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MACROECONOMIC

Slowing growth and deteriorating inflation outlook

Quarterly report,
Webinar, 7 April 2022

OUTLOOK

GROWTH SLOWS, INFLATION TO INCREASE FURTHER, FISCAL CONSOLIDATION SLOWS WHILE THE CURRENT ACCOUNT DETERIORATES

- Headwinds in the global economy have increased after the escalation of the Russia-Ukraine conflict. .
- **GDP** growth slows below 2% in 2022 as inflation erodes real incomes, policies tighten, and supply chain problems could intensify.
- With the extension of the energy price cap, the **inflation** could peak soon, although increasing food prices, will push the index further upwards until late spring.
- The **central bank** will continue tightening, the base rate could reach 4.5% by the end of 2022
- **Fiscal consolidation** slows, as energy support has fiscal costs, just as plans for tax cuts.
- The spike in energy prices worsens the **current account** further.

OUTLOOK

GROWTH SLOWS, INFLATION TO INCREASE FURTHER, FISCAL CONSOLIDATION SLOWS WHILE THE CURRENT ACCOUNT DETERIORATES

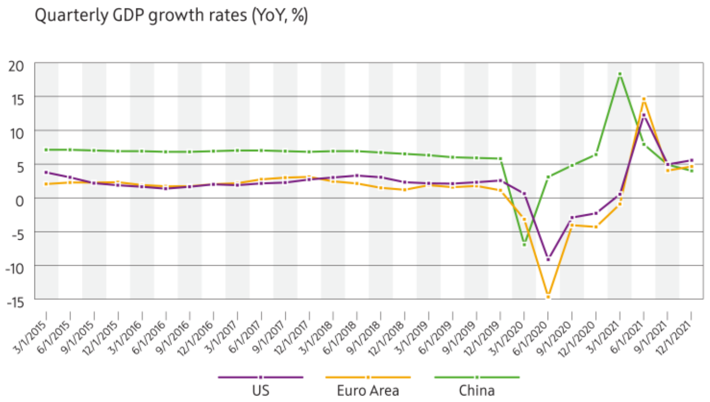
	OTP forecast					Market consensus*		
	2019	2020	2021	2022	2023	2021	2022	2023
Real economy (YoY, %)								
Real GDP	4.2	-3.7	5.9	1.7	3.3	5.6	4.0	4.3
Cons. expenditure of housh.	3.8	-4.8	7.5	3.7	3.1	6.5	4.5	4.2
Public consumption	8.0	1.5	-1.0	2.7	3.0	0.6	2.0	1.6
Investment	12.7	4.4	4.0	2.6	6.9	6.0	6.7	7.0
Exports	4.6	-9.3	11.5	2.6	4.0	12.0	6.2	5.6
Imports	8.8	-5.9	14.2	2.3	3.8	13.7	5.8	5.3
Prices and labour market (YoY, %)								
Consumer prices	3.8	2.6	5.0	8.0	4.3	5.0	7.8	4.2
Nominal wage growth	14.9	6.7	7.1	9.0	7.0	7.1	8.1	7.5
Government and BOP (% of GDP)								
Government sector balance	-4.4	-9.4	-7.1	-7.0	-6.0	-7.1	-6.0	-4.9
Public debt	35.3	47.4	48.9	52.5	55.2	49.9	51.5	52.2
Current account	-4.9	-5.1	-7.0	-8.5	-7.9	-6.8	-6.3	-5.9
Interest rate and exchange rate								
Key interest rate (%, eop)	2.50	1.50	1.75	4.50	4.00	1.75	3.56	3.61
EURRON (eop)	4.79	4.87	4.95	5.05	5.15	4.95	5.01	5.02

Source: OTP bank, Focus Economics

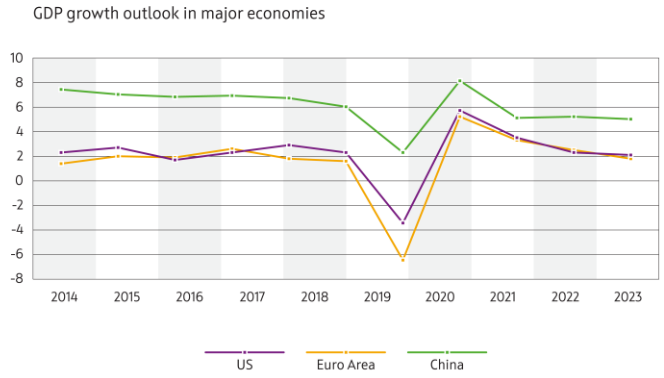
GLOBAL ECONOMY

ALL MAJOR ECONOMIES HAVE RECOVERED FROM THE COVID, HOWEVER HEADWINDS ARE INCREASING

Quarterly GDP growth rates (YoY, %)



GDP growth and outlook in major economies



With ample policy support, all major economies have exceeded their pre-pandemic level. The euro area was the last economy to complete this task by 2022Q4

However, the recovery has been accompanied by a sharp rise in inflation in the US and Europe, on account of supply chain bottlenecks and rising energy prices, plus tight labor markets in the US.

- China has been in a different situation, where inflation remained more contained, while problems in the real estate sector weigh on the outlook.
- Growth is expected to slow in all three regions.
- The Russia-Ukraine conflict and the corresponding sanctions deteriorates the outlook further, through (i) higher energy and food prices (ii) supply chain problems, (iii)increased risk aversion.

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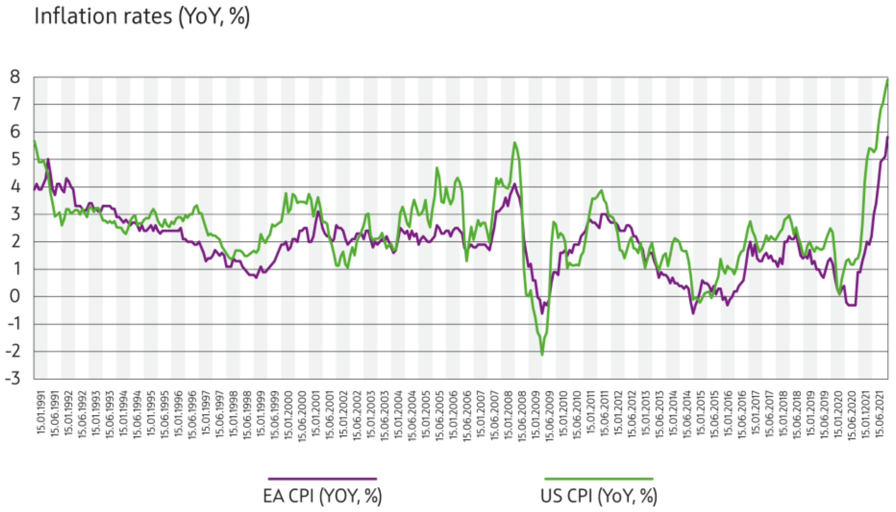
WITH THE RECENT SPIKE IN ENERGY PRICES INFLATION PEAK IN DEVELOPED ECONOMIES IS POSTPONED

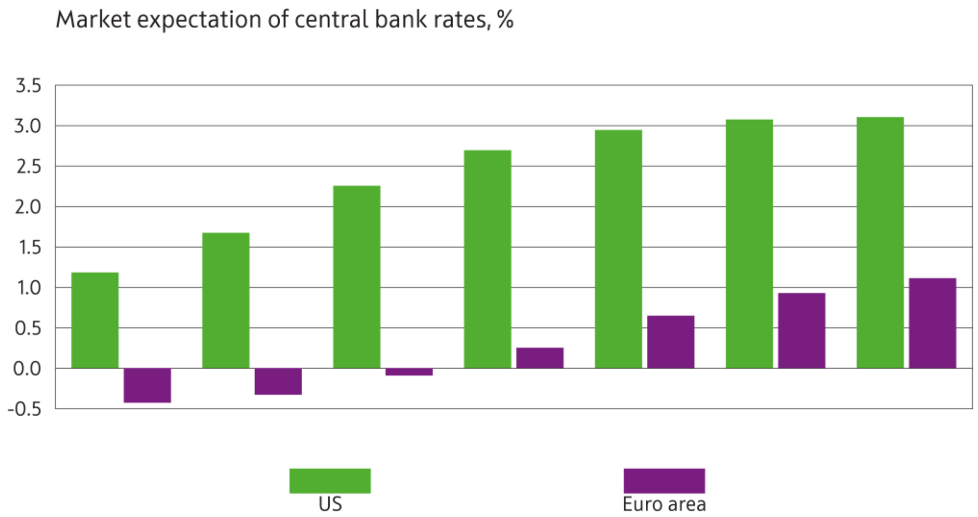


Inflation rates (YoY, %)

- Roughly half (in the euro area) and third (in the US) of the recent inflation increase was driven by energy and fuel inflation.
- The Russia-Ukraine conflict brought a spike in energy prices, and will increase food prices, plus could exaggerate supply chain problems. All this means that the inflation peak is postponed in developed economies to 2022Q2.
- Core inflation could increase even longer as energy cost pass through to broader range of product prices and labor markets remain tight.

GLOBAL ECONOMY

DESPITE THE CONFLICT THE FED AND ECB WILL CONTINUE TIGHTENING



Market expectation of central bank rates, %)

The escalation of the Russia – Ukraine conflict did not change initial central bank plans, given record high inflation levels. The FED started by a 25 bps hike in March, and foreseen to increase the rate at every meeting this year, 50 bps hikes at some meeting is also possible. The base rate could peak at 3% next year

The ECB is projected to start rate hikes at the end of this year, and the pace of tightening is also expected to be less steep than in the US. The base rate could increase until 2024, when it could reach 1%.

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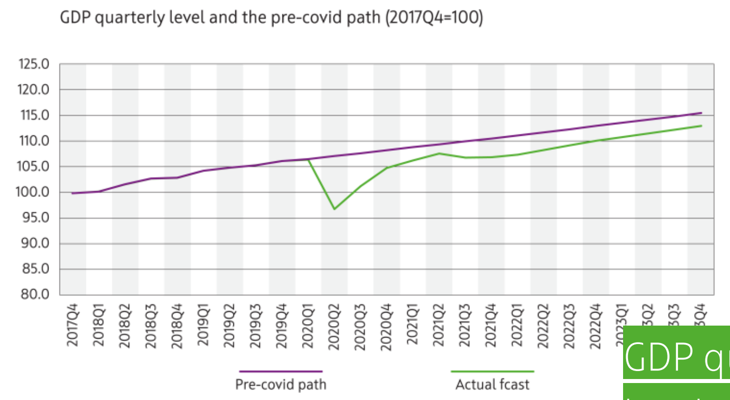
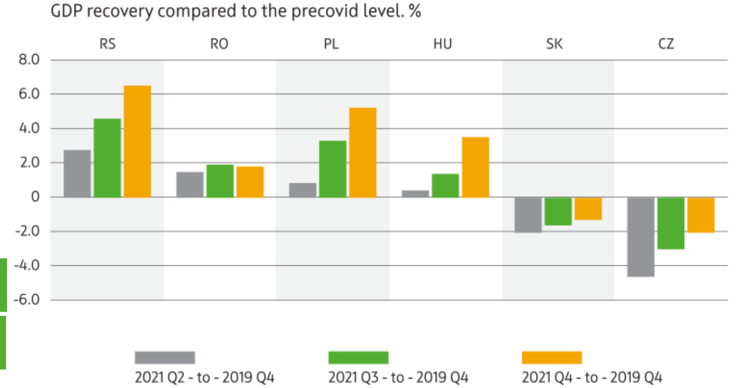
REMARKABLE RECOVERY IN ROMANIA SINCE 2020Q2, BUT ECONOMIC GROWTH HALTED BY 2021Q4

- Romania exceeded its pre-virus level but was roughly 2% below the pre-virus trend by 2021Q2. However from 2021H2 growth substantially slowed and by 2021Q4, the economy already stagnated on a QoQ basis.
- Incoming data for January-February do not suggest improvement, while the Russia-Ukraine conflict further deteriorates the outlook. Although trade ties are moderate, higher energy prices, slower euro area growth and the increasing risk premium will take its toll on activity and increases inflation.
- From 2021Q2 to 2021Q4 in regional comparison, Romania slided back from the second to the fourth best performing country in the CEE region after Serbia, Poland and Hungary if compared to the pre-virus GDP level.



GDP quarterly level and the pre-covid path



GDP levels compared to 2019Q4, %

REAL ECONOMY

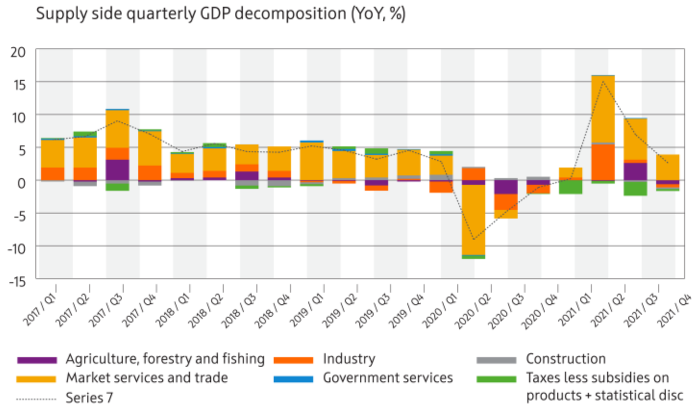
LOOKING AHEAD GROWTH IS SET TO SLOW AS INFLATION ERODES REAL INCOME AND POLICIES TIGHTEN

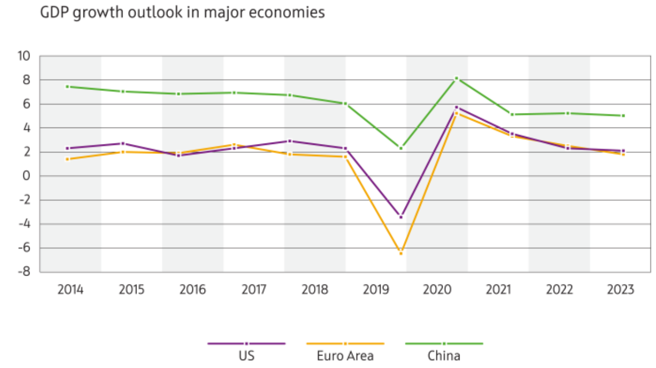
- From the sectoral side agriculture and industry substantially weakened for Q4, while growth in market services slowed on account of the sharp delta pandemic wave and base effects. From the expenditure side, inventories explains most of the growth slowdown.

- Looking ahead growth is set to slow, as inflation erodes real incomes, policies tighten, while supply chain problems could deteriorate on account of the Russia-Ukraine conflict and the related sanctions..

- Romanian growth performance is foreseen to move from around average to slightly below compared to regional peers, given its weaker 2021H2 performance and need to consolidate fiscal affairs more than other economies.

Supply side quarterly GDP decomposition





Growth outlook

COMPANY EMPLOYMENT STATISTICS SUGGEST A FULL RECOVERY. REAL WAGE GROWTH HAS SLOWED, AND THE KEY QUESTION IS HOW IT REACT TO HIGH INFLATION?

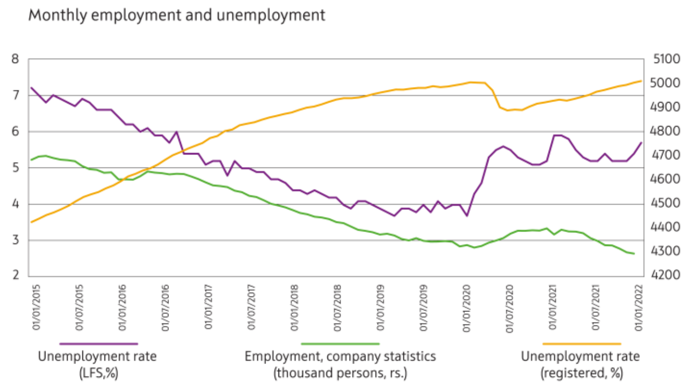
LABOUR MARKET

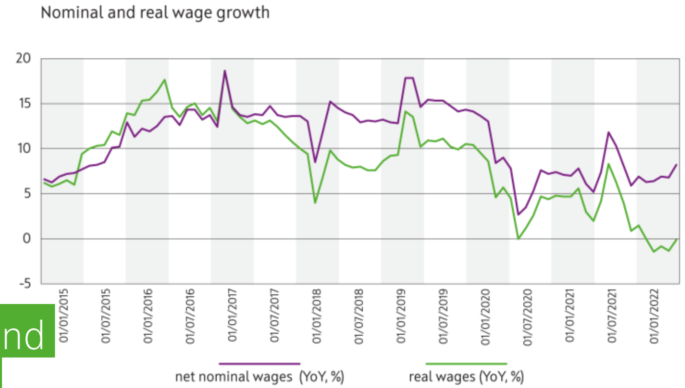
- Employment has recovered from the covid crisis, and wage growth stabilized around 6% until October. However it has started to pick-up mildly by the end of the year.

- Unemployment is still above the pre-covid level and labour market tighteness has not increased to precovid levels either.

- Rising inflation led to fall in real wages in October-January. Looking ahead the key question is how wages will react to high inflation? A significant spillover could complicate the anti-inflation efforts of the central bank, but lower real wages weakens consumer spending.

Monthly employment and unemployment





Nominal and real wage growth

FISCAL PROCESSES

STRONG REVENUES HELPED TO MODERATE THIS 2021 DEFICIT DESPITE EXTRA SPENDING, HOWEVER CONSOLIDATION SLOWS

- Fiscal consolidation is a must amidst rising interest rates, and due to the fact that Romania is under EDP.
- The budget deficit moderated in 2021, higher-than-expected revenues were more than enough to offset increased spending in 2021: the cash deficit turned out at 6.8% of GDP (plan: 7.1%)
- We foresee a gradual fiscal **consolidation** in line with the adopted convergence program, but also expect some slippages compared to the plans, given increasing energy subsidies proposed tax cuts and slowing growth..
- Government debt could increase up to 2024, could reach 55% of GDP by 2023

Monthly budget balance data and the quarterly ESA balance (%of GDP)

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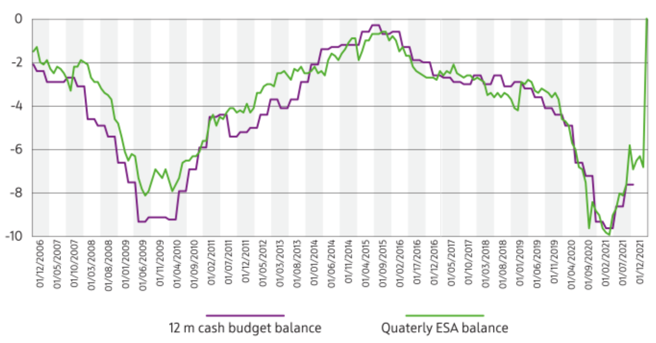
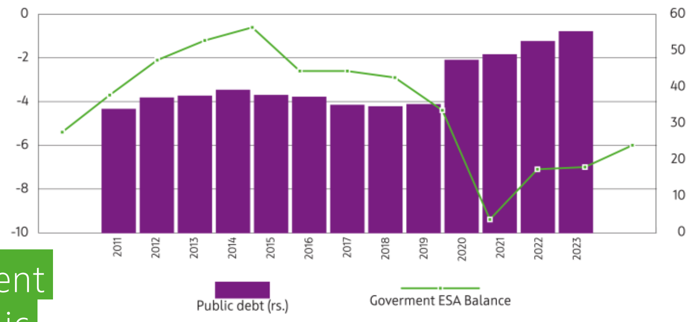


General government balance and public debt outlook

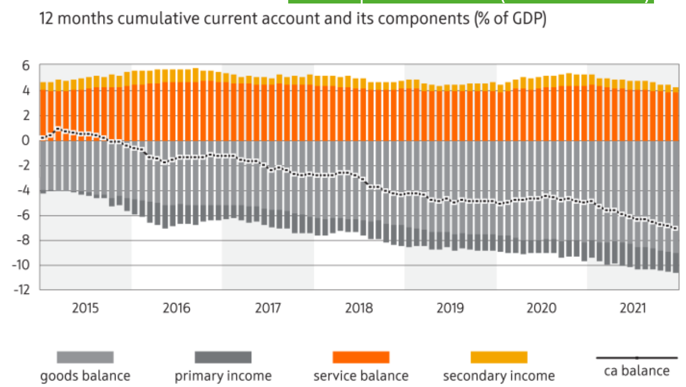
General government balance and public debt outlook (% of GDP)

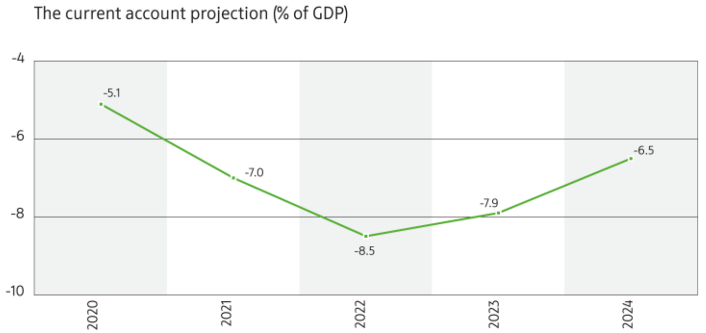


THE TWIN DEFICIT PROBLEM PERSISTED, HIGH ENERGY PRICES KEEP THE CURRENT ACCOUNT DEFICIT ELEVATED

- Despite the collapse in domestic demand in 2020, the twin deficit problem persisted as the goods balance continued to deteriorate practically uninterruptedly.
- Looking ahead, the current account will also be affected negatively by the recent increase in energy prices, as Romania is a net energy importer, although in net terms to a much smaller extent than neighboring countries.
- As fiscal consolidation proceeds, the twin deficit problem could start to ease, however the 2022-2023 external balances are negatively affected by the recent surge in energy prices.

12 months cumulative current account and its components (% of GDP)



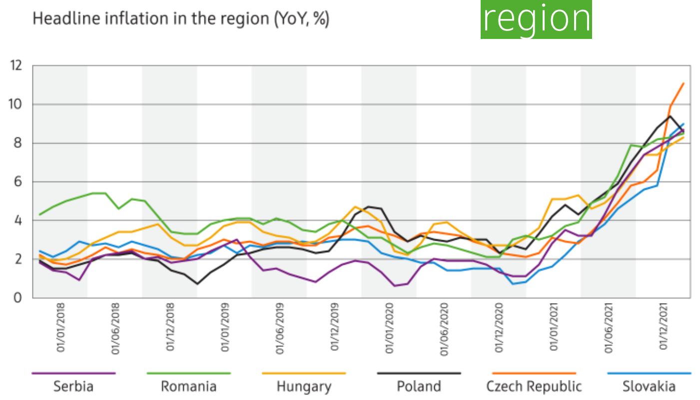


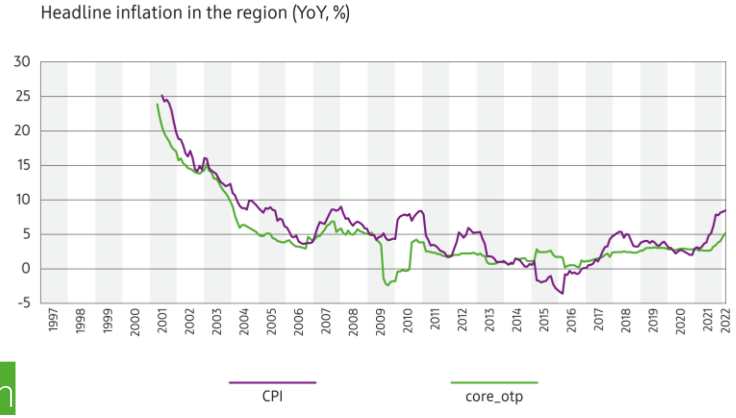
The current account projection (% of GDP)

THE SHARP INCREASE IN INFLATION ON ACCOUNT OF ENERGY AND FOOD PRICE SHOCKS IS A REGIONAL PHENOMENON

- Inflation has been on a sharp upward path reaching 8.5% by February. The rise has been driven by energy and food price shocks. The former is obvious from the record high producer price growth.
- The contribution of energy inflation has varied from month to month given the accounting of the energy price cap measures.
- Romania is not an outsider in the region, inflation rates have climbed-up everywhere to levels not seen in decades.
- Still, core inflation remained relatively contained (5.2% in February).

Headline inflation in the region





Inflation and core inflation

INFLATION OUTLOOK

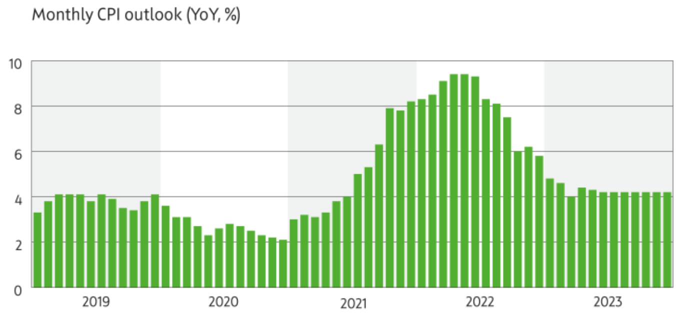
WITH THE EXTENSION OF THE ENERGY PRICE CAP, INFLATION COULD PEAK AROUND APRIL-MAY.

- Romania entered the covid crisis with a fully liberalized energy market for households. The 2021 household energy price increase therefore had a larger direct effect than in the region;

- From November the government has capped household energy prices, and recently the cap has been extended to March 2023

- Based on the measures above, we don't expect another regulated energy price hike until April 2023. However larger company energy costs could still increase, furthermore, the Russia-Ukraine conflict will add to pressures on food prices.
- Overall, we foresee inflation to peak around 9.5% around April-May, and could gradually decline afterfwards.

Monthly CPI outlook



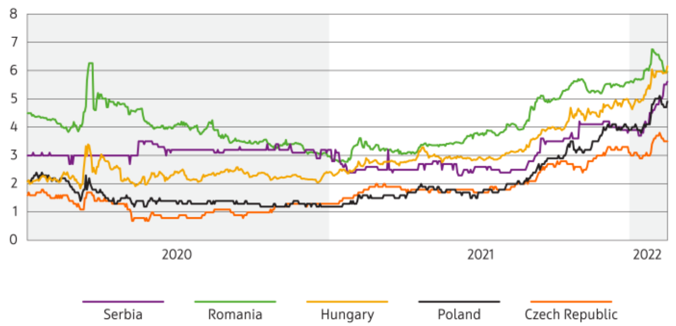
THE CENTRAL BANK WILL CONTINUE TIGHTENING, GIVEN THE INFLATION OUTLOOK, AND GLOBAL INTEREST RATE DEVELOPMENTS.

MONETARY POLICY

- The expectation of monetary tightening of major central banks have started to exert upward pressure on regional yields including Romania from last August;
- The increase in the yield curve was also driven by substantial upward inflation surprises;
- Reflecting these developments and increasing interbank rates, the BNR decided to hike the base rate by 25 bps in October, followed by another rate hike in November and January. The bank stepped-up the rate hike pace to 50 bps in February.
- The BNR will continue tightening, given the inflation outlook, recent FX interventions and global interest rate developments. The base rate could reach 4.5 by end

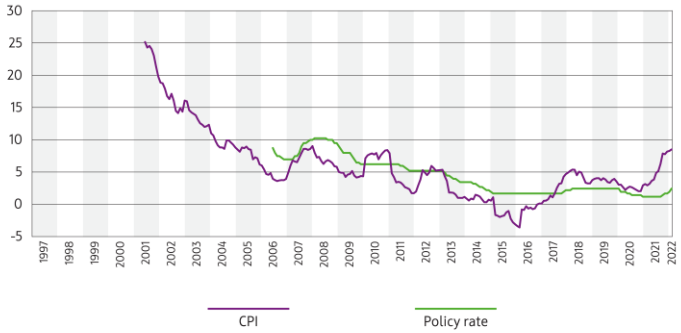
10Y government yields in regional comparison

10Y government yields in regional comparison (%)



Policy rate and inflation, monthly

Policy rate and inflation (%)

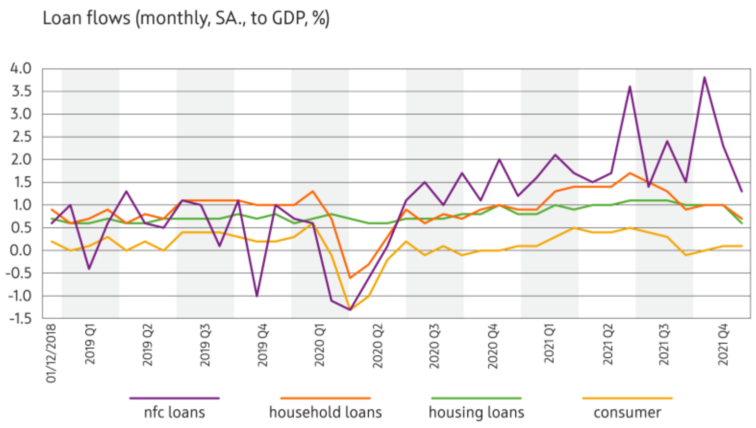


LOAN MARKETS

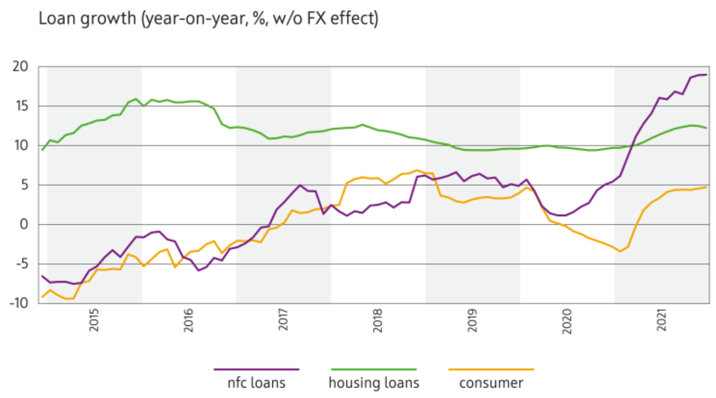
STRENGTHENING CORPORATE, STABLE MORTGAGE AND WEAKENING CONSUMER LOAN GROWTH

- Annual growth of corporate (19%+) and housing loans (12%+) remained strong in January, while consumer loan growth – hit by the Covid - remained around 5%.
- However, the early signs of weaker demand might have arrived in January, net monthly loan origination (SA) started to weaken in the case of corporate and housing loans.

Mortgage and consumer credit flows to GDP (monthly, SA, Annualised)



Corporate and retail credit growth (Y-o-Y; %, without revaluation)



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Thank you!

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