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GDP REPORT

11 September 2018

As expected, growth picked up in Q2, fuelled by rebounding consumption; investment disappointed

- In the second quarter of this year, Romania's economy posted 4.1% advance (gross data; Chart 1), up from 4.0% in the period of January-March. On QoQ basis, the economy registered 1.4% QoQ gain (seasonally and working day adjusted data), propelled by re-accelerating wage growth and higher consumer confidence. This upswing came after a quite disappointing Q1 reading (+0.1% QoQ). Non-farm private sector GDP, a better indicator for underlying trends, posted 3.6% annual (Chart 2) and 0.9% quarterly increases.
- About the big picture: it is important to mention that Romania's economy had been firing on all cylinders, outpacing most of its peers in the CEE region in the past few years, but GDP growth has lost some momentum since 2017, as the fiscal fuel started to run out of steam, monetary policy turned less accommodative and external economic condition also became less supportive. Therefore, the country's growth pace is expected to align with its potential in the years ahead. Nonetheless, we reiterate that risks coming from strongly pro-cyclical and miscalibrated fiscal policy led to higher downside risks over the medium and long term.
- The expenditure side of Q2 GDP data pointed to some soft spots, as only consumption expenditures and the change in inventories registered positive contribution to growth (Chart 3). It is worth mentioning that the latter item frequently shows large swings and, therefore its Q2's increase could easily reverse in the following quarters. In Q2, consumption expenditure recorded robust growth rates (1.6% QoQ and 5.1% YoY), after disappointing in the past two quarters (Chart 5). We note that in the first quarter of this year, household consumption decelerated sharply as net wage growth lost steam on the back of important tax changes (transferring the burden of social contributions from employers to employees) and significant base effects. This, coupled with soaring inflation, sharply rising borrowing costs, and plunging confidence had a negative effect on consumption expenditures. Nevertheless, household consumption fared well in the second quarter, fuelled by the re-acceleration of wages (Chart 6) and recovering confidence (Chart 7).
- Investment into fixed assets were the most disappointing parts of the NIS report, as it shaved off around 0.7 percentage points from the annual GDP growth, after registering positive contributions in the past few quarters (Chart 3). In QoQ terms, gross fixed capital formation (GFCF) fell for the second consecutive quarter (Chart 5). It is worth mentioning that while household consumption exceeded its previous peak by a wide margin, GFCF failed to reach the levels seen in 2008, an unfavourable feature of the current economic expansion cycle. More detailed data reveal that the annual growth rate of investment into new constructions remained in negative territory, and equipment as well as other investment expenditures decelerated too (Chart 8). In the case of constructions, high-frequency statistics suggest that the cooling residential market could have played a role in the drop (Chart 9). On the other hand, civil engineering (covering mostly investment into infrastructure) picked up a bit in H1 2018, but from a particularly subdued level. We recall that, in the past few years, scaling back public investments was a key tool of authorities to keep the government budget deficit close to the 3% target. Undoubtedly, cash-flow-based government budget figures for H1 pointed to improvements in public investment, but a significant portion of the increase came from the acquisition of a missile system with limited impact on real economy.
- In light of Q2 figures, the government budget constraints, sluggish EU fund absorption, and rather soft data on home purchasing intentions (Chart 10), we became less optimistic about the short-term outlook of investments. However, as the shock of higher borrowing costs fades (ROBOR rates eased most recently), the tight labour market (Chart 11) provides support for households' confidence and the labour shortage is also expected to urge companies to invest into new technology; moreover, as EU fund absorption should pick up more significantly at the end of the 2014-2020 budgeting period, we think that investment will gain some momentum in the years ahead.

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- On the production side, the fresh statistics mimicked Q1 data (Chart 4), in line with our expectations. Market services remained the key driver of the economy, with the trade sub-sector benefiting from the recovering domestic demand, while the ITC segment continued to deliver the fastest growth pace among the main branches of the services sector (5.1% YoY). At the same time, industrial output was also an important contributor to GDP growth.
- Regarding the short-term perspective, we think that a deceleration of the annual growth rate may come in Q3 chiefly because of an important base effect (in Q3 2017, Romania's economy posted a very strong 2.2% QoQ increase). Economic sentiment data for July and August were rather soft too, with the ESI indicator hovering near its Q2 level (Chart 12). After 2017's excellent harvest, we assume that agricultural output may decrease somewhat this year, with a negative effect on Q3's growth (agriculture has a relatively large weight in Q3 GDP due to seasonality). Nevertheless, it is important to note that incoming information are ambiguous. On the one hand, the official estimation of the European Commission showed that early crops like wheat, barley and rape recorded lower yields than in 2017 owing to dry weather conditions (Chart 13), while maize and sunflower, which are harvested later and benefited from the abundant precipitation in June and July, fared well. On the other hand, the Minister of Agriculture said that even wheat output was excellent, exceeding last year's production. Another uncertainty factor is the impact of the African swine fever. The total number of pigs affected by the disease or slaughtered has reached almost 160,000 according to the latest (6 September) statistics of the ANSVSA (National Authority for Veterinary Health and Food Safety). This represents around 4% of 2017's total livestock of swine. According to our estimation, the negative impact of the disease is far less than 0.1% of GDP, but it is difficult to see how the situation may evolve in the following period.
- In all, we keep our 3.9% growth estimate unchanged for this year (we revised downward our 2018'projection from 4.0% before Q2 data saw the light of day), but it is important to mention that the outlook remains surrounded by uncertainties, among others, coming from agriculture output, while the latest disappointment in investment does not bode well for the outlook, either. Regarding 2019, we think that GDP growth may slow slightly, to 3.7%. The particularly strong labour market is an upside risk: if coupled with strong confidence, it could lead to higher-than-expected domestic demand (elections will be held too, with the risk of further populist measures). However, overall, we think that risks are tilted rather to the downside owing to less supportive external conditions and limited fiscal room for addressing economic shocks.

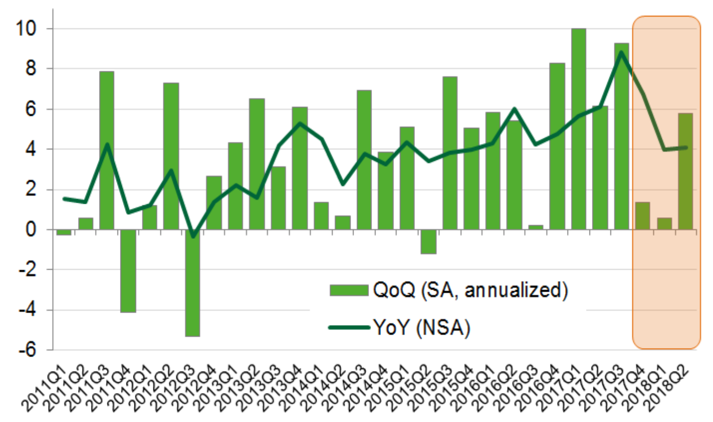
Main macro forecasts

Key economic indicators		2011	2012	2013	2014	2015	2016	2017	2018F	2019F
Real GDP	%	**2.0**	**1.2**	**3.5**	**3.4**	**3.9**	**4.8**	**6.9**	**3.9**	**3.7**
Final consumption of households	%	1.3	2.4	-2.4	4.2	5.5	8.0	8.2	4.1	3.6
Cons. expenditure of housh.	%	1.4	1.7	2.6	4.2	5.9	8.1	10.2	5.4	4.1
Public consumption	%	0.2	0.3	-4.6	3.5	-0.3	3.2	1.0	-0.8	1.4
Investment	%	6.2	3.6	-5.4	3.3	7.5	-2.1	4.7	1.1	3.7
Exports	%	11.9	1.0	19.7	8.0	4.6	8.7	9.7	7.6	7.1
Imports	%	10.1	-1.8	8.8	8.7	8.0	9.8	11.3	8.5	7.2
Consumer prices	% annual avg	5.8	3.3	4.0	1.1	-0.6	-1.5	1.3	4.7	3.1
Government sector balance	in % of GDP	-5.4	-3.7	-2.1	-1.4	-0.8	-3.0	-2.9	-3.0	-2.9
Public debt	in % of GDP	34.0	36.9	37.5	39.1	37.7	37.4	35.0	35.0	35.5
Current account	in % of GDP	-5.0	-4.8	-1.1	-0.7	-1.2	-2.1	-3.3	-3.8	-3.9
Key interest rate	% annual avg	6.2	5.3	4.8	3.3	1.9	1.8	1.8	2.5	3.1
Key interest rate	% end of period	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.75	3.25
EUR/RON	annual avg	4.24	4.46	4.42	4.44	4.44	4.49	4.57	4.66	4.69
EUR/RON	end of period	4.32	4.43	4.48	4.48	4.52	4.54	4.66	4.66	4.72
Nominal GDP	RON bn.	562.1	595.4	635.5	668.6	712.6	767.4	858.7	938	1,008
Unemployment	%	7.2	6.8	7.1	6.8	6.8	5.9	4.9	4.5	4.4
Nominal wage growth	%	4.1	4.2	4.8	7.6	9.8	9.9	14.8	12.9	9.1
Real wage growth	%	-1.6	0.8	0.8	6.5	10.4	11.7	13.3	7.8	5.8
Nominal GDP	EUR bn.	132.6	133.6	143.8	150.4	160.3	170.9	188.0	201	215

Sources: NIS, NBR, Eurostat, OTP Research

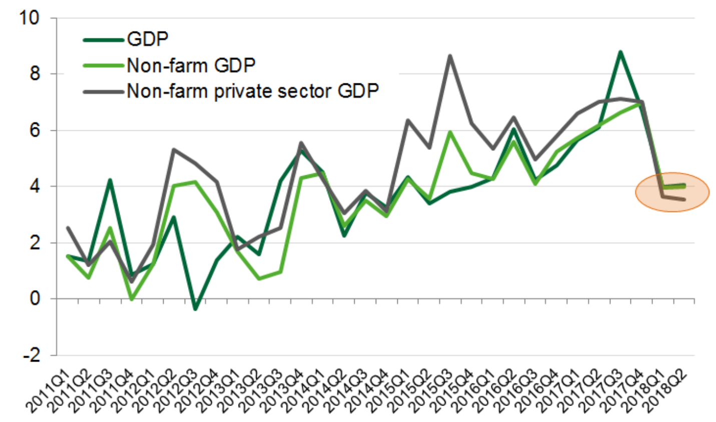
Chart set:

Chart 1: Summary chart of GDP growth (%)



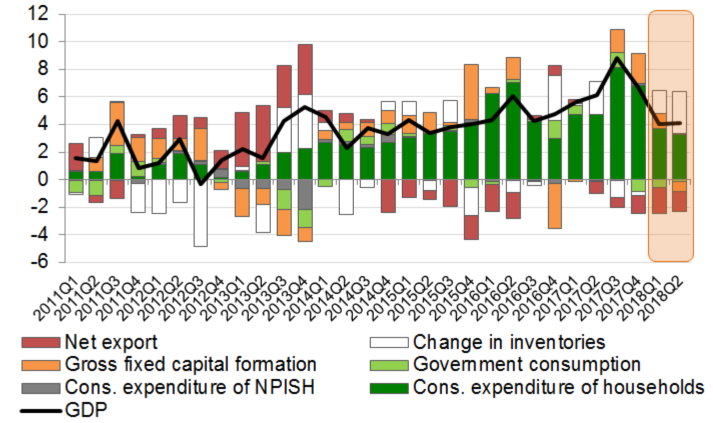
Sources: NIS, OTP Research

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



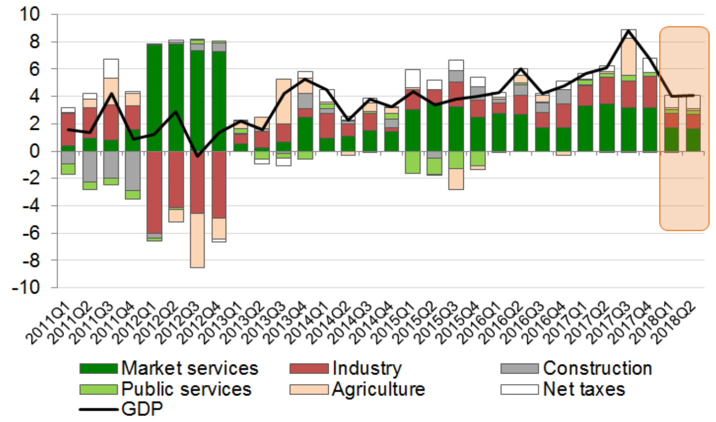
Sources: NIS, OTP Research

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



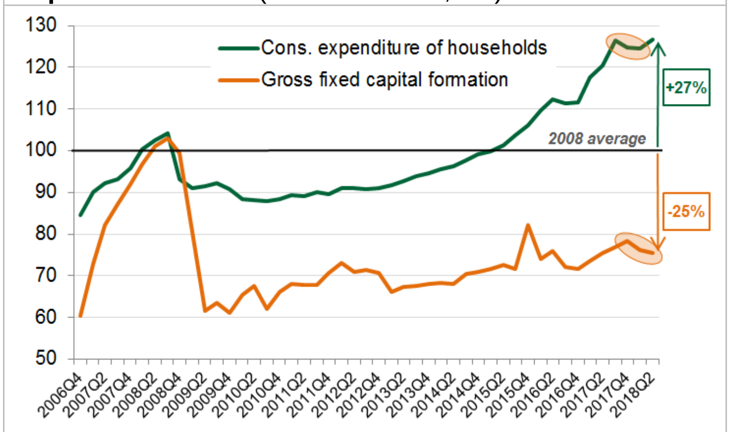
Sources: NIS, OTP Research

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



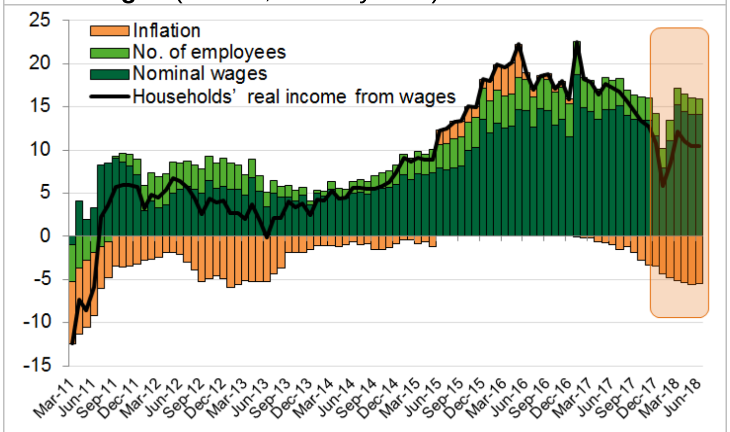
Sources: NIS, OTP Research

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



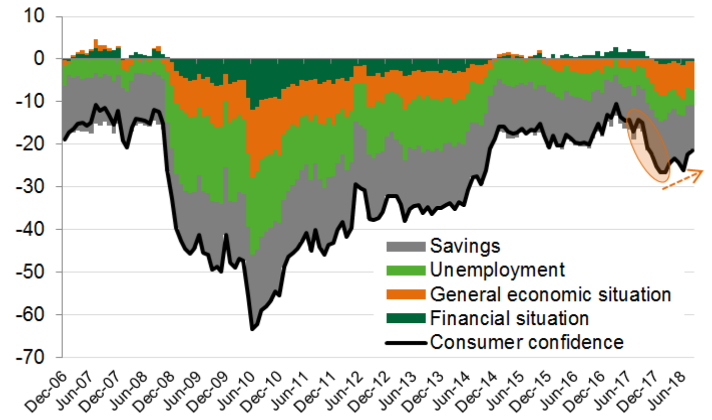
Sources: NIS, OTP Research

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



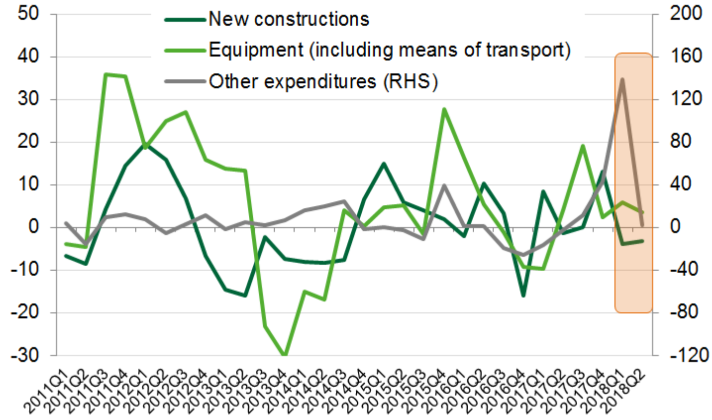
Sources: NIS, OTP Research

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



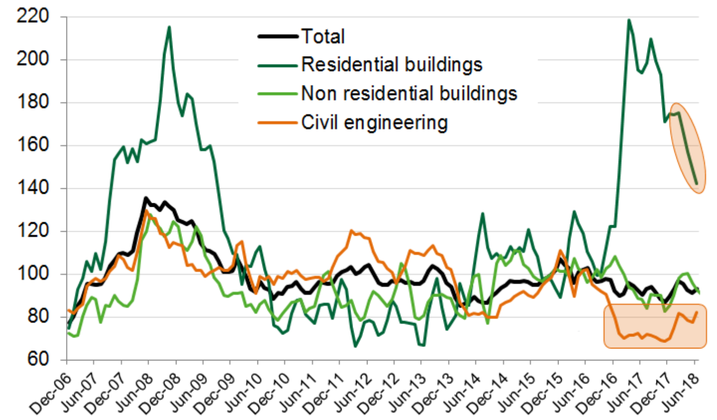
Sources: EC, OTP Research
Note: the components of the consumer confidence indicator reflect the expectation of households over the next 12 months

Chart 8: Net investment (YoY %)



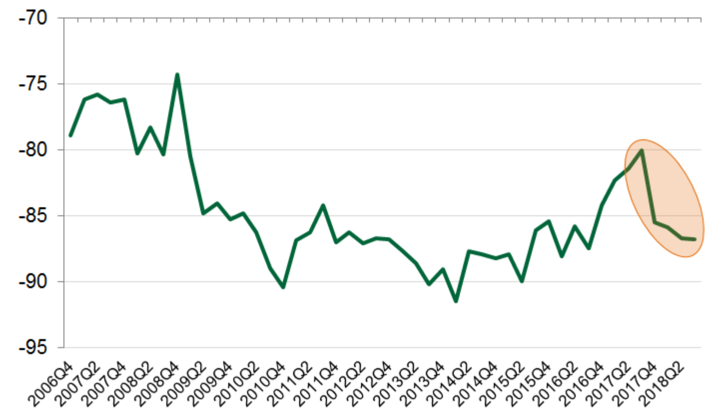
Sources: NIS, OTP Research

Chart 9: Construction production (2010 av. = 100, 3M mov. av.)



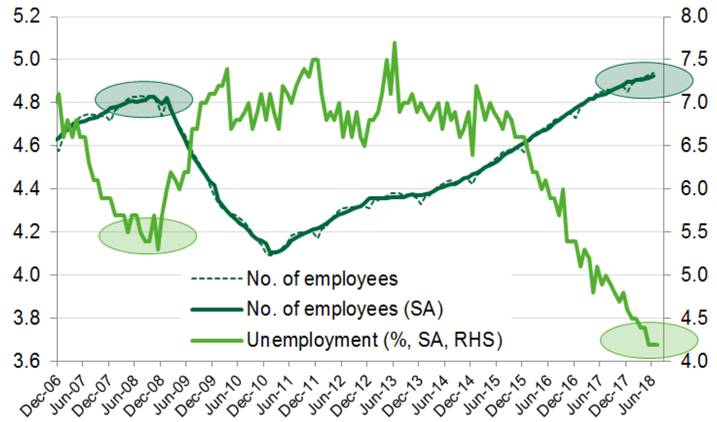
Sources: NIS, OTP Research

Chart 10: Intention to purchase or build a home within the next 12 months (balance of opinions)



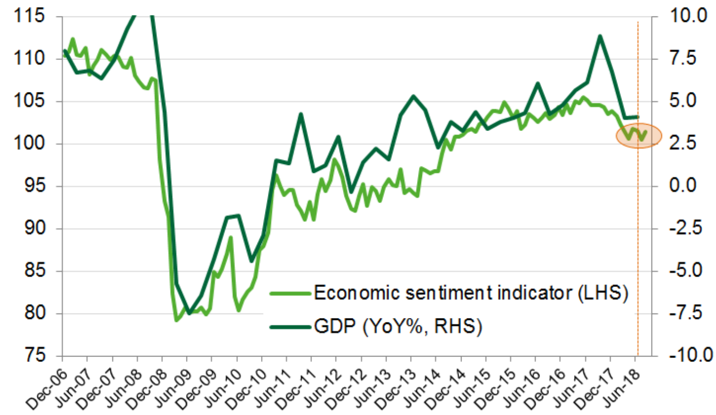
Sources: EC, OTP Research

Chart 11: Labour market indicators



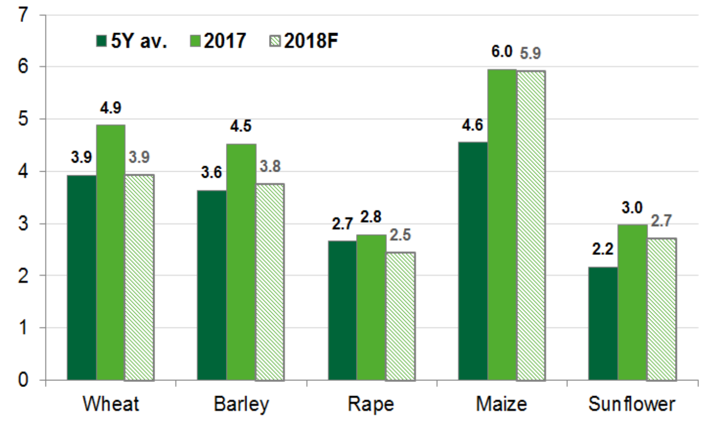
Sources: NIS, OTP Research
Note: no. of employees at entities with at least four employees

Chart 12: GDP growth vs. economic sentiment indicator



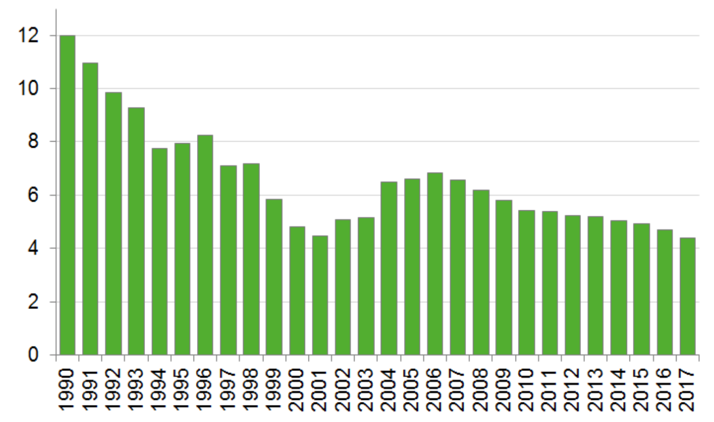
Sources: NIS, EC, OTP Research

Chart 13: Crop yields
(t/ha)



Sources: EC, OTP Research

Chart 14: Swine livestock
(in mn)



Sources: NIS, OTP Research

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