otp Research

BALANCE OF PAYMENTS REPORT

24 August 2018

Lower outflows of investment income helped keep the C/A deficit stable in the second quarter of 2018; The Turkish currency crisis is expected to have a modest impact via the trade channel

- In the middle of 2018, Romania's current account posted a 3.4% deficit (see Chart 1), a touch lower than in the first quarter of this year (3.5% of GDP, according to the revised data of the NBR). This came after lower profits at foreign-owned companies more than offset the shrinking surplus of the services' balance and secondary income (Chart 3). Simultaneously, Romania's external financing capacity indicators continued to hover around the -2% threshold. Similarly to previous quarters, FDI flows and EU funds more than offset the gap of the current account, helping to further ease Romania's external debt ratio.
- Regarding the big picture, we reiterate that Romania's external financing indicators marked a turning point in 2014-2015 on the back of a revival in consumption, which was stimulated by a loose fiscal policy too. However, the current account deficit is still financed by foreign direct investments and EU funds. Moreover, the country's robust GDP growth also helped to keep the external debt ratio on a downward trajectory. We highlight as well that the financing need of the government budget rose significantly (Chart 2), but the private sector is more prudent than before the crisis, which help to alleviate the risks.
- In the second quarter of this year, the balance of primary income prevented the C/A deficit from deteriorating, as it posted a 2.1% gap, 0.5 percentage point lower than in Q1 (Chart 3). This came as investment income earned by non-residents fell sharply (Chart 4) owing to lower profits at foreign-owned companies. The recent development surprised us to some extent, as swiftly worsening corporate profitability is rather unusual at the expansion stage of the economic cycle. However, it should be noted that, undoubtedly, Romania's economy lost steam in the past few quarters and the slowdown could have had stronger-than-expected negative effects on corporations. Nonetheless, it is also important to add that profitability levels may register significant swings owing to a wide range of one-off factors too. Therefore, a stabilisation or even a reversal cannot be ruled out in the following period.
- The balance of goods was practically unchanged in Q2 (Chart 3), as exports were able to keep pace with imports. The detailed Q2 GDP statistics are not available yet, but high-frequency indicators suggest that households' consumption has started to recover after Q1's sudden break (Chart 5). Nonetheless, the growth rate of household expenditures remained below the peaks seen in 2017, helping to avoid an even stronger increase of imports. We also note that a deeper look at the data reveals some warning signs too, as excluding trades with passenger cars and motorcycles, the balance of consumer goods would have continued to deteriorate (Chart 6).
- In the case of services, the general trends did not change in Q2, as the surplus shrank further, by around 0.2 ppts, to 4.0% (Chart 3). Similarly to the previous few quarters, the deterioration was mainly due to transport services (Chart 7), but the travel segment also continued to weigh on the balance, as households preferred foreign trips instead of domestic journeys. In the second quarter of this year, tourists' overnight stays increased by only 0.1% YoY in Romania, owing to a fall (-1.0%) in the number of resident guests, Eurostat's data showed. The surplus of secondary incomes also decreased by 0.1 pp (Chart 3), after Romanians working abroad sent home less money.
- Net inward direct investments stood at 2.6% of GDP, almost unchanged compared to Q1 (Chart 8). The structure of flows remained healthy too, with a relatively low share of debt instruments. We noted in our previous report that Romania still seems to be an attractive destination for foreign investments but the underdeveloped level of infrastructure is one of the important weaknesses of the country. We recall that carmaker BMW recently decided to invest one billion euros in a new plant in Debrecen, Hungary, 40 km away from the Western border of Romania. The new factory will have a production capacity of 150,000 cars per year and is expected to create over 1,000 jobs. One of the key reasons for this location was the city's very good infrastructure, and its suitable logistic connections.

Treasury Sales Team
+40 372 31 85 88
sales.treasury@otpbank.ro

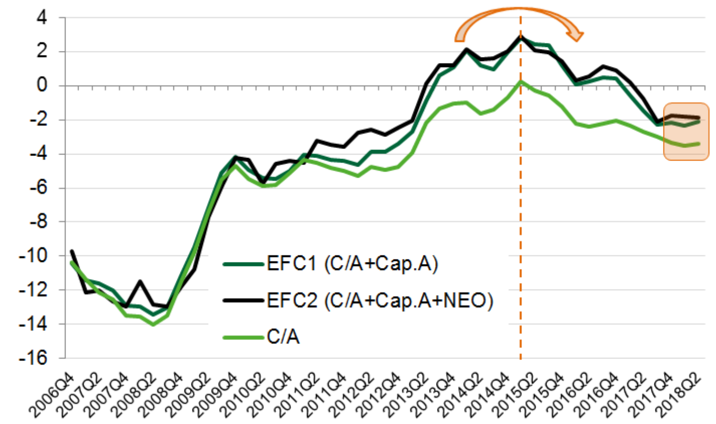
Chief Economist
Gergely Tardos
+36 1 374 7273
tardosg@otpbank.hu

Analyst
Csaba Bálint
+4021 307 58 96
csaba.balint@otpbank.ro

- In the second quarter of this year, Romania's external debt (excluding intercompany lending) eased to 34.7% of GDP, one percentage-point lower than in Q1 (Charts 9 & 10). Meanwhile, the NBR's foreign exchange reserves have decreased somewhat, but they remained adequate, easily covering imports and short-term debt (Chart 11).
- In the light of the recent turmoil and currency crisis in Turkey, it may be worth having a glance at the Romanian-Turkish economic ties. Traditionally, Turkey has been an important trading partner of Romania, owing to its geographical proximity as well as several historical and cultural links. In 2017, Romania exported goods to Turkey in the value of EUR 2.1 bn, representing 3.3% of the country's total exports (Chart 12). This share put Turkey on the seventh place on Romania's top export partners, following the UK (4.1%) and Bulgaria (3.4%), but outpacing Spain (3.0%) and Poland (3.1%), while it was particularly far from the number one partner, Germany (22.9%). At the same time, Romania imported goods worth EUR 3.0 bn (4.0% of the total; see Chart 13), which led to a sizable deficit in the country's trade balance with Turkey. Detailed statistics on the structure of exports (Chart 14) reveal that Romania preponderantly sells machinery and transport equipment to Turkey (around half of this group comes from road vehicles), manufactured and raw materials (with a high share of iron and steel as well as metalliferous ores), but the export of foods (mostly cereals) is also important. In the case of services, Romania's trade balance is close to zero, with modest flows in both directions (around EUR 0.2 bn).
- Regarding the dynamics of the trade partnership, we note that the ties were particularly strong in the middle of the 2000s, before Romania's EU accession (Chart 15), and touched a transitory bottom in 2009 because of the financial crisis. Nonetheless, after a rebound in 2010 and 2011, Turkey gradually lost from its importance as an export partner. In 2011, Romanian exports to Turkey represented 2.1% of the country's GDP, but this share shrank to only 1.1% in 2017, mainly due to lower exports of ores, iron and steel.
- It is important to mention that Romania, as an investor, has a very modest presence on external markets. In the middle of 2018, the country's net investment position recorded a negative balance of EUR 88.8 bn (around 46% of GDP), after liabilities stood at EUR 153.0 bn and assets at EUR 64.1 bn. More than half of Romanian assets stem from the NBR's international reserve, invested in safe assets, while the rest of the amount was placed mostly into EU countries. Romania's FDI (foreign direct investment) stock in Turkey is negligible (EUR 4 mn, as of 2016), Eurostat's data also showed. On the other hand, Turkey has a larger footprint in Romania, with over 15,000 registered enterprises (Chart 16), but the majority of them are SMEs. Turkish outstanding FDI in Romania stood at EUR 0.45 bn (0.7% of the total stock), mostly in the manufacturing (EUR 0.21) and services (EUR 0.20 bn) sectors.
- To conclude, we think that the depreciation of the Turkish lira, coupled with a significant slowdown, may pull back Romanian exports to Turkey. However, overall, the potential negative effects on the real economy seem to be rather limited. Nonetheless, we also note that a further escalation of the Turkish crisis could have some secondary impacts. A sharp rebound of risk aversion on global financial markets may put pressure on the leu and Romanian interest rates, particularly as Romania has larger current account and government deficits than most of its EU peers. Regarding the outlook for the C/A balance, we expect its deficit to reach 3.9% at the end of this year (0.1 pp lower than in our previous forecast, after Q2's favourable outturn). In 2019, the deficit may widen to 4.1% (unchanged compared to our previous forecast), as strong domestic demand is expected to fuel imports.

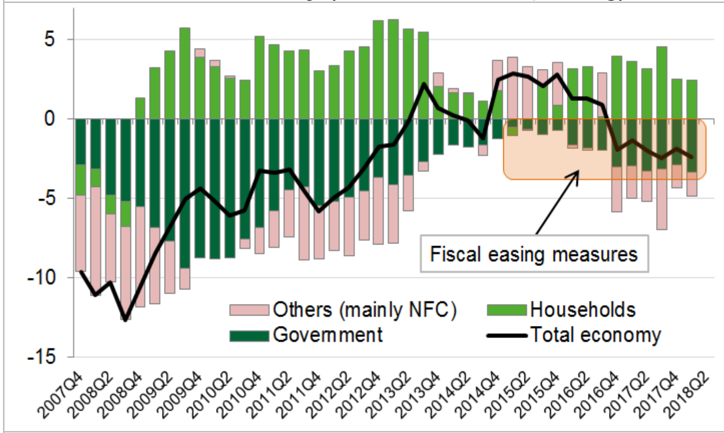
Chart set:

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



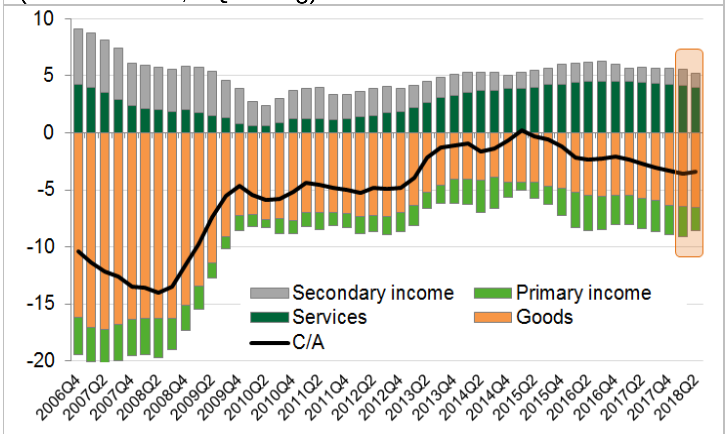
Sources: NBR, NIS, OTP Research
*Note: **EFC1** (External financing capacity 1) = Current account + Capital account; **EFC2** (External financing capacity 2) = EFC1 + Net errors and omissions*

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



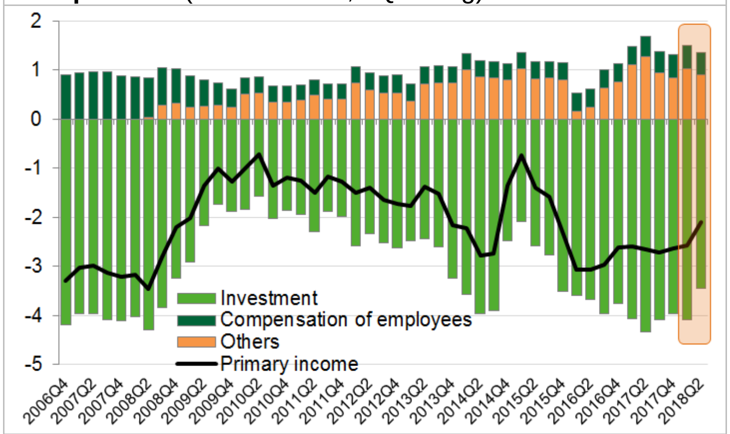
Sources: NBR, NIS, OTP Research
Note: Q2 2018 data is not available yet

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



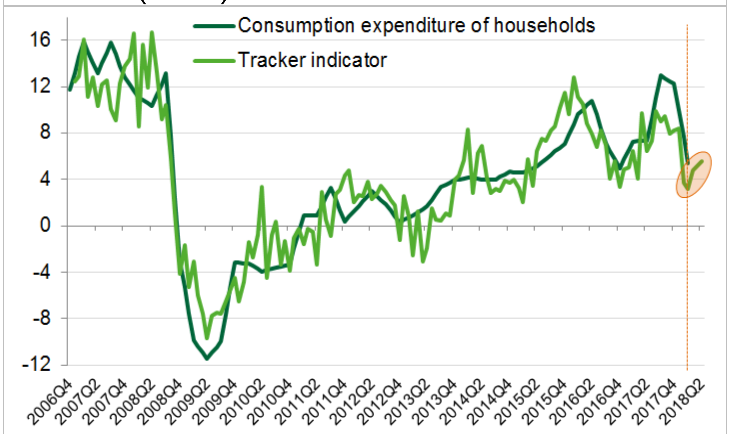
Sources: NBR, NIS, OTP Research

Chart 4: Primary income balance by its main components (as % of GDP, 4Q rolling)



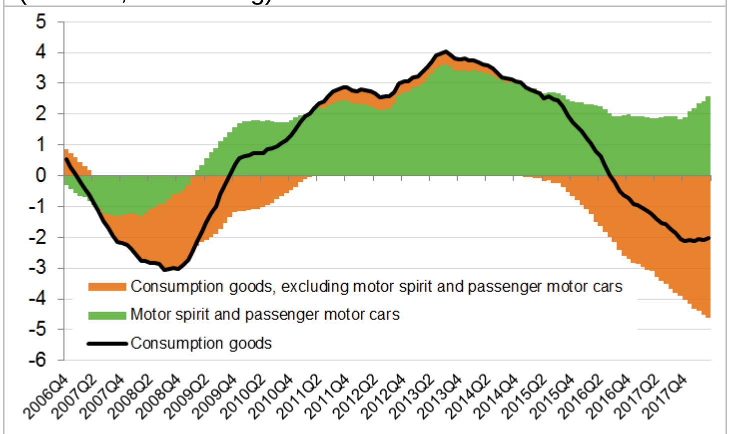
Sources: NBR, NIS, OTP Research

Chart 5: Households' consumption vs. its tracker indicator (YoY%)



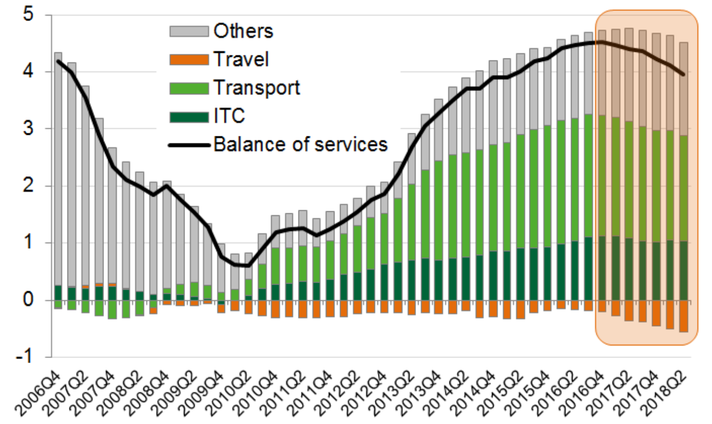
Sources: NIS, OTP Research
Note: the consumption tracker is an in-house composite indicator based on various high-frequency indicators, including among others retail sales and passenger car registration data

Chart 6: Balance of consumption goods
(EUR bn, 12M rolling)



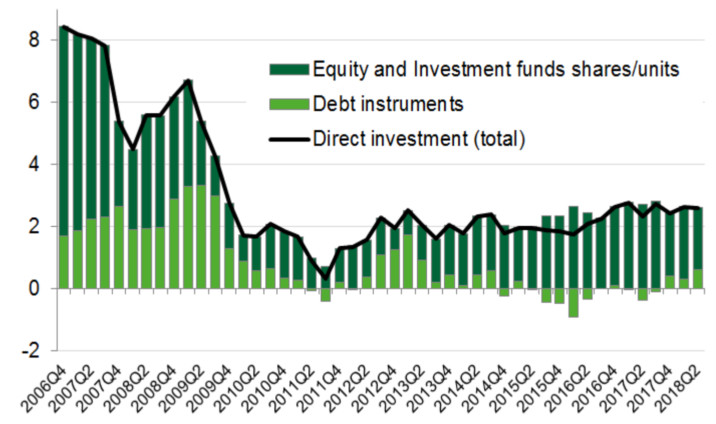
Sources: Eurostat, OTP Research

Chart 7: Services' account by its main components
(as % of GDP, 4Q rolling)



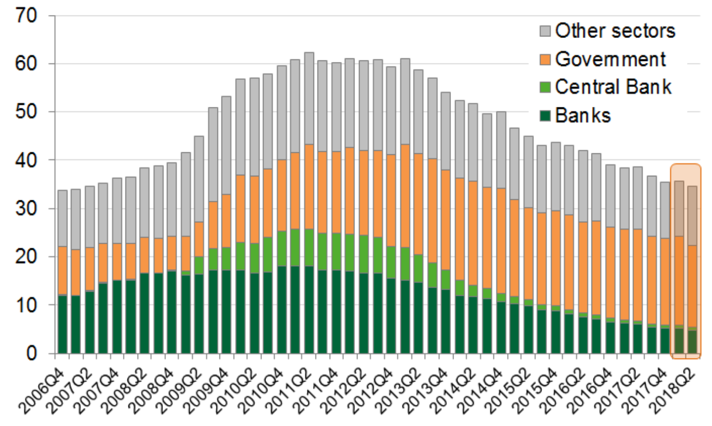
Sources: NBR, NIS, OTP Research

Chart 8: Net direct investment
(as % of GDP, 4Q rolling)



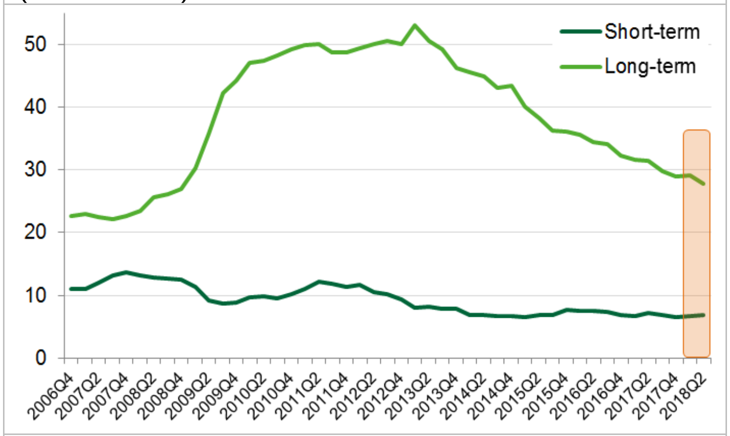
Sources: NBR, NIS, OTP Research

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



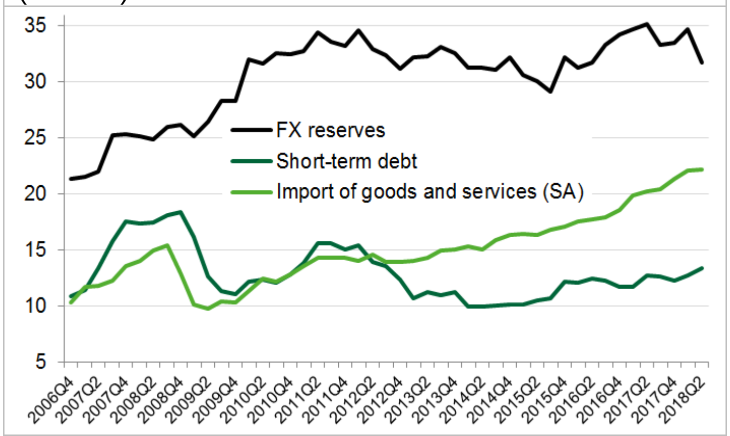
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 10: Gross external debt by maturity
(as % of GDP)



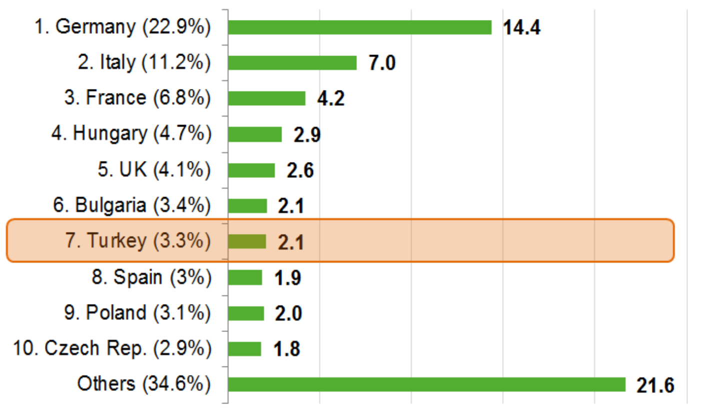
Sources: NBR, NIS, OTP Research
Note: without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 11: Reserves and reserve adequacy rules
(EUR bn)



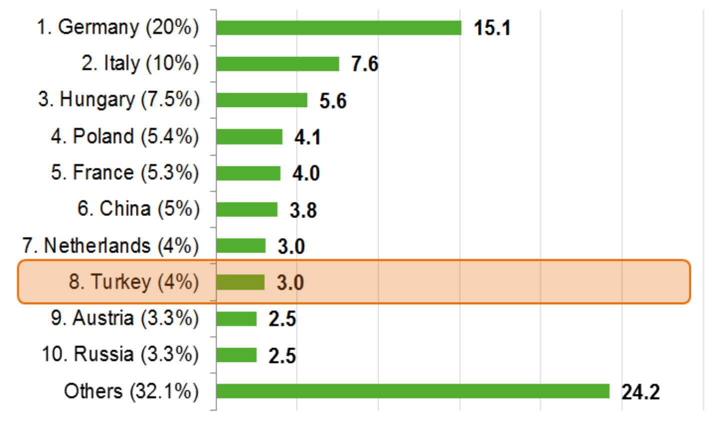
Sources: NBR, NIS, OTP Research
Note: short-term debt without intercompany lending; based on BPM5 methodology until 2012 Q4

Chart 12: Exports of goods
(as of 2017; bn EUR, share of total in brackets, FOB)



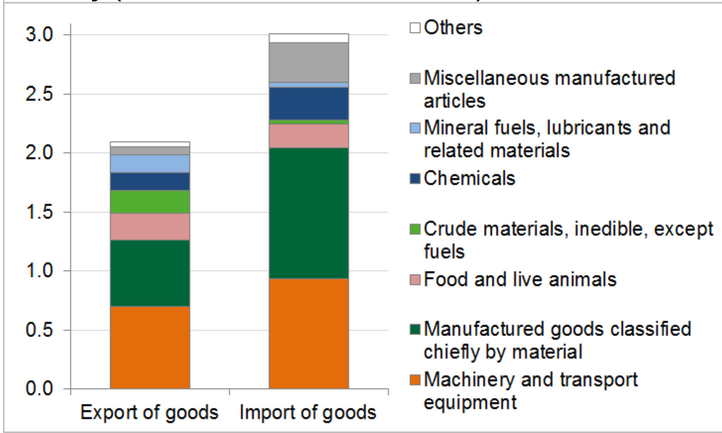
Sources: Eurostat, OTP Research

Chart 13: Imports of goods
(as of 2017; bn EUR, share of total in brackets, CIF)



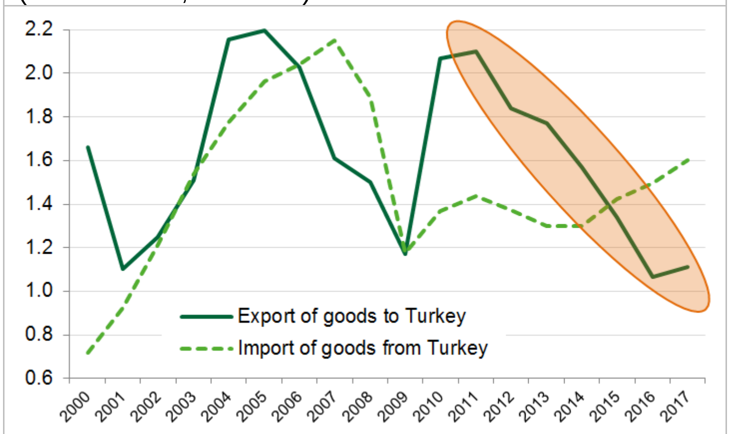
Sources: Eurostat, OTP Research

Chart 14: Structure of exports and imports with Turkey (as of 2017; bn EUR, FOB-CIF)



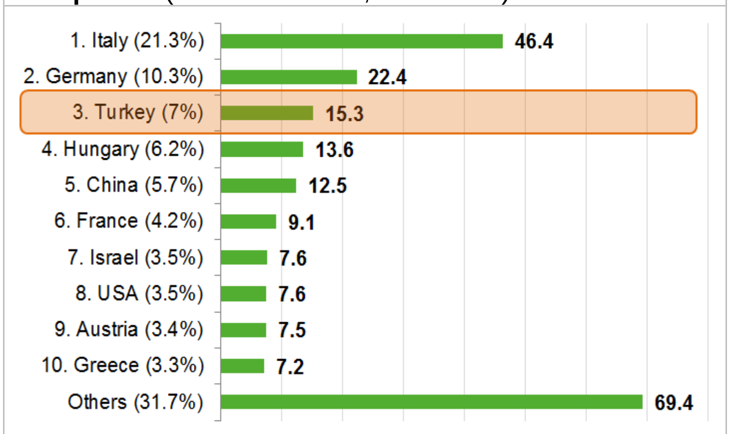
Sources: Eurostat, NIS, OTP Research

Chart 15: Trade relationship with Turkey
(as % of GDP; FOB-CIF)



Sources: Eurostat, NIS, OTP Research

Chart 16: Top investors in Romania by number of companies (as of June 2018; thousands)



Sources: ONRC, OTP Research

Disclaimer

OTP Bank Romania S.A. does not intend to present this document as an objective or independent explanation of the matters contained therein. This document a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.
This communication does not contain a comprehensive analysis of the described issues. This report is issued for information purposes only and should not be interpreted as a suggestion, an invitation or an offer to enter into any transaction, as an investment advice, and it does not constitute legal, tax or accounting advice. Also it is not and should not be considered a recommendation for investment in financial instruments according to NSC Regulations no. 32/2006 and 15/2006.
Information herein reflects current market practices. Additional information may be available on request. This document is intended only for the direct and sole use of the selected customers of OTP Bank Romania S.A. Any form of reproduction or redistribution to any other person that the intended recipients, including publication in whole or in part for any purpose, must not be made without the express written agreement of OTP Bank Romania S.A. Although the information in this document has been prepared in good faith from sources which OTP Bank Romania S.A. believes to be reliable, we do not represent or warrant its accuracy and such information may be incomplete or condensed. The issuer of this report does not claim that the information presented herein is perfectly accurate or complete. However it is based on sources available to the public and widely believed to be reliable. Also the opinions and estimates presented herein reflect a professional subjective judgment at the original date of publication and are therefore subject to change thereafter without notice. Furthermore there can be no guarantees that any market developments will unfold as forecasted. Opinions and estimates constitute our judgment and are subject to change without notice.
OTP Bank Romania S.A. may have issued reports that are different or inconsistent with the information expressed within this report and is under no obligation to update or keep current the information contained herein.
OTP Bank Romania S.A. may hold a position or act as market maker in the financial instrument of any issuer discussed herein or act as advisor or lender to such issuer. This document is not intended to provide the basis for any evaluation of the financial instruments discussed herein. In particular, information in this document regarding any issue of new financial instruments should be regarded as indicative, preliminary and for illustrative purposes only, and evaluation of any such financial instruments should be made solely on the basis of information contained in the relevant offering circular and pricing supplement when available. OTP Bank Romania S.A. does not act as a fiduciary for or an advisor to any prospective purchaser of the financial instruments discussed herein and is not responsible for determining the legality or suitability of an investment in the financial instruments by any prospective purchaser.
This report is not intended to influence in any way or to be considered a substitute to research and advice centred on the specific investment objectives and constraints of the recipient (including tax concerns) therefore investors should obtain individual financial advice. Before purchasing or selling financial instruments or engaging investment services, please examine the prospectuses, regulations, terms, agreements, notices, fee letters, and any other relevant documents regarding financial instruments or investment services described herein in order to be capable of making a well-advised investment decision. Please refer to your competent adviser for advice on the risks, fees, taxes, potential losses and any other relevant conditions before you make your investment decision regarding financial instruments or investment services described herein. OTP Bank Romania S.A. in compliance with the applicable law, assumes no responsibility, obligation, warranty or guarantee whatsoever for any direct or indirect damage (including losses arising from investments), or for the costs or expenses, detrimental legal consequences or other sanctions (including punitive and consequential damage) sustained by any natural or legal person as a result of the purchase or sale of financial instruments or engaging investment services described herein, even if OTP Bank Romania S.A. was warned of the possibility of such occurrences.
Figures described herein refer to the past and past performance is not a reliable indicator of future results. Investments in financial instruments carry a certain degree of risk (fluctuation of share prices, uncertainty of dividend, yields and / or profits, exchange rate fluctuations, etc.). The capital invested is not guaranteed, investment gains, usually assumed proportionate to risk, and past performance of financial instruments is not a guarantee for future performance.
Please note that the Internet is not a secure environment and OTP Bank Romania S.A. does not accept any liability for any loss caused by the result of using this report in a form altered or delayed by the wilful or accidental interception, corruption or virus infection.

This document has been provided to the recipients upon their prior request. Your abovementioned permission may be withdrawn by an e-mail addressed to csaba.balint@otpbank.ro or a written mail addressed to OTP Bank Romania S.A , Buzesti Street, no. 66-68, 1st district, Bucharest, Romania. Please refer to your name and e-mail address in both cases.