a remarkable revival in the first quarter of the year, primarily as it was fuelled by strong external demand (Chart 7). Meanwhile, the evolution of constructions value added remained subdued, after the remarkable advance of the residential segment was offset by the slack in other sub-sectors (Chart 8).
- Regarding the outlook, we think that the economy will remain in a really good shape in the following period. This view is supported by early soft indicators too. Note that Romania's economic sentiment indicator hit another post-crisis high in May (Chart 9), due to the strengthening confidence among managers in the services and construction sectors. Meanwhile, the stronger-than-expected recovery of the EU economy may also help to keep up momentum. Regarding agriculture output, the cold wave in the second half of April, with frost events and heavy snowfall in several areas, negatively affected crop growth. First of all, flowering rapeseed fields were damaged. But the overall perspective for winter cereals is still positive, with maize and wheat yields being forecasted to exceed last year's level.
- Nevertheless, we also anticipate that some moderation is set to take place, as the positive impact coming from government stimulus will fade. Note that nominal wages went up sharply in Q1, with the largest gains in the public sector, but as the government postponed recently the new round of wage hikes, planned for the second half of this year, salary dynamics may lose steam. However, the tight labour market will prevent any sharp slowdown. Furthermore, [headline inflation](#) is projected to climb gradually higher with a negative impact on real disposable incomes, while a slight setback in the growth rate in the number of employees may be on the cards too (Chart 10).

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- Under these conditions, advances in consumption could be moderate. Households still seem to be cautious, as reflected by the gap between the growth rates of consumption expenditures and real wages (Chart 11), despite the quite high level of the consumer confidence indicator (which hit a record high in March, and modestly softened afterwards). Households likely also see the stellar real wage growth in the latest period as rather temporary and therefore smooth out their consumption. It is also possible that households devoted a smaller share of their income to consumption, in order to raise savings for major purchases in the future (Chart 12).
- Summing it up, given Q1's positive surprise and the stronger economic recovery of the EU compared to our earlier expectations, we revised our 2017's GDP forecast to 4.5%, up from 4.1% [previously](#). On the other hand, we also suspect that economic growth rate may decrease somewhat in the coming years, as there is limited room for further large stimulus, after the government deficit already reached the 3% threshold last year. In addition, as we noted earlier, monetary policy may also turn less supportive, as inflation is set to pick up. Beyond these factors, it is important to note as well that on the back of the rapid wage growth, the country's competitiveness position could weaken too. This, coupled with the strong domestic demand, may cause the current account deficit to widen further.

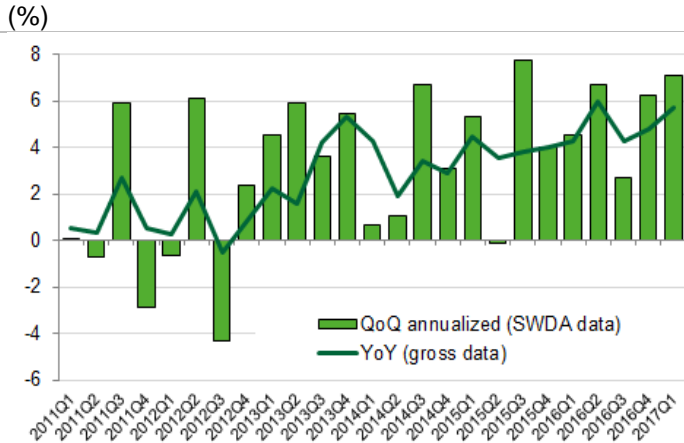
Main macro forecasts

Key economic indicators		2010	2011	2012	2013	2014	2015	2016	2017F	2018F
Real GDP	%	-0.8%	1.1%	0.6%	3.5%	3.1%	3.9%	4.8%	4.5%	3.5%
Final consumption of household	%	1.0%	1.1%	1.7%	-2.4%	4.4%	5.5%	7.3%	6.3%	3.8%
Cons. expenditure of housh.	%	1.0%	1.0%	0.8%	2.6%	4.2%	5.9%	7.5%	6.4%	4.2%
Public consumption	%	-4.9%	0.6%	0.4%	-4.6%	0.8%	0.1%	4.5%	2.8%	0.0%
Investment	%	-2.4%	2.9%	0.1%	-5.4%	3.2%	8.3%	-3.3%	5.3%	5.8%
Exports	%	15.2%	11.9%	1.0%	19.7%	8.0%	5.4%	8.3%	7.8%	6.0%
Imports	%	12.6%	10.2%	-1.8%	8.8%	8.7%	9.2%	9.8%	9.4%	6.7%
Consumer prices	% annual avg	6.1%	5.8%	3.3%	4.0%	1.1%	-0.6%	-1.5%	0.9%	2.9%
Government sector balance	in % of GDP	-6.9%	-5.4%	-3.7%	-2.1%	-1.4%	-0.8%	-3.0%	-3.0%	-3.5%
Public debt	in % of GDP	29.9%	34.2%	37.3%	37.8%	39.4%	38.0%	37.6%	38.1%	39.1%
Current account	in % of GDP	-5.1%	-4.9%	-4.8%	-1.1%	-0.7%	-1.2%	-2.3%	-3.4%	-3.7%
Key interest rate	% annual avg	6.5%	6.2%	5.3%	4.8%	3.3%	1.9%	1.8%	1.8%	2.2%
Key interest rate	% end of period	6.25%	6.00%	5.25%	4.00%	2.75%	1.75%	1.75%	1.75%	2.50%
EUR/RON	annual avg	4.21	4.24	4.46	4.42	4.44	4.44	4.49	4.52	4.47
EUR/RON	end of period	4.28	4.32	4.43	4.48	4.48	4.52	4.54	4.49	4.45
Nominal GDP	RON bn.	533.9	565.1	595.4	637.5	668.1	711.1	761.5	815.1	872.3
Unemployment	%	7.0%	7.2%	6.8%	7.1%	6.8%	6.8%	5.9%	5.1%	4.9%
Nominal wage growth	%	3.1%	4.1%	4.2%	4.8%	7.6%	9.8%	12.8%	11.1%	7.2%
Real wage growth	%	-2.8%	-1.6%	0.8%	0.8%	6.5%	10.4%	14.6%	10.1%	4.3%
Nominal GDP	EUR bn.	126.8	133.4	133.6	144.3	150.3	160.0	169.6	180.5	195.1

Sources: NIS, NBR, Eurostat, OTP Research

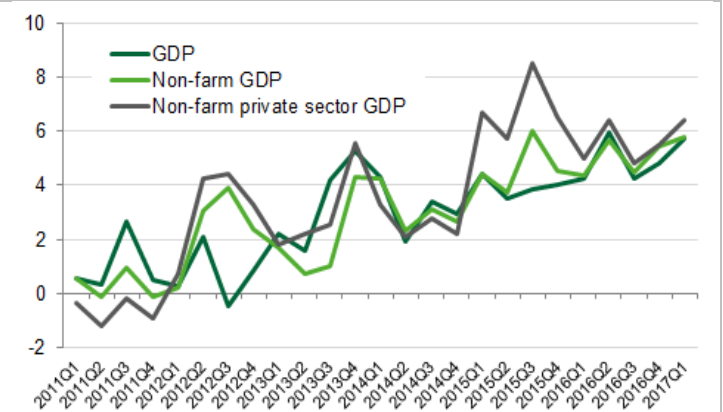
Chart set:

Chart 1: Summary chart of GDP growth (%)



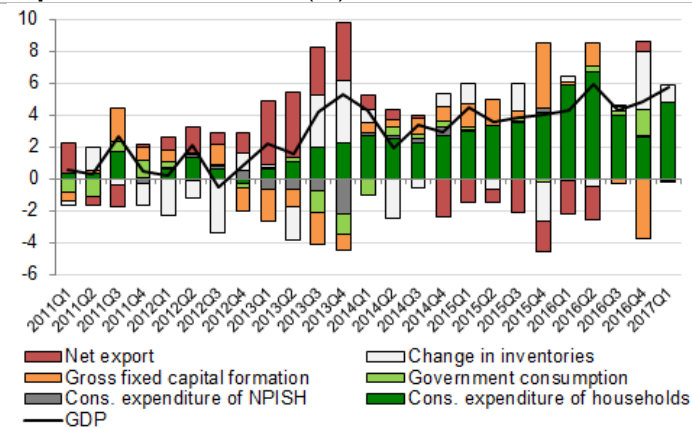
Sources: NIS, OTP Research

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



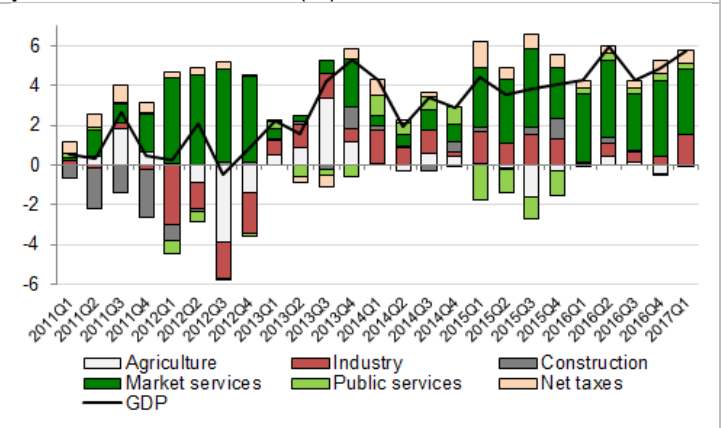
Sources: NIS, OTP Research

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



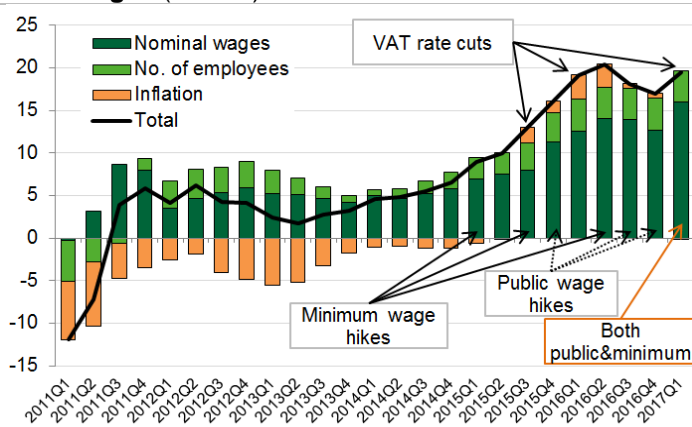
Sources: NIS, OTP Research

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



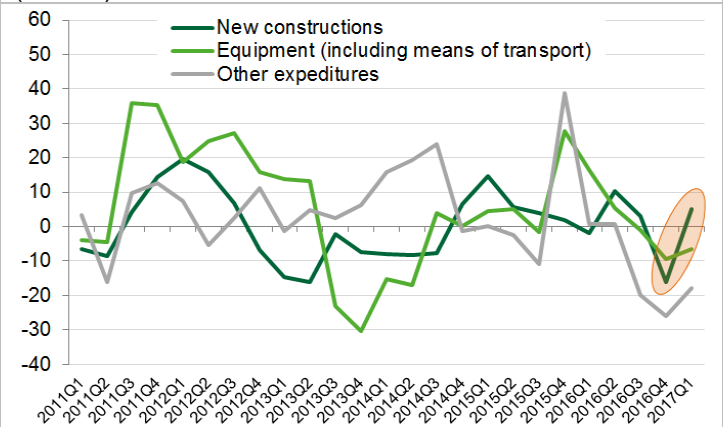
Sources: NIS, OTP Research

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



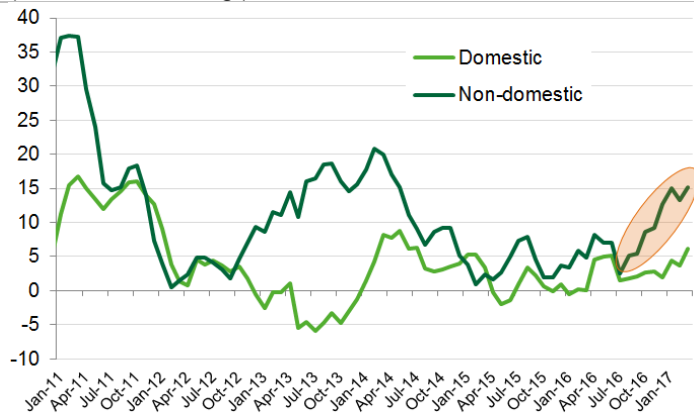
Sources: NIS, OTP Research

Chart 6: Net investments (YoY %)



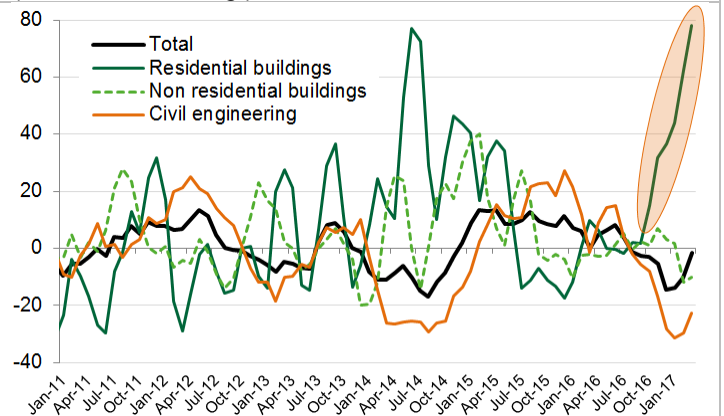
Sources: NBR, NIS, OTP Research

Chart 7: Turnover value indices in industry
(YoY, 3M mov. avg.)



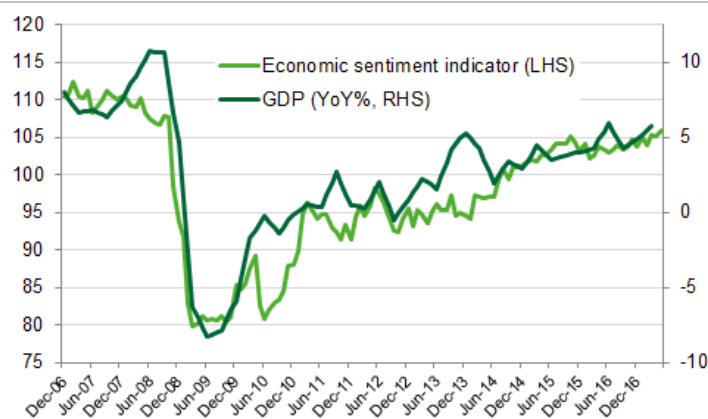
Sources: NIS, OTP Research

Chart 8: Construction works
(YoY, 3M mov. avg.)



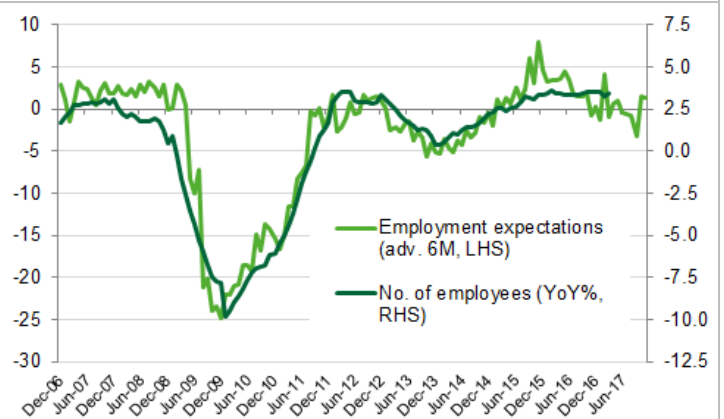
Sources: NIS, OTP Research

Chart 9: GDP growth vs. economic sentiment indicator



Sources: NIS, EC, OTP Research

Chart 10: Employment expectations



Sources: NIS, EC, OTP Research

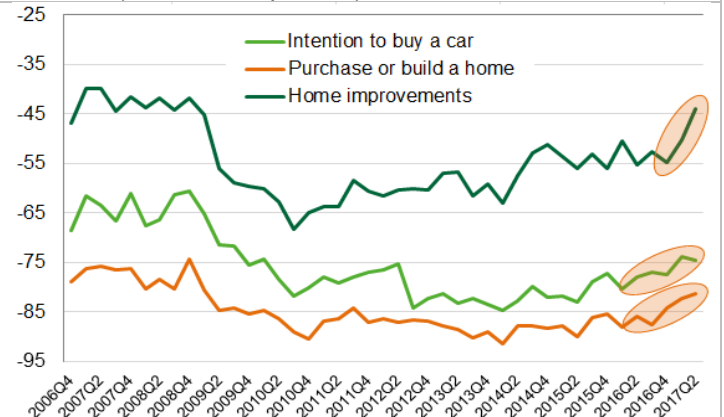
Note: employment expectations (measured as balance of opinions) are calculated as a weighted average of sectorial expectations

Chart 11: Households' consumption vs. real income from wages
(YoY%)



Sources: NIS, OTP Research

Chart 12: Households' intentions over the next 12 months
(balance of opinions)



Sources: EC, OTP Research

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