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BALANCE OF PAYMENTS REPORT

22 May 2018

Softer consumption provided relief for the C/A balance in Q1; the deficit may widen moderately later this year

- In the first quarter of 2018, Romania's current account (C/A) deficit was practically unchanged, staying at 3.4% of GDP (on 4Q rolling basis; see Chart 1), as a setback in consumption growth led to softer demand for imported goods, while an uptick in EU subsidies also helped. Romania's external financing capacity (EFC1, which is the sum of the C/A and the capital account balances), was almost flat as EU funds for investments failed to show another meaningful increase after Q4 2017's revival. The EFC2 indicator (EFC1 + Net errors and omissions) pointed to 1.6% gap at the end of Q1 2018, down from 1.8% in the previous quarter. Meanwhile, foreign direct investments (FDI) remained healthy, covering easily the deficit of the EFC indicators. Romania's external debt (excluding intercompany loans, which are more FDI-like than debt; see charts 8 & 9) remained low at 35.7% of GDP, but rose modestly compared to the previous quarter, as the government raised funds via large bond issues.
- Regarding the broader picture, we recall that the country's external balance indicators registered a turning point in 2014-2015, as the rebounding domestic demand, stimulated by loose fiscal policies too, boosted imports. Nonetheless, the C/A gap is still financed by EU funds and robust FDI flows, while strong GDP growth also helps to reduce Romania's external debt ratio. It is worth mentioning that the financing need of the government increased owing to the fiscal easing, but the private sector seems to be more prudent than before the financial crisis, which is mitigating the risks (Chart 2).
- The deficit in the balance of goods played an important role in the stabilization of the C/A gap in Q1 as, in contrast with the previous few quarters, it widened only marginally (by 0.1 pp to 6.5% of GDP; Chart 3). Moreover, the annualized Q1 deficit even fell (from 6.8% to 6.5%), our in-house seasonally adjusted data showed. This outturn was mainly the result of a dip in consumption growth. The detailed Q1 GDP statistics have not been revealed yet, but timelier high-frequency indicators suggest that consumption expenditures lost some steam (Chart 4), translating into softer import growth. Meanwhile, despite the moderation of the eurozone economy, exports fared quite well in Q1.
- On the other hand, the surplus of the services' balance shrank further, by 0.1 pp to 4.1% of GDP as exports were not able to keep pace with imports (Chart 5). The more detailed statistics revealed that the travel segment was among the key drivers again (Chart 6). This is in contrast with the evolution seen in the case of goods, where falling consumer confidence weighed on imports. One of the reasons could be that customers' profile is quite different (not all households can afford foreign trips) as well as tours are frequently scheduled well ahead of the date of departure. Therefore travel services are less sensitive to transitory shifts in confidence.
- In Q1, the balance of primary incomes helped to keep the C/A under control, as it pointed to a smaller deficit (2.4%, down from 2.6% in the previous quarter), after EU subsidies (chiefly agricultural grants) picked up. Simultaneously, the surplus of secondary incomes, which also includes remittances from abroad, was flat at 1.4% of GDP.
- Net inward direct investments reached 2.5% of GDP, marginally higher than a quarter earlier (2.4%; Chart 7). The structure of the FDI flow was also healthy owing to the large share of investments in equity. We recall that the favourable macroeconomic environment at global level as well as still low labour costs make the country an attractive destination. However, the significant and sudden changes of several taxes triggered concerns among foreign investors with presence in Romania. In order to unlock the full potential of FDIs, more predictable tax policies, coupled with stronger focus on infrastructure improvement and education, would be beneficial.
- In Q1, Romania's gross external debt rose from 35.5% to 35.7% of GDP, almost exclusively on the back of higher government debt (Charts 8 & 9). This came after the Ministry of Finance tapped external markets, raising EUR 2 bn via eurobond issues. The foreign exchange reserve of the NBR remained adequate, easily covering imports and short-term debt (Chart 10).

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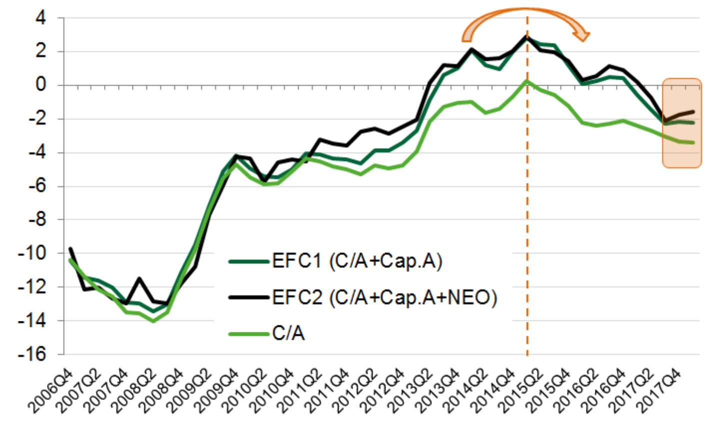
- Undoubtedly, softer consumption provided a relief for the C/A balance in Q1, but wage growth bounced back most recently, pointing to 15.5% YoY gain in March (up from 8.0% in January and 11.2% in February), while the unemployment rate hit an all-time low of 4.5%. Apparently, these developments already have helped consumer confidence (Chart 11) to recover some of the losses caused by the worries about the latest tax changes (transferring the burden of social contributions from employers to employees) and tighter monetary conditions. Therefore, a pick-up in consumption is expected later this year. In addition, rallying crude oil prices are set to make imports more expensive, putting further pressure on the C/A balance. Given this context, we continue to believe that Romania's C/A deficit could widen further, reaching 4.0% this year and 4.1% next (both revised 0.1 pp higher compared to our previous forecasts).
- We reiterate that the C/A gap is still financed from EU funds and net inward FDI flows but, together with the quite high government budget deficit, it puts Romania into an unfavourable position compared to other EU countries (Chart 12). This picture may spook some investors when significant shocks show up (e.g. quicker-than-expected Fed hikes), leading to weakening pressure on the leu and higher borrowing costs.

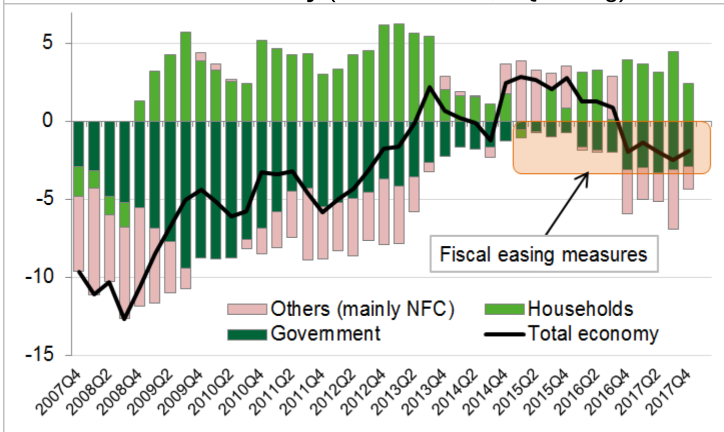
Chart set:

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



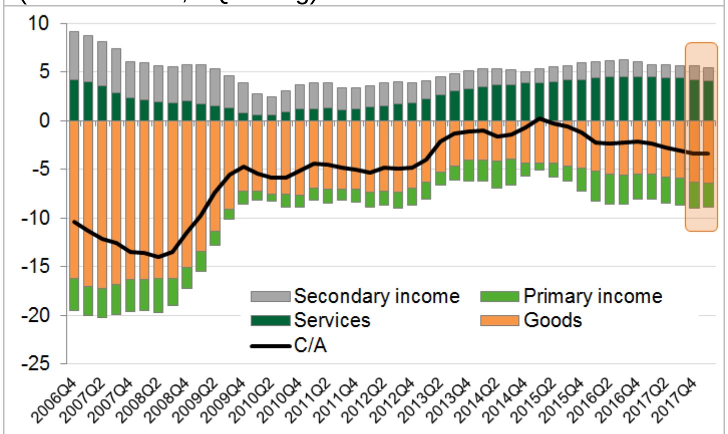
Sources: NBR, NIS, OTP Research
*Note: **EFC1** (External financing capacity 1) = Current account + Capital account; **EFC2** (External financing capacity 2) = EFC1 + Net errors and omissions*

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



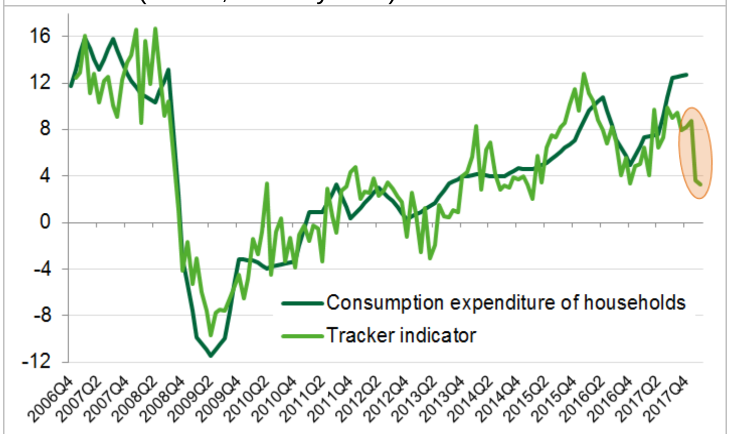
Sources: NBR, NIS, OTP Research
Note: Q1 2018 data is not available yet

Chart 3: Current account by its main components
(as % of GDP, 4Q rolling)



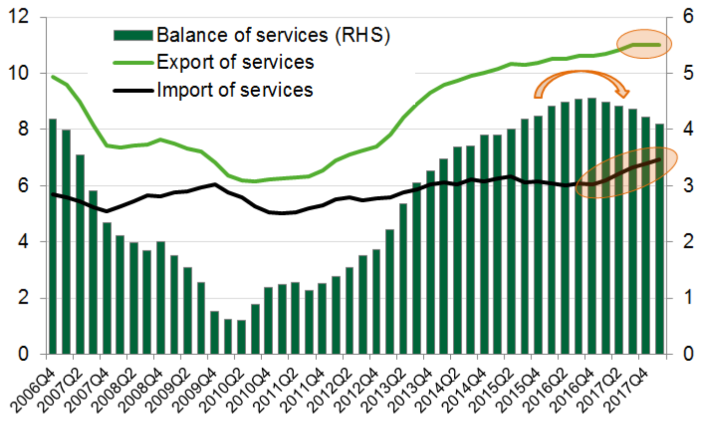
Sources: NBR, NIS, OTP Research

Chart 4: Households' consumption vs. its tracker indicator (YoY%, monthly data)



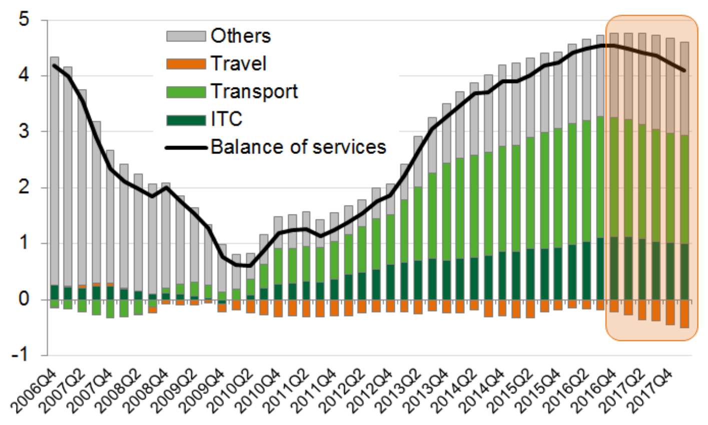
Sources: NIS, OTP Research
Note: the consumption tracker is an in-house composite indicator based on various high-frequency indicators, including among others retail sales and passenger car registration data

Chart 5: Services' account
(as % of GDP, 4Q rolling)



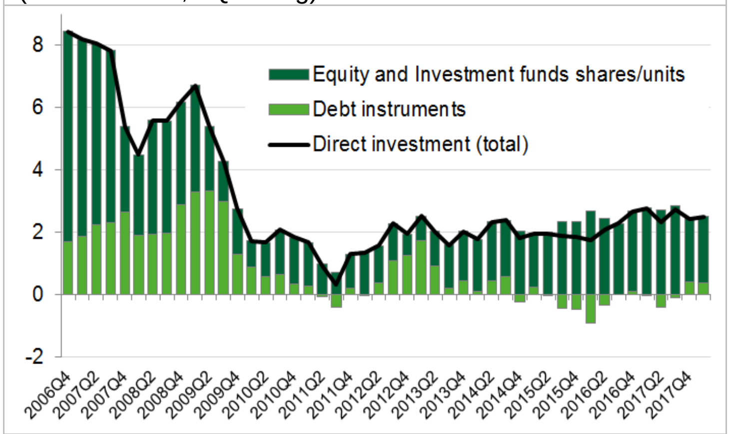
Sources: NBR, NIS, OTP Research

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



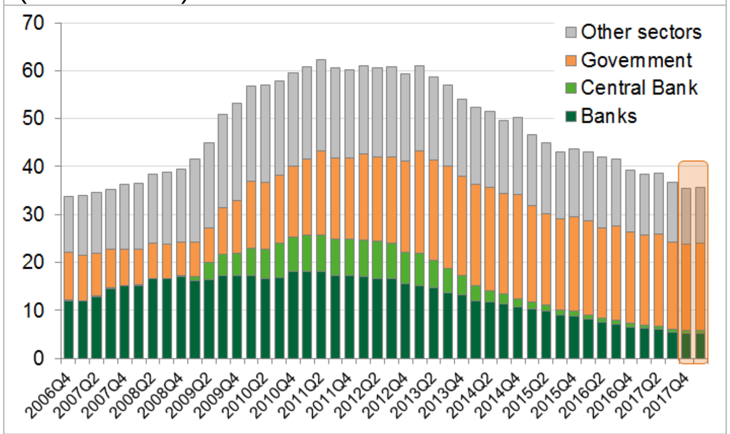
Sources: NBR, NIS, OTP Research

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



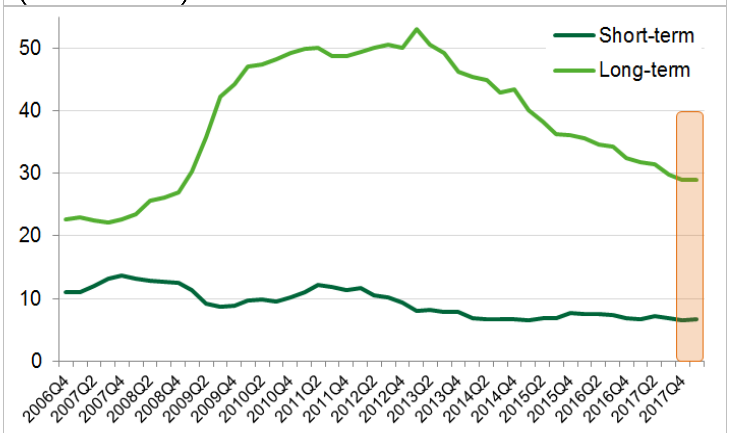
Sources: NBR, NIS, OTP Research

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



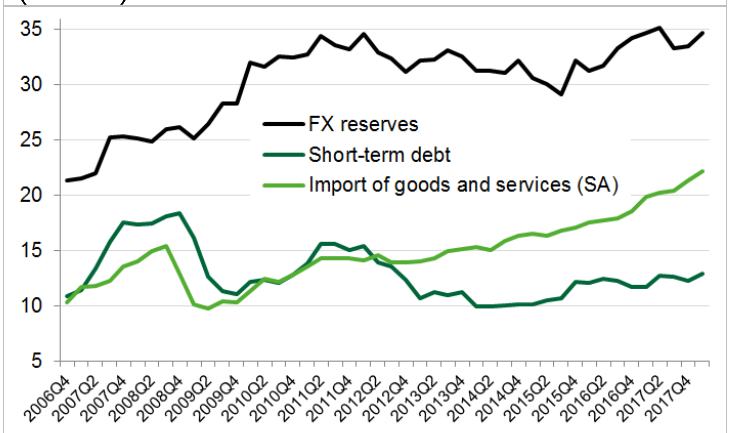
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

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



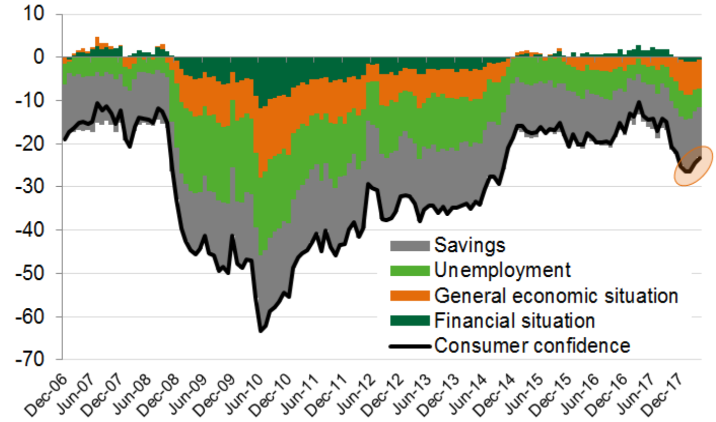
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

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



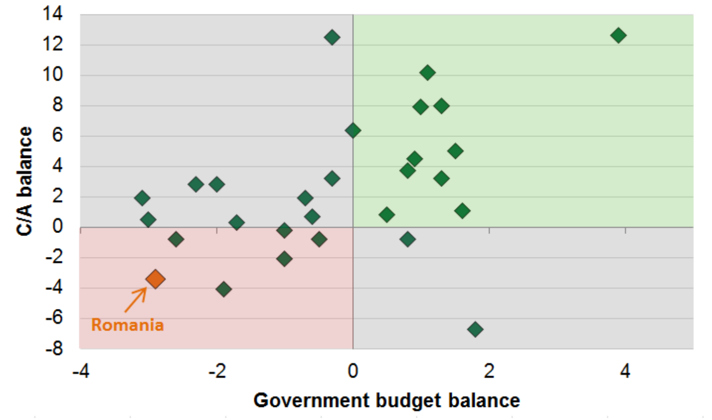
Sources: NBR, NIS, OTP Research
Note: short-term debt without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 11: 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 12: C/A and government budget balance in EU countries (% of GDP, 2017)



Sources: Eurostat, OTP Research

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