

GDP REPORT

7 September 2017

Q2 2017: another stellar growth, propelled by consumption; GDP growth may reach 5.6% this year

- In Q2, Romania's economy posted another cheering advance, with the annual growth rate climbing to 5.9% (gross data), up from Q1's 5.7% (see Chart 1), the NIS's preliminary detailed statistics revealed. In quarter-on-quarter comparison, the country's GDP grew by 1.6% (seasonally and working day adjusted data), a very impressive rise, after the 1.8% gain in the first quarter of the year. The fresh figures were in line with the flash estimation of Romania's statistical office, published in mid-August. However, the NIS's flash estimate had exceeded expectations by a wide margin (market consensus: 4.8%, similarly to our call) and put the country on the top of the EU in terms of the achieved annual growth pace. Meanwhile, excluding agriculture as well as public services, Romania's economy would have registered even higher advance (6.7% YoY, see Chart 2), providing evidence of a definitely strong underlying performance.
- There was no meaningful change in the big picture, with practically all of the key indicators suggesting that Romania is in the maturity stage of the economic cycle, getting an extra boost from aggressive fiscal easing. At the same time, loose monetary conditions and, most recently, a stronger-than-expected recovery of the EZ provided further support, propelling the GDP growth pace near pre-crisis levels.
- The detailed data show that consumption remained the main driver of growth (Chart 3). This came as no surprise, given the sharp advance in households' real disposable income, fuelled by employees' increasing bargain power amid a swiftly tightening labour market, and also supported by a series of government stimuli measures (Chart 5). Moreover, the stock of consumption loans started to expand too, after a prolonged period of contraction, helping households' expenditure to rise.
- On the other hand, gross fixed capital formation remained quite weak, with very modest, 0.6-percentage-point contribution to annual growth (Chart 3) but, admittedly, this still corresponds to a slight improvement compared to the first quarter of the year. The main reason behind this disappointing evolution was the plunge in public investments in the past few quarters (Chart 6). The detailed breakdown for Q2 is not available yet, but the budget execution data indicated that the share of public investments in total GDP, most likely, stood at very low levels in the second quarter too. In contrast, reviving corporate lending in H1, driven by credits with medium- and long-term maturities, suggests that private investments presumably started to recover. Simultaneously, net exports shaved off around 1.4 percentage points from the annual GDP increase, after domestic-demand-fuelled imports grew faster than exports, even though the EU economy performed surprisingly well.
- On the production side, the detailed figures practically reproduced the structure seen in Q1, with market services and industry delivering the largest contributions to growth. Given the robust domestic demand, but also due to the rapid development of Romania's ITC and BPO sectors, market services have been playing a very important role for a long while. Nonetheless, in the past few quarters, industry also revived, primarily, on the back of strong external demand (Chart 7). On the other hand, the construction sector continued to struggle, after the impressive performance of the residential segment was more than offset by plummeting infrastructural works. It should be added that the number of building permits points to healthy increases, providing a positive outlook for the sector.
- Some early indicators, like the economic sentiment index for July and August, signal that the annual GDP growth rate may lose steam in Q3 (Chart 9). However, we think this is rather unlikely, given a positive base effect (the country's economy grew by only 0.7% QoQ in Q3 2016, the lowest rate in the past two years) and a favourable outlook in the case of agriculture (Chart 10). Agriculture has a much-heavier-than-usual weight in Q3, due to the harvest period. But we also think that, on QoQ basis, Romania's economy may record a slightly lower advance than in the previous quarter, as the positive impact of the fiscal impulse fades a bit, while in Q4, another modest deceleration may come, pulling back the annual growth rate as well. The government recently decided to increase the fuel excise duty, in order to keep the deficit near to the 3% target. The higher tax rate will be implemented in two steps (15 September and 1 October). This, together with the uncertainties around next year's structure of the government budget, may have a potentially negative effect on the economy in the last quarter of 2017.

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- Regarding the medium- and long-term outlook, similarly to our [previous report](#), we continue to believe that a normalisation period is around the corner, with growth rates getting closer to sustainable levels. We recall that Romania's economy is running at full power, but the fiscal fuel seems to be running out. Admittedly, the government promised further easing measures, like large wage increases in the public sector, but we doubt if these plans can be kept without correction measures in other areas, causing many uncertainties to the private sector. Simultaneously, monetary policy is expected to turn less supportive too, amid rising inflation. The tight labour market, particularly the shortage of qualified workforce, as well as the lower investment rate (relative to the historical average) may also limit the country's growth potential. In this context, we expect Romania's GDP to increase by 5.6% this year, and 3.7% next. Nonetheless, both of our forecasts were revised upward (from 4.5% in 2017 and 3.5% in 2018) in the light of the positive GDP surprises in H1 and the better than expected performance of the EU economy.

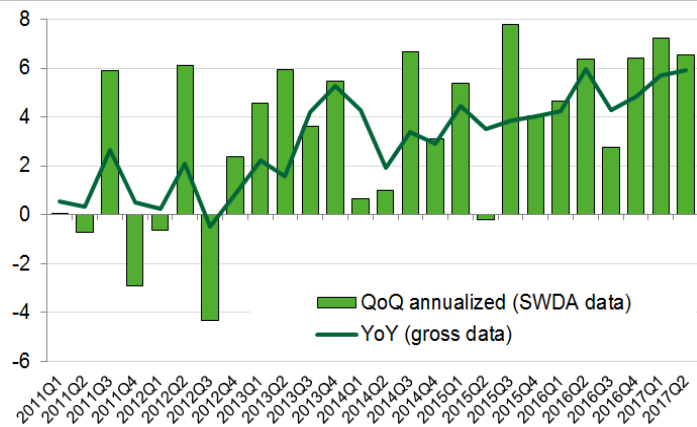
Main macro forecasts

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%	5.6%	3.7%
Final consumption of households	%	1.0%	1.1%	1.7%	-2.4%	4.4%	5.5%	7.3%	7.2%	4.0%
Cons. expenditure of housh.	%	1.0%	1.0%	0.8%	2.6%	4.2%	5.9%	7.5%	7.4%	4.5%
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%	7.9%	6.3%
Imports	%	12.6%	10.2%	-1.8%	8.8%	8.7%	9.2%	9.8%	9.9%	6.9%
Consumer prices	% annual avg	6.1%	5.8%	3.3%	4.0%	1.1%	-0.6%	-1.5%	1.1%	3.1%
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%	37.7%	38.6%
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	4.53	4.50
EUR/RON	end of period	4.28	4.32	4.43	4.48	4.48	4.52	4.54	4.52	4.49
Nominal GDP	RON bn.	533.9	565.1	595.4	637.5	668.1	711.1	761.5	825.3	886.6
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%	12.9%	8.0%
Real wage growth	%	-2.8%	-1.6%	0.8%	0.8%	6.5%	10.4%	14.6%	11.6%	4.8%
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

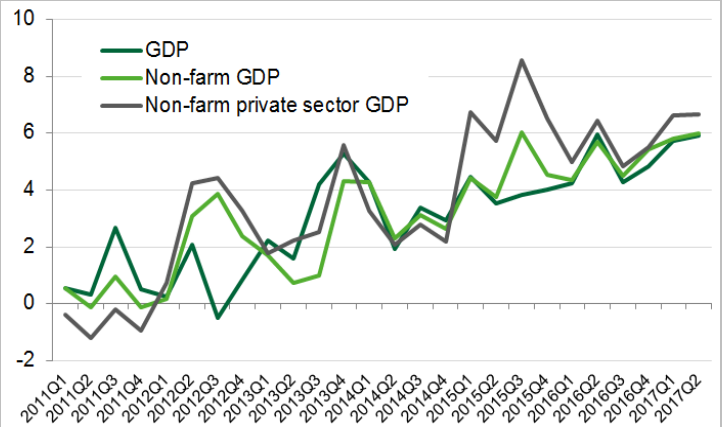
Chart set:

Chart 1: Summary chart of GDP growth (%)



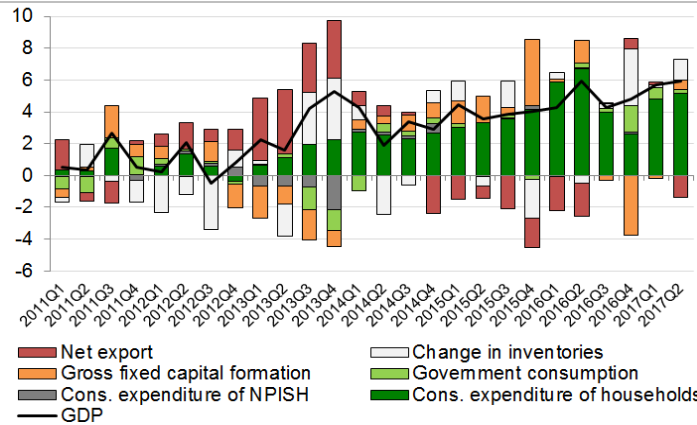
Sources: NIS, OTP Research

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



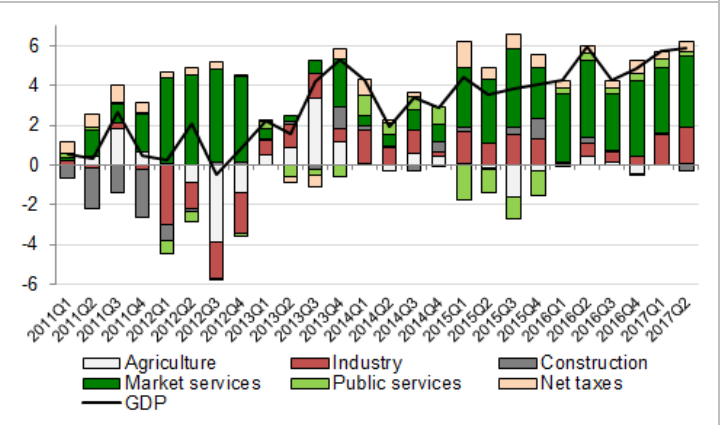
Sources: NIS, OTP Research

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



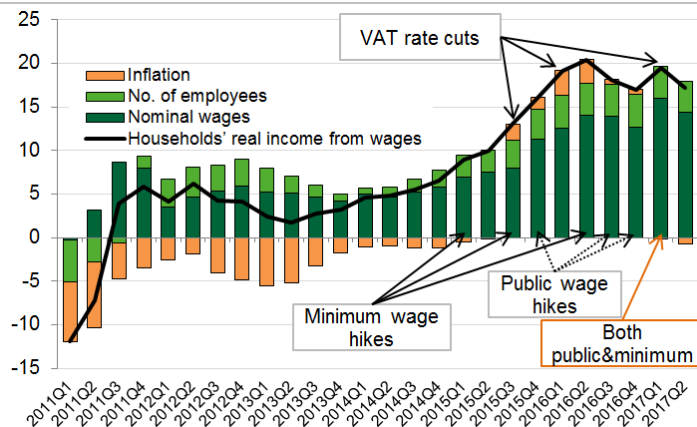
Sources: NIS, OTP Research

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



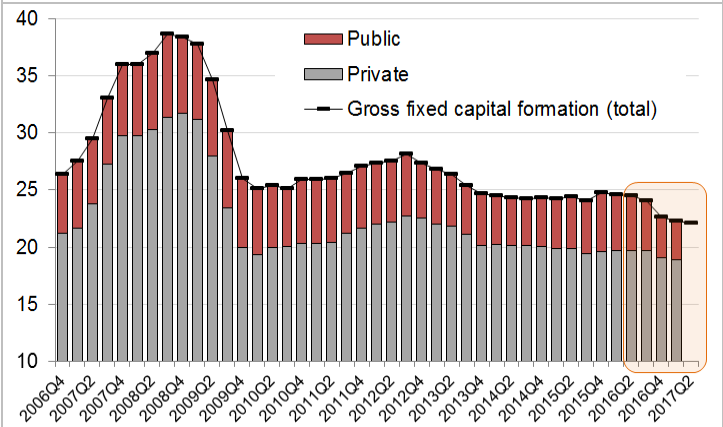
Sources: NIS, OTP Research

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



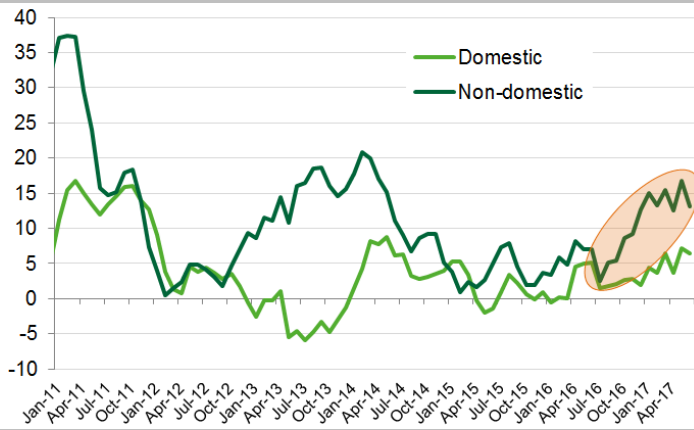
Sources: NIS, OTP Research

Chart 6: Capital investments by sectors (% of GDP, 4Q rolling)



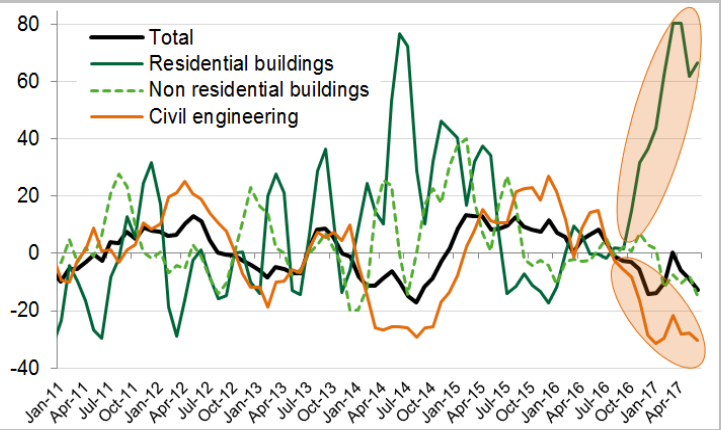
Sources: NIS, Eurostat, OTP Research

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



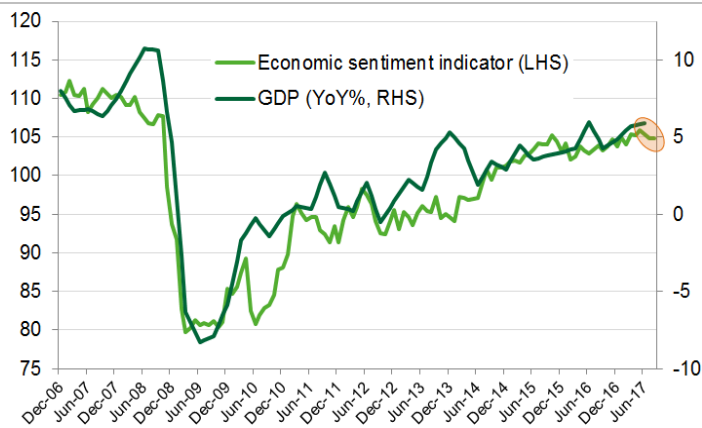
Sources: NIS, OTP Research

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



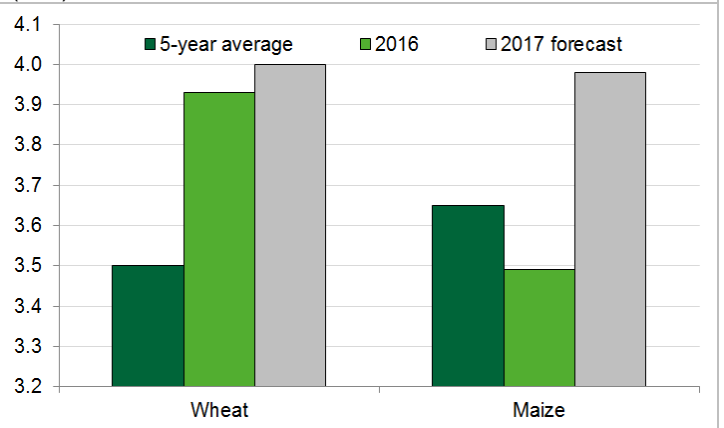
Sources: NIS, OTP Research

Chart 9: GDP growth vs. economic sentiment indicator



Sources: NIS, EC, OTP Research

Chart 10: Crop yields
(t/ha)



Sources: EC, OTP Research

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