

GDP REPORT

8 December 2017

***Romania's economy is firing on all cylinders;
However, the deceleration may be around the corner***

- Romania's statistical office confirmed the country's Q3 GDP growth rate at 8.8% YoY (gross data) and 2.6% QoQ (seasonally and working day adjusted data). These figures correspond to a sharp acceleration compared to Q2's already stellar performance (6.1% YoY and 2.0% QoQ; see Chart 1). This makes Romania the fastest-growing economy in the EU, and probably this was one of the strongest growth rates at global level too. The 'flash' GDP estimate for Q3, published a few weeks earlier, caused a large positive surprise, exceeding significantly even our most optimistic 6.6% YoY call (market consensus stood at 5.8% YoY, according to a Reuters survey). Non-farm private sector GDP, our preferred underlying measure, grew rapidly as well, posting 7.0% YoY advance, up from 6.9% YoY in Q2 (Chart 2). This growth rate implies definitely strong performance, but also reveals that agriculture played a key role in Q3's sharp upsurge of the headline GDP data.
- Currently, Romania's economy is firing on all cylinders, but the cheering growth figures of the latest period started to raise sustainability questions too, as they were mainly driven by soaring consumption, while investment showed relatively weak performance (Chart 5). We [reiterate](#) that a mix of steroids lifted Romania's already strong economic growth rate in the past few years. These stimulus factors included a series of fiscal measures aiming to boost consumption (Chart 6), supportive monetary policies, a revival of the EZ economy, and most recently, an exceptional harvest too. Given this context, we think that Romania's economy most likely marked the peak of the post-crisis business cycle in Q3 2017. Admittedly, the risks coming from running above potential have increased too. Nonetheless, we continue to expect robust, albeit much slower growth rates in the years ahead, as the positive effects of the stimulus factors fade.
- On the expenditure side, domestic demand continued to fuel growth in Q3, with households' consumption expenditures recording an eye-watering 13.3% annual advance (versus 7.7% YoY a quarter earlier). This gain was the largest since Q3 2007. The 13.3% YoY advance corresponded to 7.9-percentage-point contribution to Q3 GDP growth (Chart 3). We underscore that the pick-up in expenditures was also supported by a strong statistical base effect (expenditures pointed to a relatively weak performance in the same period of the previous year). In addition, the excellent agricultural harvest could have boosted own consumption in rural areas. This latter assumption is also supported by the lack of correlation between consumption growth as well as real income from wages and consumer confidence dynamics (Charts 6&7). Gross fixed capital formation increased more modestly on QoQ basis (1.2%), but given the favourable base effect, its annual growth rate jumped to 8.8%, up from Q2's soft 0.2% expansion. At the same time, not surprisingly, net exports have registered larger negative contribution to the GDP advance (Chart 3).
- On the production side, agriculture's output underpinned the already buoyant performance of the economy (Chart 4), as it pointed to 33.4% YoY increase in Q3. We estimate that the real value added in agriculture may reach a multi-year high in 2017 (Chart 8). Undoubtedly, this outturn was supported by favourable weather conditions. Nevertheless, we also think that some structural progress could have started to take shape in the sector. Crop cultivated area is still far from the levels seen in 90s and early 2000s, but it has pointed to a mildly increasing trajectory since 2007. Meanwhile, the number of employees in agriculture remained extremely large relative to Romania's peers in the CEE region, but it registered a significant drop compared to the pre-EU-accession period. This development, coupled with fresh funds from the EU and other private investments in the sector, led to some productivity improvements. At the same time, we also note that there is room for further progress, as average crop yields are still far from those in the EU.
- Excluding the value added in agriculture and volatile public services, Romania's economy would have increased by 1.1% QoQ last quarter, down from 1.5% QoQ in Q2. The slower quarterly growth rate was mainly due to a deceleration in industrial production (0.4% vs. 1.5% QoQ). This outturn might be rather transitory, given the healthy external demand. Simultaneously, market services, the economy's primary driver, also pointed to a smaller gain (1.3% QoQ), following a sharp uptick in the previous quarter (2.1% QoQ). Construction works expanded on quarterly basis, but in annual comparison, the sector continued to be sluggish given the disappointing public investments.

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- Regarding the short-term outlook, we expect Romania's economy to decelerate. The latest tax increases, elevated concerns and uncertainties around fiscal policies already took toll on sentiment indicators (mainly domestic-demand-sensitive sectors), suggesting that a modest slowdown could be on the cards already in Q4 (Chart 9&10). Meanwhile, the financial shock caused by the sudden jump in interest rates and the leu's increased volatility may start to weigh on the real economy starting from the turn of 2017-2018 (for further details please see our latest monetary policy [comments](#)). Beyond the fading impact of earlier stimuli measures and one-off items, miscalibrated government policies that fuel consumption instead of investments, as well as the failure to achieve quality improvement in the case of education and health (Chart 11), are likely to transform into a bottleneck for the country's growth potential.
- Given the surprisingly strong performance in Q3, we revised upwards our 2017 growth forecast to 7.1%. Nonetheless, we expect the economy to rise by only 4.0% in 2018.

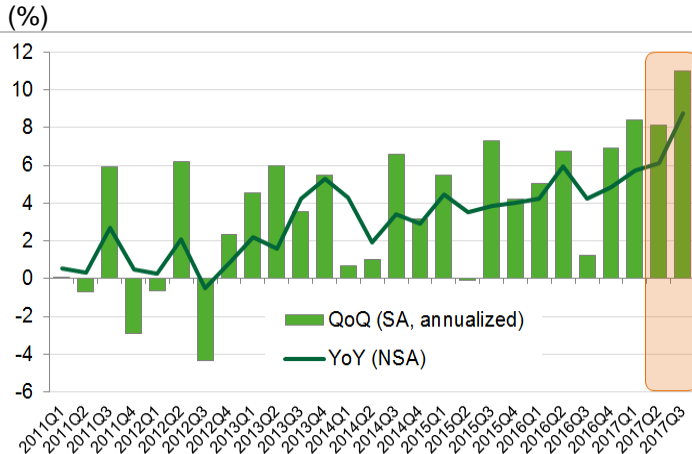
Main macro forecasts

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	7.1	4.0
Final consumption of households	%	1.0	1.1	1.7	-2.4	4.4	5.5	7.3	8.4	5.1
Cons. expenditure of housh.	%	1.0	1.0	0.8	2.6	4.2	5.9	7.5	8.9	5.1
Public consumption	%	-4.9	0.6	0.4	-4.6	0.8	0.1	4.5	3.3	3.3
Investment	%	-2.4	2.9	0.1	-5.4	3.2	8.3	-3.3	4.7	5.8
Exports	%	15.2	11.9	1.0	19.7	8.0	5.4	8.3	8.6	6.7
Imports	%	12.6	10.2	-1.8	8.8	8.7	9.2	9.8	10.3	7.5
Consumer prices	% annual avg	6.1	5.8	3.3	4.0	1.1	-0.6	-1.5	1.3	3.9
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	37.2	37.7
Current account	in % of GDP	-5.1	-4.9	-4.8	-1.1	-0.7	-1.2	-2.1	-3.0	-3.7
Key interest rate	% annual avg	6.5	6.2	5.3	4.8	3.3	1.9	1.8	1.8	1.8
Key interest rate	% end of period	6.25	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.00
EUR/RON	annual avg	4.21	4.24	4.46	4.42	4.44	4.44	4.49	4.56	4.59
EUR/RON	end of period	4.28	4.32	4.43	4.48	4.48	4.52	4.54	4.62	4.56
Nominal GDP	RON bn.	533.9	565.1	595.4	637.5	668.1	711.1	761.5	838	910
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	9.9	13.2	9.9
Real wage growth	%	-2.8	-1.6	0.8	0.8	6.5	10.4	11.7	11.7	5.7
Nominal GDP	EUR bn.	126.8	133.4	133.6	144.3	150.3	160.0	169.6	184	198

Sources: NIS, NBR, Eurostat, OTP Research

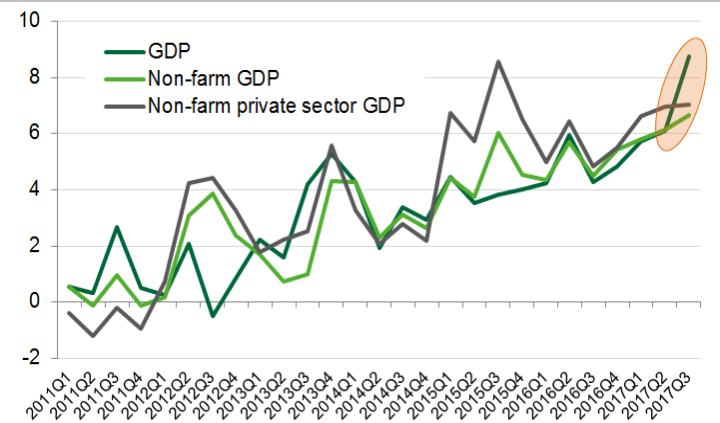
Chart set:

Chart 1: Summary chart of GDP growth (%)



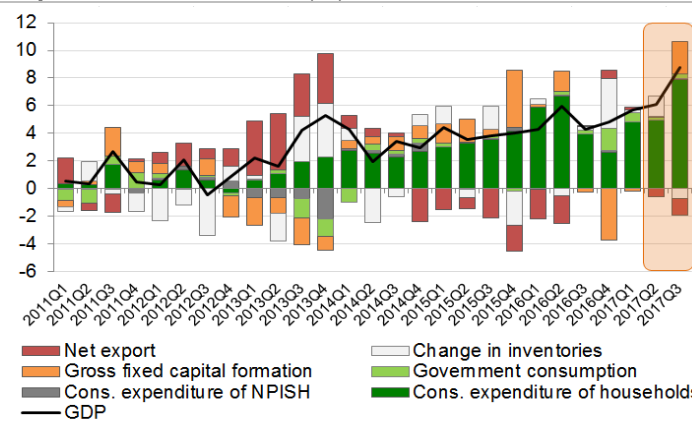
Sources: NIS, OTP Research

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



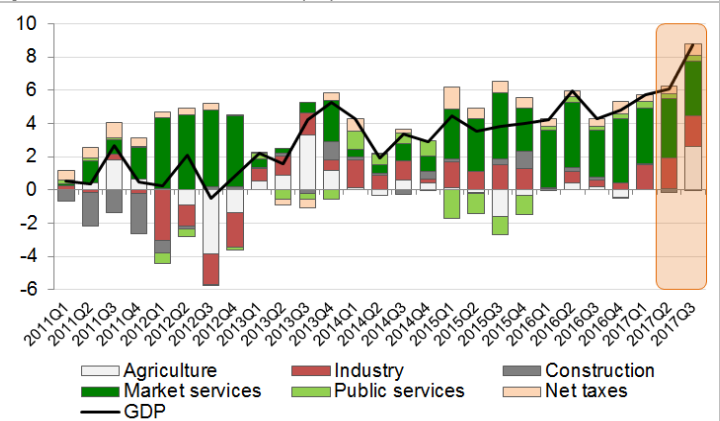
Sources: NIS, OTP Research

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



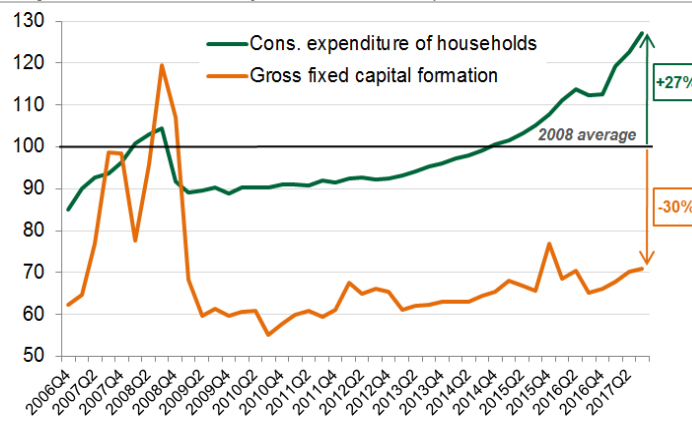
Sources: NIS, OTP Research

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



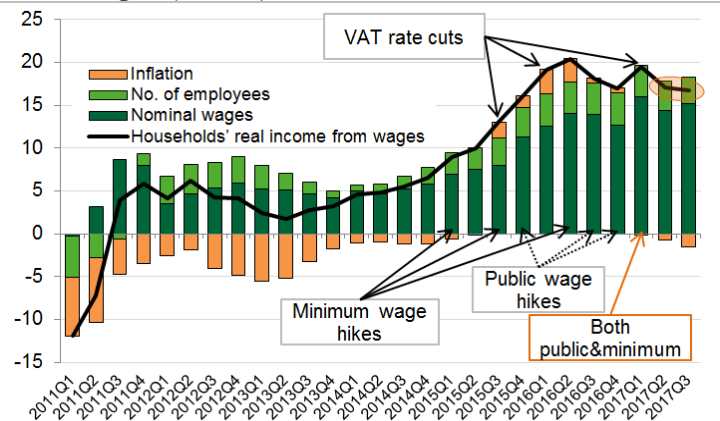
Sources: NIS, OTP Research

Chart 5: Evolution of households' consumption vs. capital investment (2008 av. = 100)



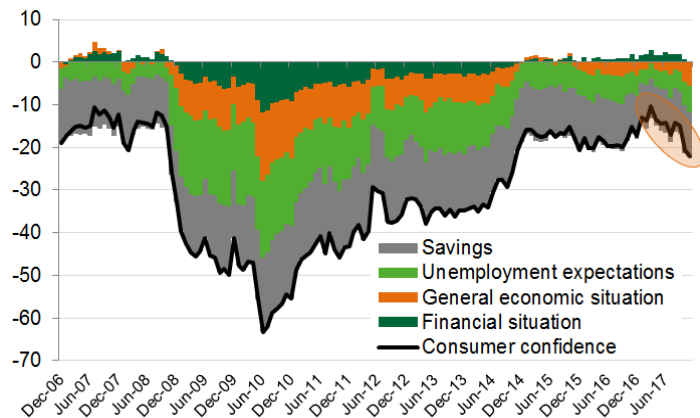
Sources: NIS, OTP Research

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



Sources: NIS, OTP Research

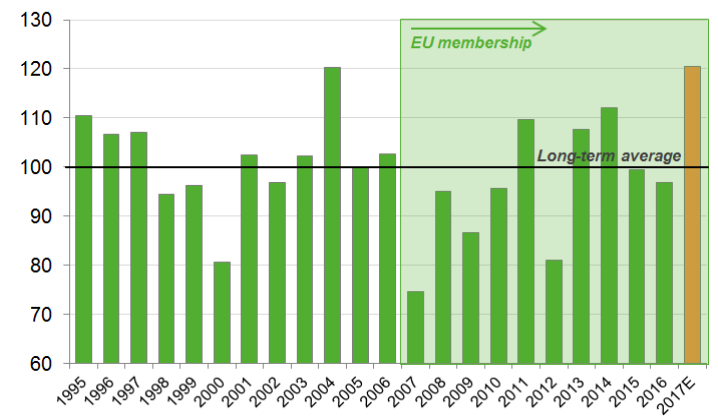
Chart 7: Decomposition of consumer confidence indicator (balance of opinions)



Sources: EC, OTP Research

Note: the components of the consumer confidence indicator reflects the expectation of households over the next 12 months

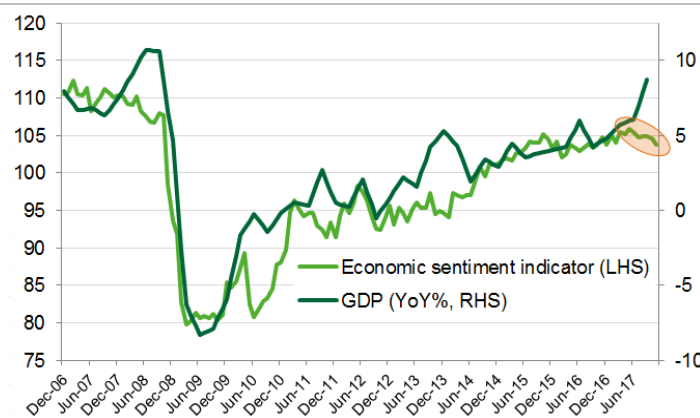
Chart 8: Value added of agriculture (constant prices, long-term av. = 100)



Sources: NIS, OTP Research

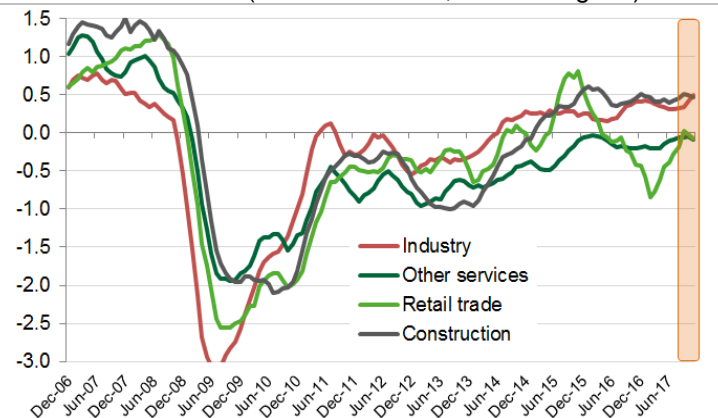
Note: 2017's data is OTP estimation

Chart 9: GDP growth vs. economic sentiment indicator



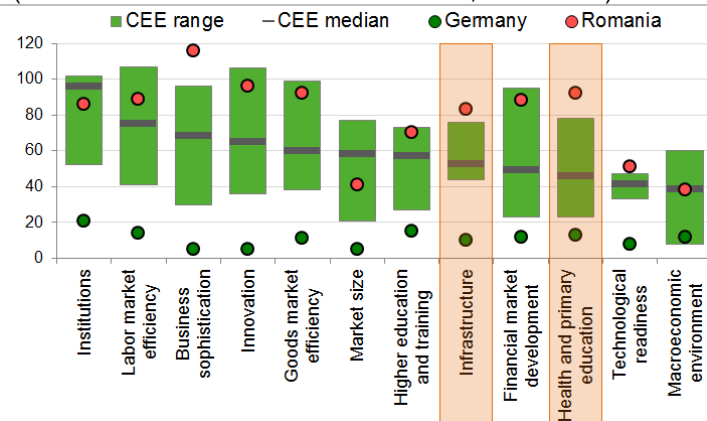
Sources: NIS, EC, OTP Research

Chart 10: Sentiment indicators in the main economic sectors (normalised data, 6M moving av.)



Sources: NIS, EC, OTP Research

Chart 11: Competitiveness indices by main domains (Rank out of 137 countries of the world; 1st is best)



Sources: World Economic Forum, The Global Competitiveness Report 2017-2018, OTP Research

Note: CEE region includes Bulgaria, Czech Republic, Croatia, Hungary, Poland and Slovakia

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