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GDP REPORT

10 June 2019

Strong domestic demand fuelled Romania's economy in Q1; Slowdown could be just round the corner

- The NIS confirmed Romania's Q1 GDP growth pace at 5.0% YoY (gross data) and 1.3% QoQ (seasonally and working day adjusted data). These figures corresponds to a significant acceleration compared to Q4's 4.1% YoY and 1.0% QoQ advances (see Chart 1). We recall that back in May, the so called flash Q1 GDP estimate of the NIS caused a positive surprise, with the 5% growth data exceeding the market consensus (Reuters survey: 3.9%) as well as our expectation (4.1%). Non-farm private sector GDP, an indicator tracking underlying trends more accurately, pointed also to a sharp acceleration in the first quarter of this year (Chart 2).
- Undoubtedly, Q1's strong outturn improves the growth outlook for the whole year. However, we think that the more general picture is still unchanged. Most likely, Romania's economy has passed the peak of the business cycle and is heading for a deceleration over the coming years. Meanwhile, the particularly stretched government budget and revived inflation pressure leave no room for meaningful stimulus; on the contrary, tightening measures could come, particularly if an external shock appears. We recall that owing to the relatively high twin deficit, Romania seems to be more vulnerable than most of its peers in the CEE region.
- In line with the signal provided by high-frequency indicators (Chart 5), household consumption expenditure was the key driver behind Q1's robust GDP growth pace (Chart 3). Consumption grew rapidly, fuelled by a pick-up of real disposable incomes (Chart 6), as another round of minimum and public wage hikes came into force. Meanwhile, gross capital formation also revived, after posting a series of disappointing figures in 2018. The recovery of investments was mainly due to a sharp increase in new constructions, more detailed statistics revealed (Chart 7). Monthly construction output data suggest that the residential segment helped the most, but the other main components (non-residential and civil engineering) also played some role (Chart 8). On QoQ basis, exports fared relatively well (+2.4%, seasonally and working day adjusted data), with sales from earlier inventory, likely, also helping growth. Similarly to several other CEE countries, this outturn shows that on the short run export is rather resilient to the headwind coming from the weaker EZ economy. Nevertheless, despite this uptick, export was not able to keep pace with domestic-demand-fuelled imports (+3.0% QoQ). In addition, in annual comparison the gap between exports (3.5% YoY) and imports (9.5% YoY) continued to widen. Therefore, net exports registered an even larger negative contribution to Q1's annual GDP growth. It is also worth noting that the contribution of inventories to the growth decreased somewhat, from 3.2 pps to 2.4 pps, but historically this level is still particularly high, translating into a potential drag for the following quarters.
- On the production side (Chart 4), market services played the key role in Q1's acceleration, as expected, with the domestic-demand-sensitive retail trade and HORECA sectors performing particularly well. In addition, IT&C services also shifted into higher gear. Beside market services, value added of construction sector increased too, but growth in industry was subdued, owing to weakening external demand (Chart 9).
- Regarding the short-term outlook, it is worth mentioning that early soft data for the first two months of Q2 point to somewhat slower GDP growth (Chart 10). In addition, April's deceleration of retail sales and new passenger car registrations suggest that consumption may have started to lose steam. In Q1, net wages grew by 16.5% YoY on average, but we expect around two percentage points slower growth pace in Q2. This, together with higher inflation, is set to result in less impressive dynamics for real disposable incomes and, implicitly, is likely to limit consumption growth.
- In Q1, the residential segment of the construction sector supported investment, but we have some doubts if the segment will be able to keep growing as rapidly as in Q1. Keeping in mind some recent data about the real estate market (e.g. dwelling prices lost momentum, housing credit slowed a bit and transactions even fell at the beginning of 2019), a scenario of gradual cool-down seems more likely than further soaring (Chart 8). On the other hand, higher EU fund absorption likely will help but, in this case, the stretched government budget may become a bottleneck, while the spillover effect of earlier sector-level taxes is also a source of uncertainty.

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- Simultaneously, considering some unfavourable signs about the eurozone's economy (Chart 11), but still robust domestic demand, we think that net export will remain a drag on growth.
- In Q3, agricultural output could be a risk factor, as early estimations foresee a somewhat weaker harvest (Chart 12). But agriculture has caused significant positive surprises over the past two years. It remains to be seen whether the sector will be able to surprise on the upside again.
- To conclude, based on the very strong performance of the economy in Q1, together with the relaxation of the banking sector duty, we improved our 2019 GDP growth expectation to a fairly cautious 3.9% expansion rate (up from 3% in our previous report). Our cautiousness is due to some early signs about the domestic and global economy. We project a still robust growth pace of almost 3% increase for Romania in whole-year 2020. Nonetheless, we note that uncertainties are high as risks coming from the global environment seem to be on the rise, while a build-up of vulnerabilities can be observed on the domestic front.

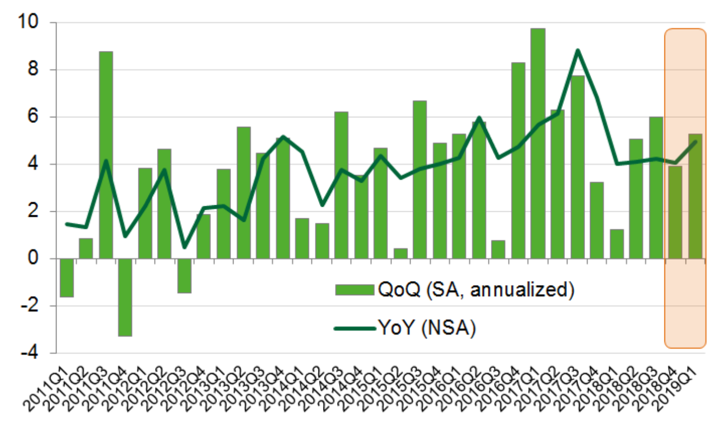
Main macro forecasts:

Indicators		2012	2013	2014	2015	2016	2017	2018	2019F	2020F
Real GDP	%	**2.1**	**3.5**	**3.4**	**3.9**	**4.8**	**7.0**	**4.1**	**3.9**	**2.9**
Final consumption of households	%	1.7	0.2	4.2	5.5	7.4	9.0	3.7	4.9	3.2
Cons. expenditure of housh.	%	1.6	2.0	4.2	5.9	8.3	10.1	5.3	5.3	3.3
Public consumption	%	7.5	-2.9	3.5	-0.3	2.2	2.6	1.8	2.0	1.8
Investment	%	3.1	-5.6	3.3	7.5	-0.2	3.5	-3.2	3.4	3.9
Exports	%	1.1	20.2	8.0	4.6	16.0	10.0	5.4	5.2	5.7
Imports	%	-1.8	8.8	8.7	8.0	16.5	11.3	9.1	6.6	6.2
Consumer prices	% annual avg	3.3	4.0	1.1	-0.6	-1.5	1.3	4.6	3.9	3.3
Government sector balance	in % of GDP	-3.7	-2.2	-1.3	-0.7	-2.7	-2.7	-3.0	-3.0	-3.0
Public debt	in % of GDP	37.0	37.6	39.2	37.8	37.3	35.2	35.0	35.3	36.0
Current account	in % of GDP	-4.8	-1.1	-0.7	-1.2	-2.1	-3.2	-4.5	-5.1	-5.5
Key interest rate	% annual avg	5.3	4.8	3.3	1.9	1.8	1.8	2.4	2.5	2.8
Key interest rate	% end of period	5.25	4.00	2.75	1.75	1.75	1.75	2.50	2.50	3.00
EUR/RON	annual avg	4.46	4.42	4.44	4.44	4.49	4.57	4.65	4.75	4.82
EUR/RON	end of period	4.43	4.48	4.48	4.52	4.54	4.66	4.66	4.78	4.84
Nominal GDP	RON bn.	593.7	635.5	668.6	712.6	765.1	856.7	944.2	1,024	1,094
Unemployment	%	6.8	7.1	6.8	6.8	5.9	4.9	4.2	3.9	3.9
Nominal wage growth	%	4.2	4.8	7.6	9.8	9.9	14.7	13.1	14.9	8.2
Real wage growth	%	0.8	0.8	6.5	10.4	11.7	13.2	8.1	10.5	4.7
Nominal GDP	EUR bn.	133.2	143.8	150.4	160.3	170.4	187.6	202.9	216	227

Sources: NIS, NBR, Eurostat, OTP Research

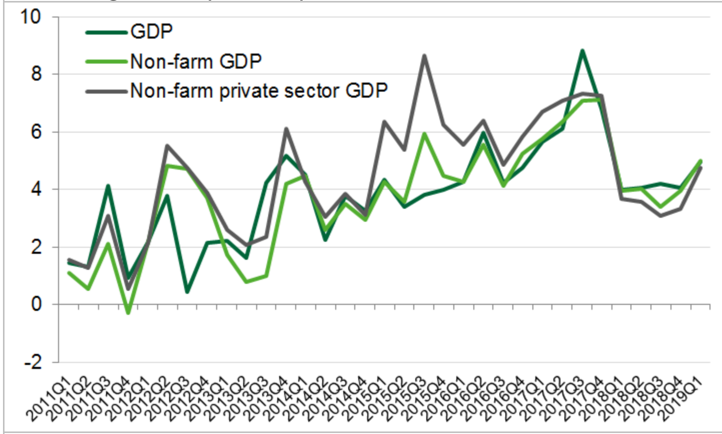
Chart set:

Chart 1: Summary chart of GDP growth (%)



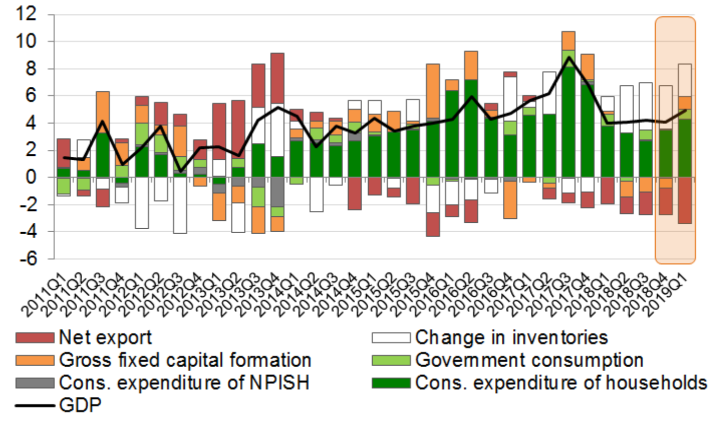
Sources: NIS, OTP Research

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



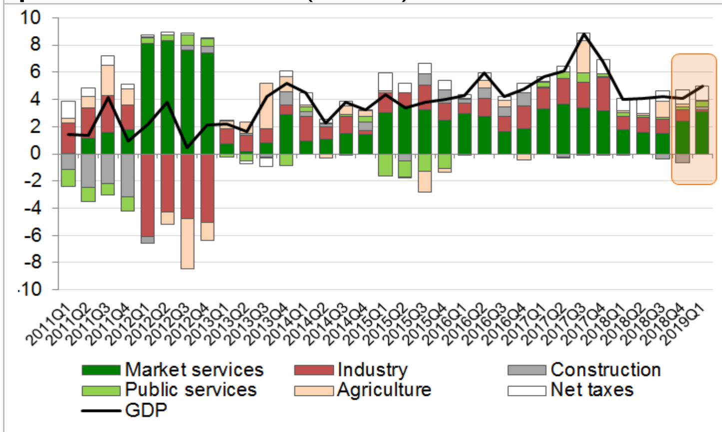
Sources: NIS, OTP Research

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



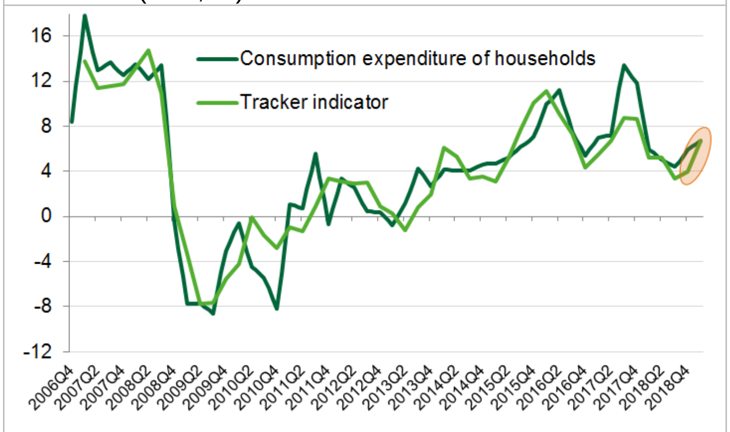
Sources: NIS, OTP Research

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



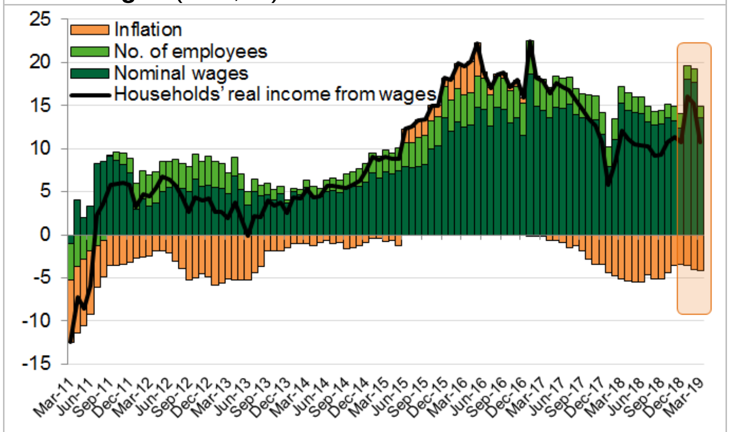
Sources: NIS, OTP Research
Note: in 2012, the sharp increase in market services' and the significant fall in industry's contribution to growth was mainly the result of a methodological change of the NIS

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



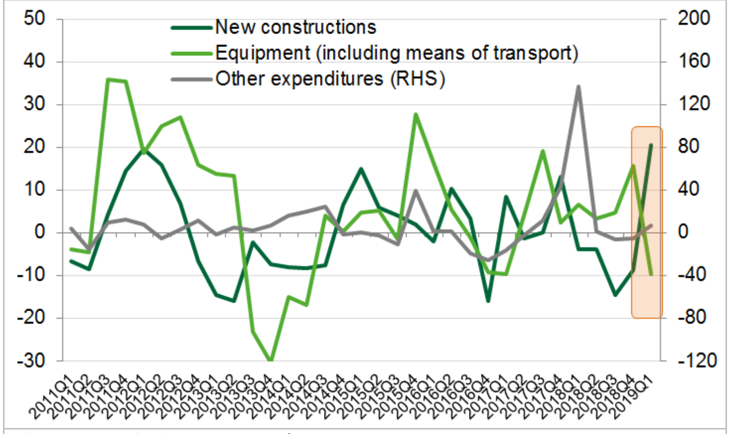
Sources: NIS, OTP Research
Note: the consumption tracker is an in-house composite indicator based various high-frequency indicators, including among others retail sales and passenger car registration data

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



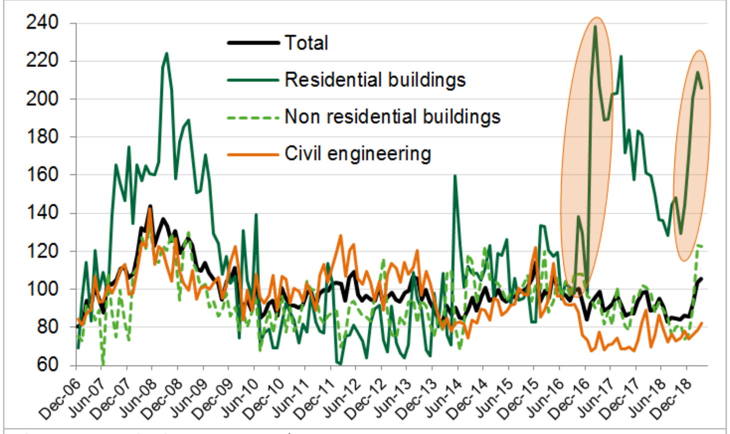
Sources: NIS, OTP Research

Chart 7: Net investment by types
(YoY, %)



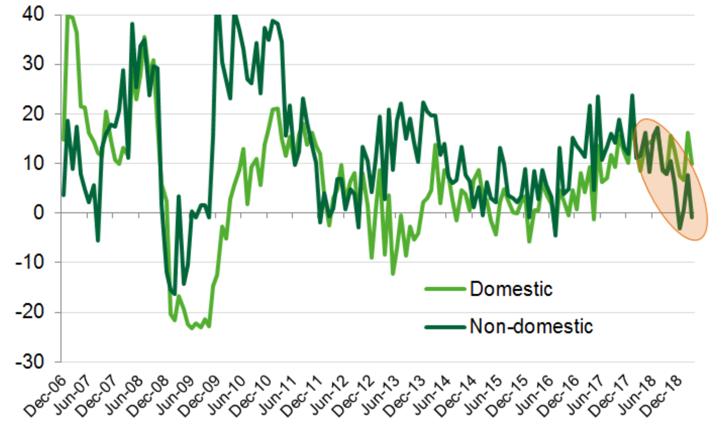
Sources: NIS, OTP Research

Chart 8: Construction works
(2015 av.=100)



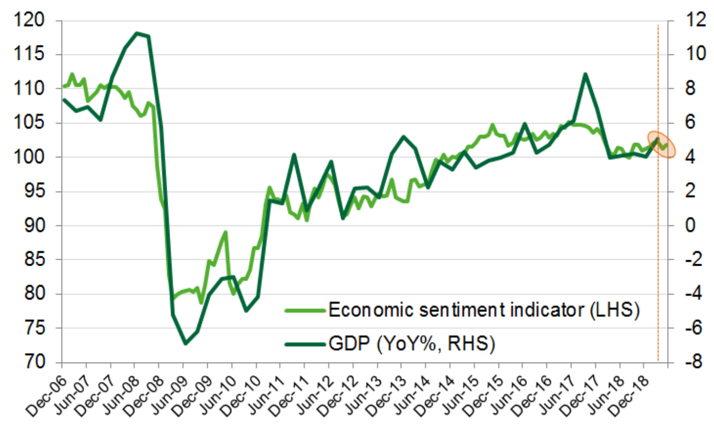
Sources: NIS, OTP Research

Chart 9: Turnover value indices in industry
(YoY, %)



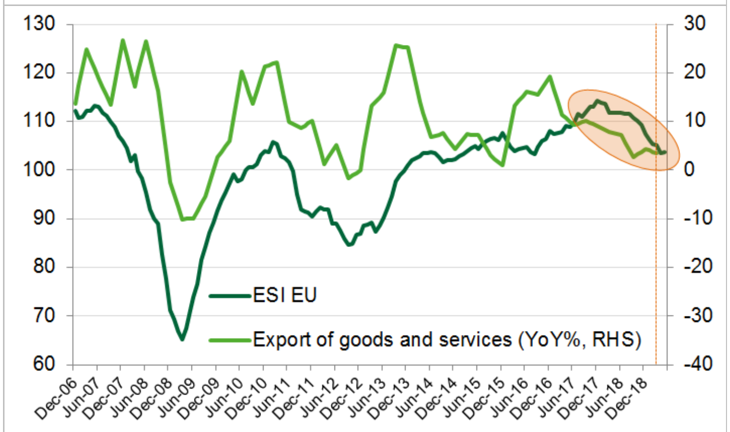
Sources: NIS, OTP Research

Chart 10: GDP growth vs. economic sentiment indicator



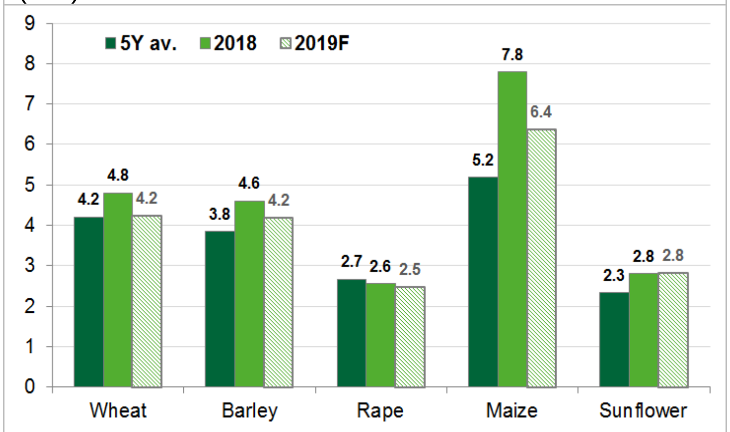
Sources: NIS, EC, OTP Research

Chart 11: Romanian exports and EU level economic sentiment indicator



Sources: NIS, EC, OTP Research

Chart 12: Crop yields
(t/ha)



Sources: EC, OTP Research

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