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GDP REPORT

10 December 2018

Agriculture caused Q3's positive surprise; our GDP growth forecast revised to 4.1%

- The National Institute of Statistics confirmed Romania's Q3 GDP growth rate at 4.3% YoY (NSA; see Chart 1) and 1.9% QoQ (SA). This came after Q2's 4.1% YoY and 1.5% QoQ increases. It is worth mentioning that last month, when the NIS released its first estimate on Q3 GDP, the data caused significant positive surprise. Analysts, including us, had expected Romania's GDP growth to slow near 3% rather than running above 4%, a Reuters poll had showed. In November, the NIS's flash estimate did not reveal the sectorial details of Q3 data but we had assumed that better-than-expected agricultural output could have played a key role in the surprise and, indeed, good harvest boosted growth by adding 1.1 percentage point to Q3's 4.3% advance, the fresh statistics revealed. Nevertheless, non-farm private sector GDP, our preferred underlying indicator, pointed to a deceleration (2.8% YoY in Q3 vs. 3.6% YoY in Q2; see chart 2).
- Regarding the more general picture, we recall that, in the past few years, Romania recorded particularly strong advances. Nonetheless, since 2017, the country's growth pace has lost some steam, as the impact of earlier fiscal stimulus measures had started to diminish, monetary policy turned less accommodative, and the momentum of the eurozone's economy also softened. We expect Romania's GDP growth to align gradually with its potential in the following years, but it is important to add that downside risks have increased on the back of pro-cyclical fiscal policy and uncertainties around the perspective of the global economy.
- On the expenditure side, household consumption grew surprisingly rapidly on QoQ basis (3.6%). Nonetheless, it is worth mentioning that seasonally adjusted quarterly statistics are often noisy, and are subject to revisions. For instance, our in-house seasonally adjusted data point to a much slower increase (1.1% QoQ). In any case, consumption expenditure lost a bit of steam in annual comparison, which better suits the picture painted by high-frequency indicators (Chart 5). Owing to this modest year-over-year slow-down, household consumption expenditure registered a smaller contribution to annual GDP growth, but still has remained a key engine of the economy (Chart 3). On the other hand, gross fixed capital formation (GFCF) recorded a negative contribution to the growth. The good news is that GFCF shaved off from the increase less than it did a quarter earlier, as investments into equipment picked up (Chart 8). In Q3, the build-up of inventories helped again. However, this poses a warning sign, as the increase in inventories may reverse quickly, with a significant negative effect on future growth.
- As expected, net exports continued to weigh on the economy after domestic-demand-fuelled imports slowed less than exports. The sluggish performance of exports (-0.5% QoQ and 2.8% YoY) was probably the result of slower growth in the eurozone. In Q3, the eurozone's GDP grew by 0.2% QoQ and 1.6% YoY, down from 0.4% QoQ and 2.2% YoY in the previous quarter. Since the EU accession, Romania's economy has become more open and connected to the European community, with the share of total exports in GDP reaching around 42% in 2018, up from 32% in 2006 (Chart 9). In addition, the structure of exports became more concentrated, with machinery and transport equipment giving 46% of total exported goods, up from 30% in 2006 (Chart 10). The country's integration into the European value chains has provided an extraordinary boost for the Romanian economy in the past decade. Nonetheless, it also led to higher sensitivity to the global economic cycle, with downside risks when external conditions worsen.
- Despite mixed weather conditions and the African swine fever, agriculture performed particularly well in Q3, with real value added exceeding even last year's excellent output. We think that this was the result of structural progress, which has taken shape in the sector in recent years. Farms became more productive (Chart 11), taking advantage of EU funds as well as bank loans (banks' exposure to agriculture has almost tripled over the past decade), while the footprint of foreign investors using advanced technologies has increased too.

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- Market services grew somewhat slower than a quarter earlier (0.5% QoQ vs. 0.8% QoQ in Q2), but on annual basis, the sector remained a very important contributor to GDP growth (Chart 4). Among the components of market services, IT&C, probably Romania's most successful domain, showed the largest increase (2.1% QoQ and 7.9% YoY). The growth pace of industry slowed somewhat on QoQ basis, but in annual comparison it remained healthy. Meanwhile, value added in construction dropped and, accordingly, the sector was again the weakest link of the economy. Detailed high-frequency data indicate that the annual growth of construction output was dragged down by the cooling residential segment amid higher borrowing costs. This came after a strong revival in 2017. Civil engineering works recorded a marginal increase compared to its very low level in the same period of the previous year.
- Summing it up, we think that Romania's economy may register somewhat slower but still robust growth paces in the following few years, as the unusually tight labour market (Chart 12) is expected to support consumption. Simultaneously, gross fixed capital formation may recover owing to higher EU fund absorption and because capacity constraints are set to urge companies to invest more. Because of Q3's strong outturn, we expect Romania's economy to increase by 4.1% this year, faster than previously thought (we had expected 3.8% rise, before Q3 data were revealed). In 2019, we see the country's GDP to grow by 3.7%. However, we underscore that downside risks are on the rise due to increasing uncertainties around global economic growth. We think that, at this moment, Romania is much more resilient than in was before the 2008 financial crisis, but it seems to be more vulnerable than most of its peers in the CEE region because of relatively high twin deficits. Given this context, if external shocks appear, fiscal and monetary policy has to be tightened. Therefore, a potential downturn on the external front could quickly derail the country's growth path from our base scenario.

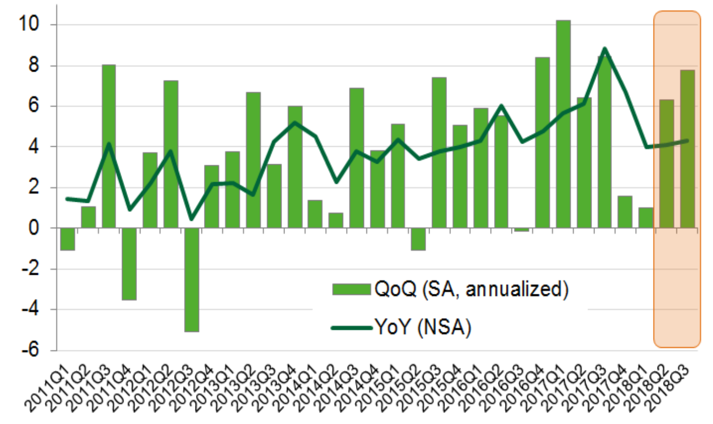
Main macro forecasts

Key economic indicators		2011	2012	2013	2014	2015	2016	2017	2018F	2019F
Real GDP	%	**2.0**	**2.1**	**3.5**	**3.4**	**3.9**	**4.8**	**6.9**	**4.1**	**3.7**
Final consumption of households	%	0.0	1.7	0.2	4.2	5.5	8.0	8.2	4.6	4.4
Cons. expenditure of housh.	%	1.6	1.6	2.0	4.2	5.9	8.1	10.2	5.2	4.8
Public consumption	%	-1.2	7.5	-2.9	3.5	-0.3	3.2	1.0	-0.6	1.4
Investment	%	6.1	3.1	-5.6	3.3	7.5	-2.1	4.7	0.9	3.7
Exports	%	12.1	1.1	20.2	8.0	4.6	8.7	9.7	5.9	5.1
Imports	%	10.1	-1.8	8.8	8.7	8.0	9.8	11.3	8.0	5.8
Consumer prices	% annual avg	5.8	3.3	4.0	1.1	-0.6	-1.5	1.3	4.7	3.2
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	37.6	39.2	37.8	37.2	35.1	35.0	35.4
Current account	in % of GDP	-5.0	-4.8	-1.1	-0.7	-1.2	-2.1	-3.2	-4.1	-4.3
Key interest rate	% annual avg	6.2	5.3	4.8	3.3	1.9	1.8	1.8	2.4	2.8
Key interest rate	% end of period	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.50	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.	559.2	593.7	635.5	668.6	712.6	767.4	858.7	943	1,014
Unemployment	%	7.2	6.8	7.1	6.8	6.8	5.9	4.9	4.2	4.1
Nominal wage growth	%	4.1	4.2	4.8	7.6	9.8	9.9	14.8	12.9	10.1
Real wage growth	%	-1.6	0.8	0.8	6.5	10.4	11.7	13.3	7.8	6.7
Nominal GDP	EUR bn.	132.0	133.2	143.8	150.4	160.3	170.9	188.0	202	216

Sources: NIS, NBR, Eurostat, OTP Research

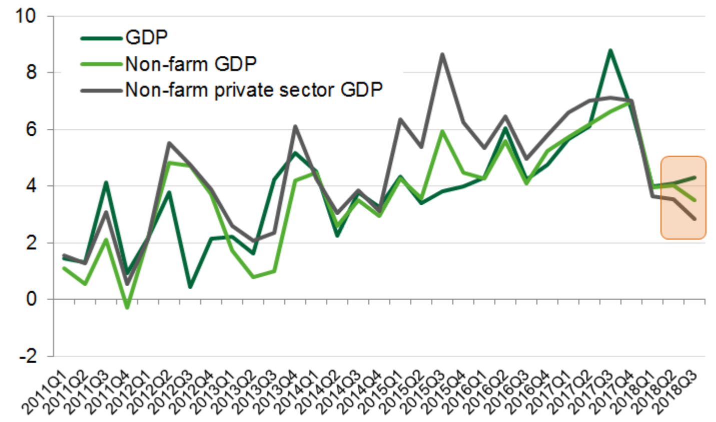
Chart set:

Chart 1: Summary chart of GDP growth (%)



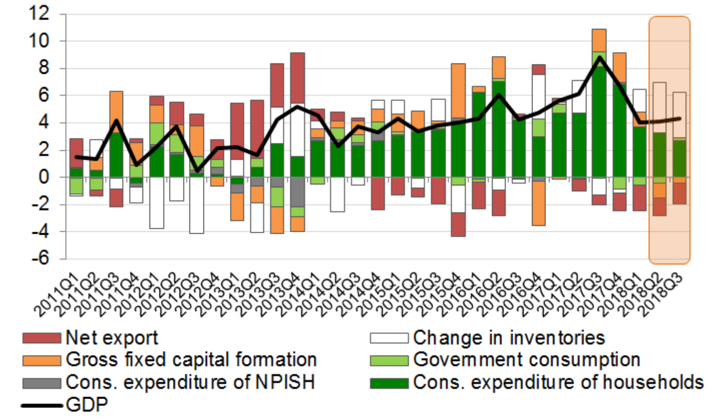
Sources: NIS, OTP Research

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



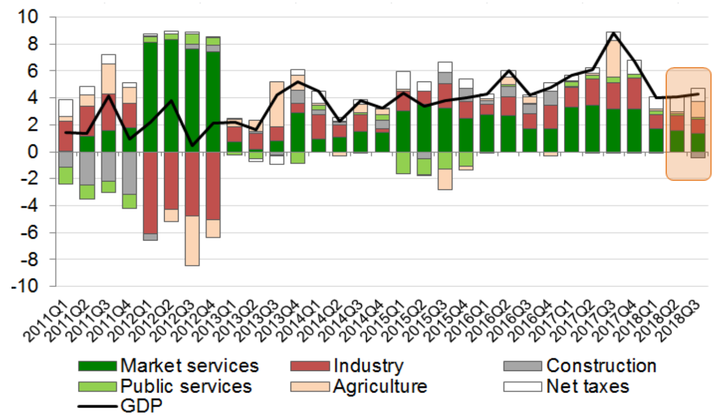
Sources: NIS, OTP Research

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



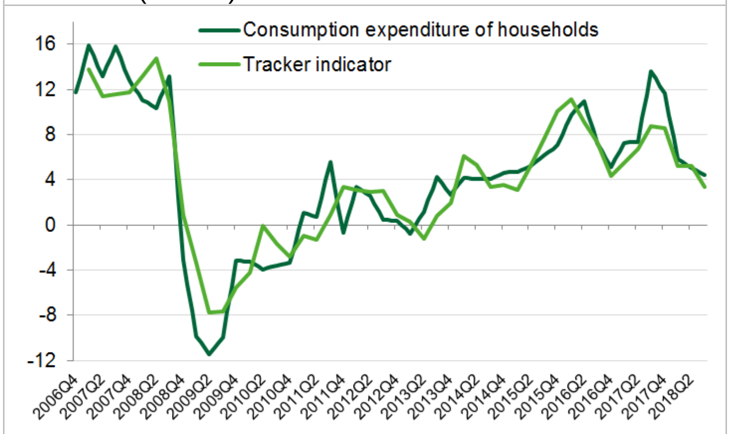
Sources: NIS, OTP Research

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



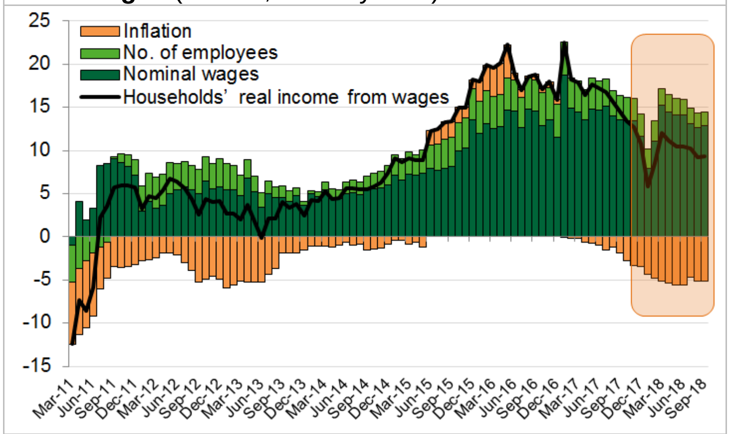
Sources: NIS, OTP Research

Chart 5: 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 %, monthly data)



Sources: NIS, OTP Research

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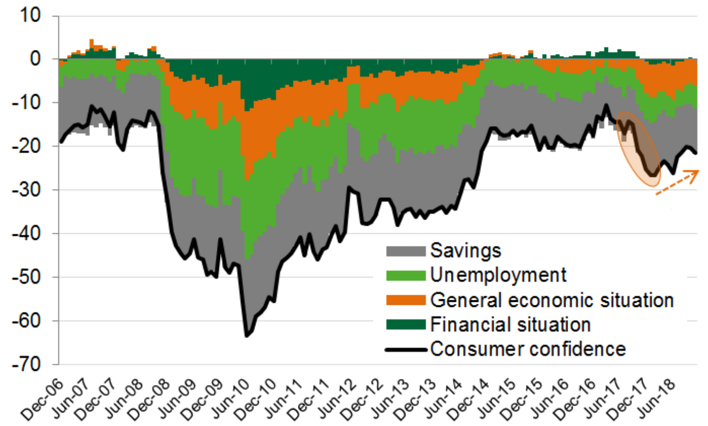
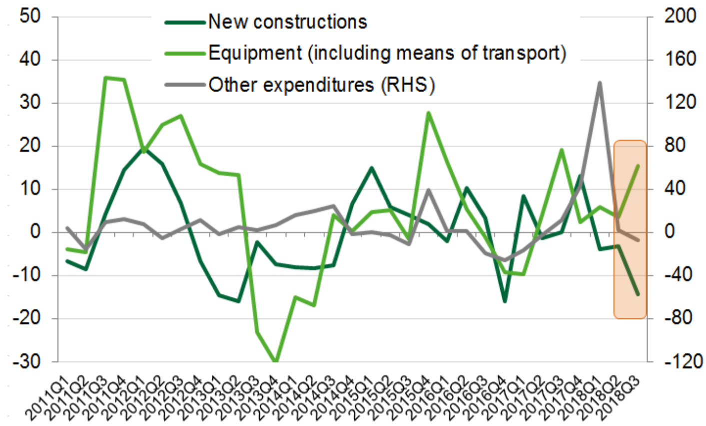
Chart 7: Decomposition of consumer confidence indicator (balance of opinions)



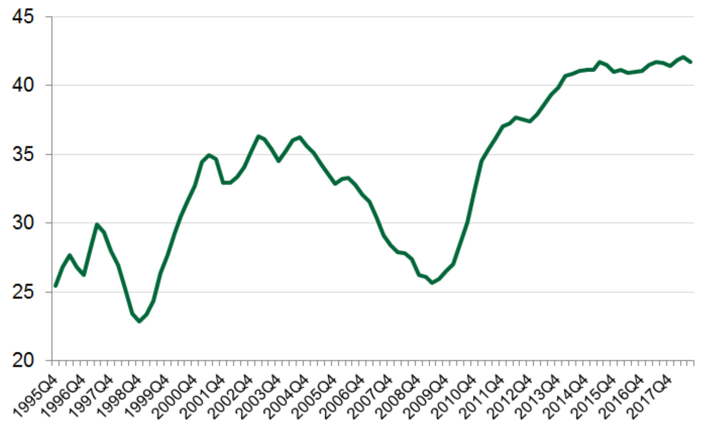
Sources: EC, OTP Research
Note: the components of the consumer confidence indicator reflect the expectation of households over the next 12 months

Chart 8: Net investment
(YoY %)



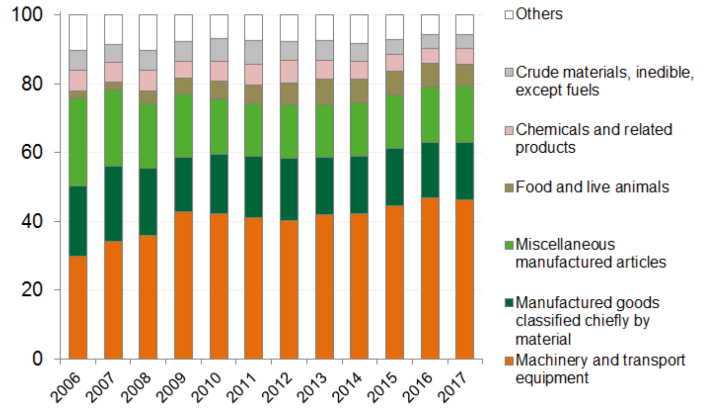
Sources: NIS, OTP Research

Chart 9: Share of exports in GDP
(%, 4Q rolling average)



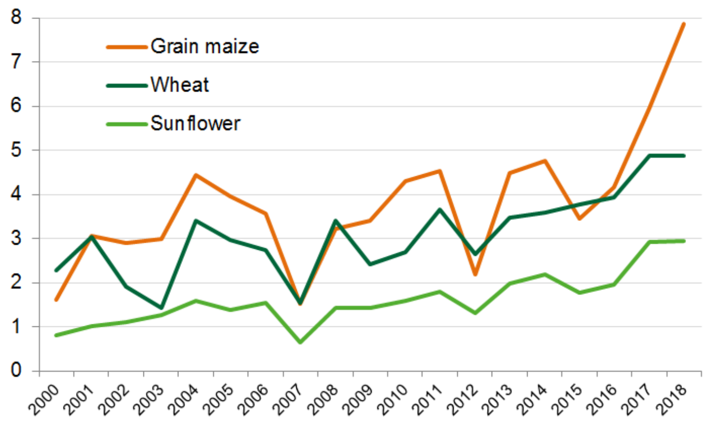
Sources: NIS, OTP Research

Chart 10: Structure of exported goods
(%)



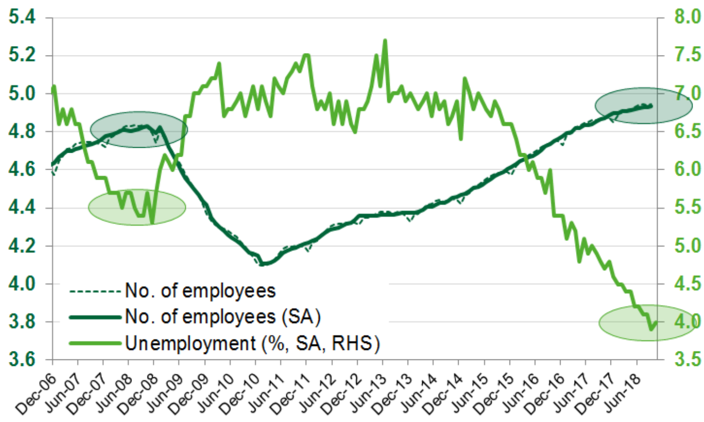
Sources: NIS, OTP Research

Chart 11: Crop yields
(tonne/ha)



Sources: Eurostat, OTP Research

Chart 12: Labour market indicators



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

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