otp Research

BALANCE OF PAYMENTS REPORT

28 August 2017

Collapsing EU fund absorption temporarily took toll on Romania's external financing capacity; C/A deficit continued to widen, as expected

- The key external balance indicators of Romania remained on a downward trajectory in the second quarter of this year (Chart 1). The country's external financing capacity (EFC1, which is the sum of the current account and the capital account) registered a sharp fall, from -0.8% of GDP in Q1, to -1.5%. Simultaneously, the earlier modest surplus of the EFC2 indicator (EFC1 plus net errors and omissions; in our opinion, the first best measure for underlying trends) also dissipated in Q2. The unfavourable developments were chiefly the results of collapsing EU fund absorption (Chart 3) and, to a lesser extent, of the widening current account deficit (Chart 4). On past form, we suspect that the sharp fall in EU transfers could be gradually reversed.
- Romania's C/A gap was at 2.7% of GDP as of June 2017 up from March's 2.6%, reaching its highest value since the beginning of 2013, but admittedly, this level still appears to be low compared to its long-term average.
- The slowly but steadily rising C/A gap in Q2 was in line with the more general economic picture of Romania: with the already robust economic growth being propelled further by fiscal measures, the current account deficit is set to climb higher. Meanwhile, the rising financing need of the government sector started to weigh on balance indicators (Chart 2). However, despite the favourable economic conditions, the double-digit wage growth and record-low unemployment rate, the private sector still seems to be much more cautious than before the outburst of the financial crisis, keeping the country on a sustainable path. At the same time, external indebtedness is also low, even compared to Romania's peers in the CEE region, while FX reserves are more than adequate.
- Beside the modest increase of the C/A deficit, the rising trade gap and the shrinking surplus in the balance of services played the key role (Chart 4). The strong revival of the EU's economy helped the export of goods to perform quite well (Chart 5) but this was not enough to outpace domestic-demand-fuelled imports' growth. In this context, the balance of goods posted a larger deficit than a quarter earlier (5.8% of GDP vs. 5.5%). Simultaneously, a turning point started to take shape in services (Chart 6). We recall that the surplus of the services' account played an important role in maintaining the external balance indicators at favourable levels as, among others, expanding transport companies and the success story of Romania's IT&C sector supported the export of services. Nonetheless, unlike imports (which got a boost from the demand-sensitive travel segment), exports apparently started to lose impetus recently. It could be too soon to declare an end of the increasing trajectory of services' surplus at the moment, as the most recent slack may provide a false signal. However, the consequences of the tight labour market, including limited free workforce and swiftly rising wages, are set to pull back export's growth in the medium term.
- Primary incomes, another important component of the C/A, partially offset the negative impacts coming from the balance of goods and services, after they registered a smaller deficit in Q2 (2.4% of GDP, down from Q1's 2.8% - Chart 4). Nonetheless, we think that this improvement was rather transitory, and owing to the divergent timing in the disbursement of agricultural subsidies, the deficit of the primary income balance will rise in the next quarter.
- Despite the modest setback in Q2, overall, net inflows of foreign direct investments stood at healthy levels, slightly exceeding 2% of GDP (Chart 7). In the light of the supportive global environment, with a revival in the EU's economy and still loose monetary conditions, we expect FDI inflows to remain robust. But Romania's attractiveness as an investment target may be dampened by worries around the government budget as well as unpredictable fiscal policies.
- Romania's gross external debt without intercompany loans (which are more FDI-like than debt) modestly increased in Q2 (Chart 8), after the Ministry of Finance tapped international capital markets in April. Simultaneously, banking institutions continued to reduce their debts , helping to keep the indicator below the 40% threshold.

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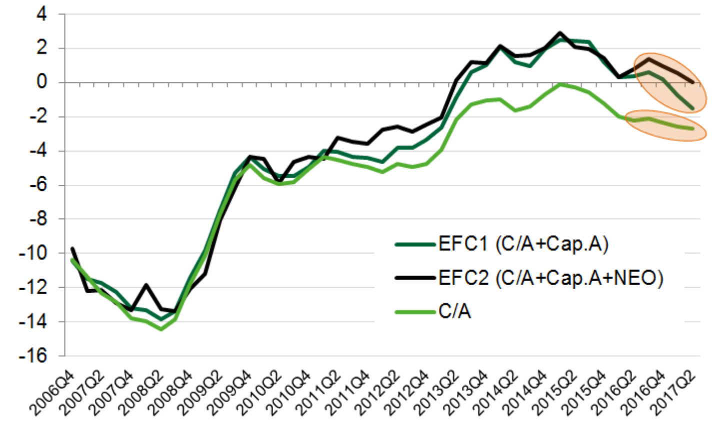
- Regarding the outlook, we continue to expect that Romania's C/A deficit will increase to 3.4% at the end of 2017, and may widen slightly further, to 3.7% in 2018. Nonetheless, this gap could be broadly covered by EU funds and FDI inflows. We also think that after a definitely disappointing start, EU fund absorption will slowly improve in the following quarters, while uncertainties around fiscal policies will remain the primary risk on the domestic front.

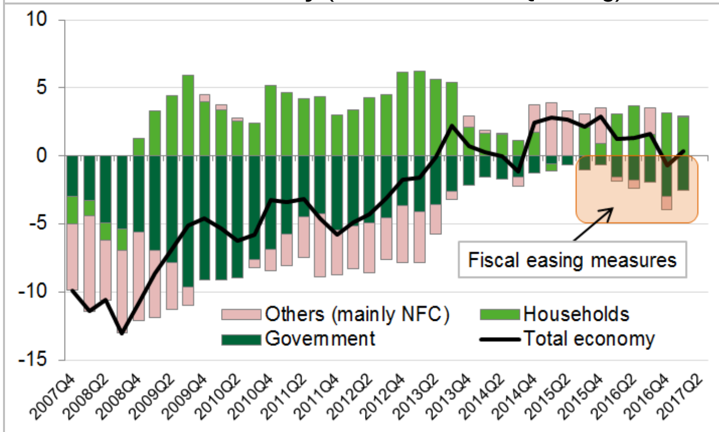
Chart set:

Chart 1: Main indicators of external balance
(as % of GDP, 4Q rolling)



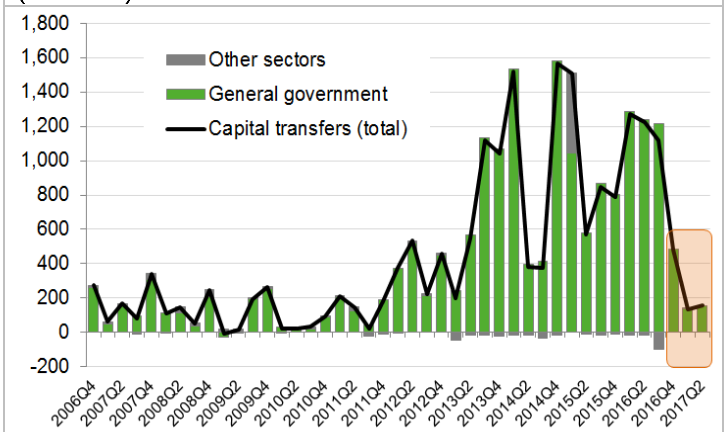
Sources: NBR, NIS, OTP Research
*Note: **EFC1** (External financing capacity 1) = Current account + Capital account; **EFC2** (External financing capacity 2) = EFC1 + Net errors and omissions*

Chart 2: Net financing capacity of the main sectors and the whole economy (as % of GDP, 4Q rolling)



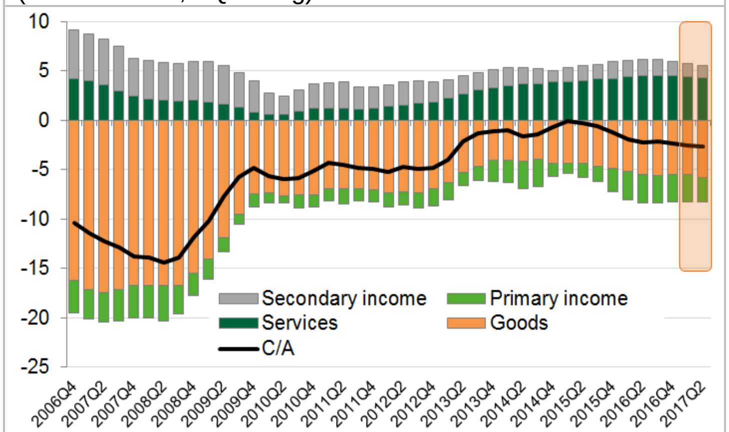
Sources: NBR, NIS, OTP Research
Note: Q2 2017 data is not available yet

Chart 3: Capital transfers
(EUR mn)



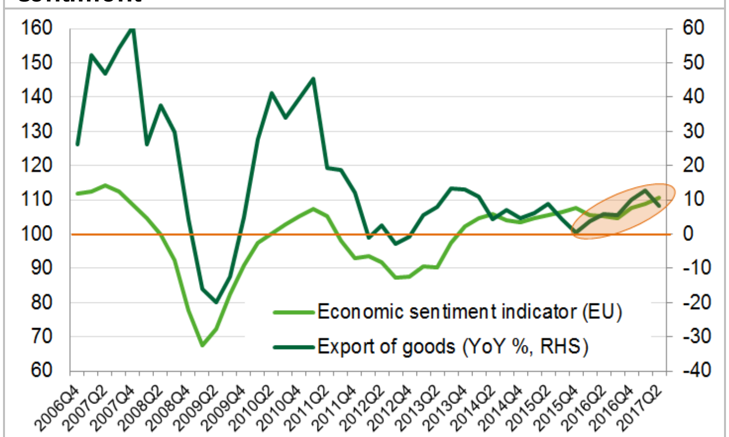
Sources: NBR, OTP Research

Chart 4: Current account by its main components
(as % of GDP, 4Q rolling)



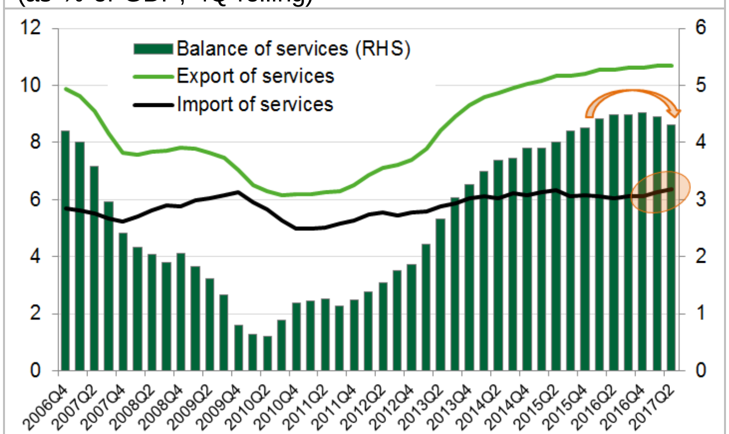
Sources: NBR, NIS, OTP Research

Chart 5: Export of goods vs. EU level economic sentiment



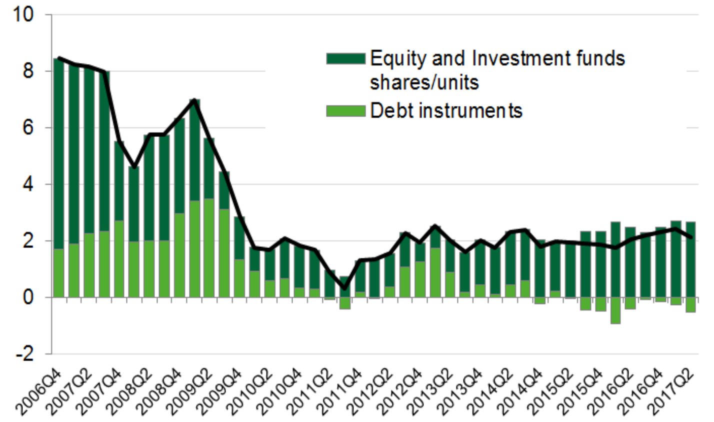
Sources: NBR, EC, OTP Research

Chart 6: Services' account
(as % of GDP, 4Q rolling)



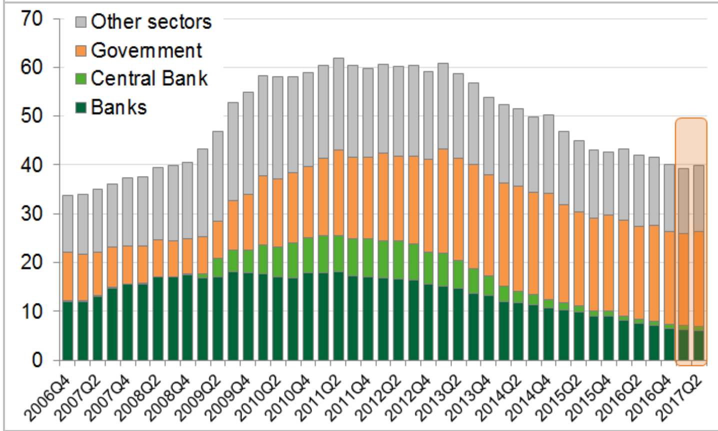
Sources: NBR, NIS, OTP Research

Chart 7: Net direct investment
(as % of GDP, 4Q rolling)



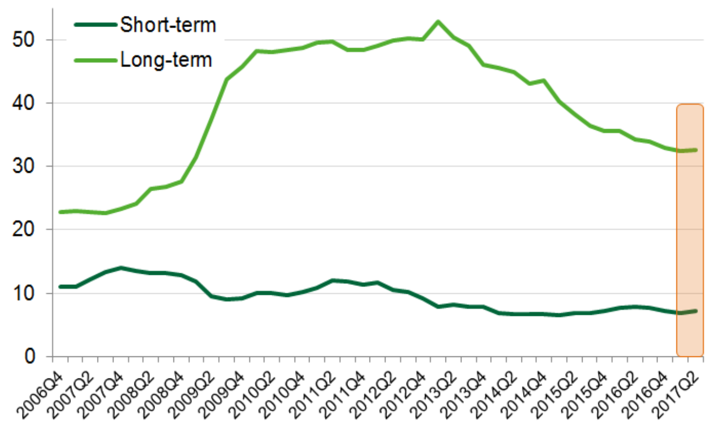
Sources: NBR, NIS, OTP Research

Chart 8: Gross external debt by sectors
(as % of GDP)



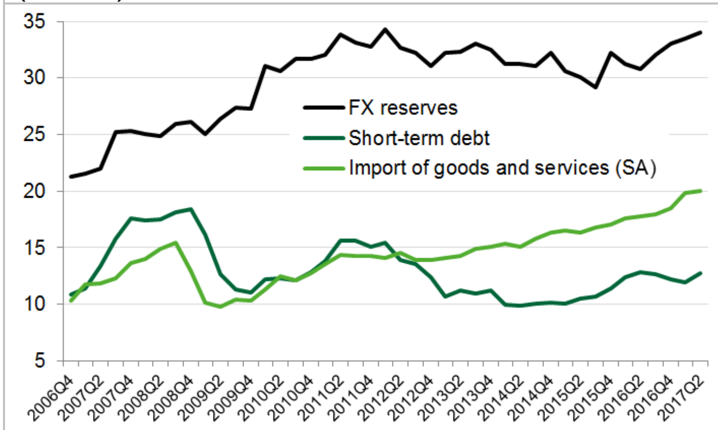
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 9: Gross external debt by tenor
(as % of GDP)



Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 10: Reserves and reserve adequacy rules
(EUR bn)



Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

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