GDP REPORT

11 March 2019

In 2018, GDP grew by 4.1%, down from 7% a year earlier; further deceleration is on the cards. A potential global downturn would catch the economy on the wrong foot

- NIS confirmed Romania's Q4 GDP growth rate at 4.1% YoY (gross data) and 0.7% QoQ (seasonally and working day adjusted data). This came after the country's economy grew by 4.2% YoY and 1.7% QoQ a quarter earlier (see Chart 1). Q4's 4.1% YoY growth pace corresponded to a modest positive surprise compared to the market consensus (Reuters survey: 3.9%), and was broadly in line with our expectation (4.2%). Non-farm private sector GDP, a better indicator for underlying dynamics, registered a slower growth rate (3.4% YoY; Chart 2) than the headline data.
- In the whole year of 2018, Romania's GDP grew 4.1%, after 2017's very strong 7.0% gain, as household consumption decelerated, the gap between exports and imports widened, and investment suffered (Chart 5). Meanwhile, the very large contribution coming from the build-up of inventories could be interpreted as an alarming sign, posing risk to future growth.
- With regard to the broader picture, we recall that Romania was one of the star performers of the CEE region (Chart 7) but, as the impact of earlier stimulus measures has started to fade, the country's economy entered a deceleration phase. It is also worth noting that the relatively wide and rising current account deficit, coupled with the stretched government budget, suggests that growth has become more fragile. The introduction of new taxes for key industries also made the outlook more uncertain.
- The expenditure side of Q4 GDP data pointed to some structural weakness, as household consumption and inventories fuelled the growth (Chart 3). Consumption picked up, supported by the acceleration of real wages (Chart 8) and a transitory upswing in consumer confidence (Chart 9). The very large contribution of inventories to GDP growth may signal that sales were not able to keep pace with production in industry due to the deterioration in external demand. 2018's record harvest could also have played a role in the accumulation of inventories but, likely, its impact was stronger in Q3 than in Q4. The sharp rise in the stock of inventories and lower exports (on QoQ basis, export have fallen for the third consecutive quarter) does not bode well for the outlook. Higher inventories might be reversed quickly, while the weakening external demand could act as another headwind in the forthcoming period. In contrast to exports, imports continued to increase rapidly, backed by higher household expenditures. Therefore, net exports shaved off 2.3 percentage points from Q4's GDP growth.
- In Q4, investment posted a small increase on QoQ basis but, compared to the same period of the previous year, it remained in negative territory, dragged down primarily by new constructions (Chart 11). It is also worth mentioning that despite the strong performance of the overall economy and the advanced stage of the business cycle, the country's investment ratio decreased to a multi-year low in 2018, a rather unusual evolution in the CEE region (Charts 12&13).
- On the production side (Chart 4), market services were in good shape, pointing to a broad-based acceleration in Q4. Among the sub-sectors, ITC delivered the fastest growth pace (9.0% YoY). Nevertheless, value added in construction shrank in annual terms and industrial output also lost steam. More detailed high-frequency indicators showed that, after a cool-down period, the residential segment of the construction sector showed some positive signs, but its non-residential counterpart fell and civil engineering works remained below their long-term activity level (Chart 14). Simultaneously, industrial output has started to feel the sharp slowdown of the eurozone economy (Chart 15).

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- Early data for Q1 painted a fairly positive short-term outlook (Chart 16). In January-February, Romania's economic sentiment indicator stood at 101.9 on average, slightly higher than in Q4 (101.4). Amid the concerns triggered by the government's latest tax changes and the depreciation of the leu, consumer confidence decreased but not as much as in a somewhat similar episode of uncertainty a year earlier (Chart 9). In addition, retail sales started 2019 on a rather strong note, posting 6.8% YoY and 1.9% MoM growth rates in January. Despite the headwinds, private loans also posted a healthy growth pace in the first month of the year. Nevertheless, it is important to add that January's credit statistics may be misleading, as the negative impact of stricter regulation and the new bank tax is expected to be felt with a lag. Moreover, other high-frequency data, particularly industry, could also show a much less favourable picture about the beginning of 2019.
- With regard to the broader context, we underscore that following 2017's synchronized cyclical upswing, global economic growth showed signs of weakening in 2018. In addition, this year is expected to bring a generalised slow-down in the largest economies of the world. The USA and China in particular are in an advanced stage of the business cycle, but the output gap, likely, has been closed in the eurozone as well. Meanwhile, the threat of a hard Brexit, trade tensions and Italy's budget woes may cause further headaches too. Recessions are difficult to predict and, in our base scenario, we still expect the global economy to expand this year. Nonetheless, it is important to reiterate that the risks coming from the external environment warrant ongoing vigilance.
- With respect to Romania, we expect GDP growth to moderate, reaching 3% this year, a still solid pace compared to the EU average. Similarly to the previous few years, household consumption could be the main engine of the economy but, likely, with a slightly lower contribution to growth. Owing to the unusually tight labour market (Chart 17), coupled with another minimum and public wage hike at the beginning of this year, nominal wage growth is expected to stay at an elevated level. Simultaneously, consumer price inflation may be also milder than in 2018, providing support for real disposable incomes.
- In the case of investments, uncertainties increased in the past few months. In the mature phase of the business cycle (as definitely is the case for Romania), gross capital formation used to excel, particularly, if financing such as EU funds is also available. Nevertheless, last year, investment failed to show a rebound and the adoption of new taxes for key sectors makes the future more difficult to predict. In our base scenario, we expect investment to register a modest advance in 2019, as the positive effect of higher EU fund absorption and the pressure on companies to improve productivity and manage capacity constraints could be offset, partially, by lower investments in energy, telecom and financial sectors. Weaker credit growth and the concerns triggered by the tax changes may have spillover-effects in other sectors too. The stretched government budget could be also a bottleneck, as policy-makers have to balance carefully between the additional costs of public investments and keeping the deficit below the 3% limit.
- With the Eurozone's sharp slowdown in mind as well as owing to the still strong domestic demand, we think that net export may register a slightly negative contribution to GDP growth in 2019. This also means that the country's current account deficit could be somewhat wider this year. We do not expect such a sharp deterioration of the balance as in 2018, still the evolution of the gap will be very closely watched, as the deficit is narrowly covered by FDIs and EU funds.
- To summarise, we reiterate that after 2017's 7% and 2018's 4.1%, Romania's economic growth pace may decelerate to 3% this year (revised downward from 3.7% in our previous report, due to less favourable assumptions about the global context and uncertainties around the latest tax changes). It is also important to underscore that risks coming from the global environment seem to be on the rise, while vulnerabilities started to build up on the domestic front (Chart 18). Therefore a potential global downturn would catch the economy on the wrong foot. It is worth noting too that soaring consumption, coupled with suffering investment does not bode well for the perspective of current account or inflation dynamics.

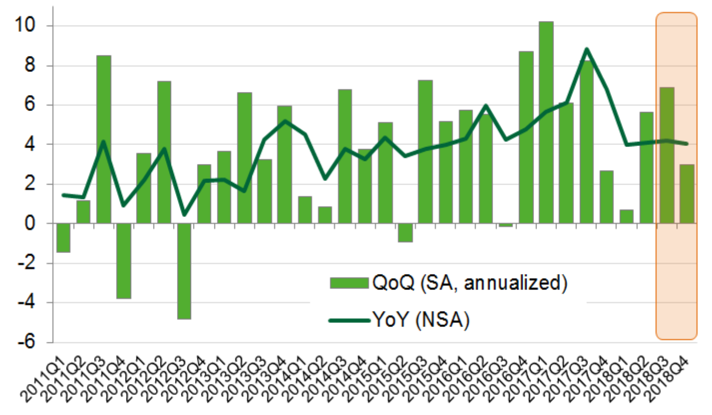
Main macro forecasts:

Indicators		2011	2012	2013	2014	2015	2016	2017	2018E	2019F
Real GDP	%	**2.0**	**2.1**	**3.5**	**3.4**	**3.9**	**4.8**	**7.0**	**4.1**	**3.0**
Final consumption of households	%	0.0	1.7	0.2	4.2	5.5	7.4	9.0	4.7	4.1
Cons. expenditure of housh.	%	1.6	1.6	2.0	4.2	5.9	8.3	10.1	5.2	4.6
Public consumption	%	-1.2	7.5	-2.9	3.5	-0.3	2.2	2.6	3.8	0.4
Investment	%	6.1	3.1	-5.6	3.3	7.5	-0.2	3.5	-3.2	0.5
Exports	%	12.1	1.1	20.2	8.0	4.6	16.0	10.0	4.7	4.5
Imports	%	10.1	-1.8	8.8	8.7	8.0	16.5	11.3	8.6	5.0
Consumer prices	% annual avg	5.8	3.3	4.0	1.1	-0.6	-1.5	1.3	4.6	3.1
Government sector balance	in % of GDP	-5.4	-3.7	-2.1	-1.4	-0.8	-3.0	-2.9	-3.0	-3.0
Public debt	in % of GDP	34.2	37.0	37.6	39.2	37.8	37.2	35.1	35.0	35.8
Current account	in % of GDP	-5.0	-4.8	-1.1	-0.7	-1.2	-2.1	-3.2	-4.6	-5.0
Key interest rate	% annual avg	6.2	5.3	4.8	3.3	1.9	1.8	1.8	2.4	2.5
Key interest rate	% end of period	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.50	2.50
EUR/RON	annual avg	4.24	4.46	4.42	4.44	4.44	4.49	4.57	4.65	4.75
EUR/RON	end of period	4.32	4.43	4.48	4.48	4.52	4.54	4.66	4.66	4.78
Nominal GDP	RON bn.	559.2	593.7	635.5	668.6	712.6	765.1	856.7	940.5	1,004
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	13.1	10.2
Real wage growth	%	-1.6	0.8	0.8	6.5	10.4	11.7	13.3	8.1	6.9
Nominal GDP	EUR bn.	132.0	133.2	143.8	150.4	160.3	170.4	187.6	202.1	212

Sources: NIS, NBR, Eurostat, OTP Research

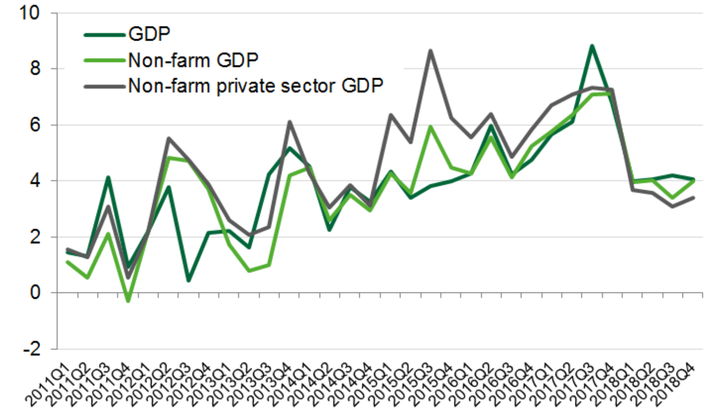
Chart set:

Chart 1: Summary chart of GDP growth (%)



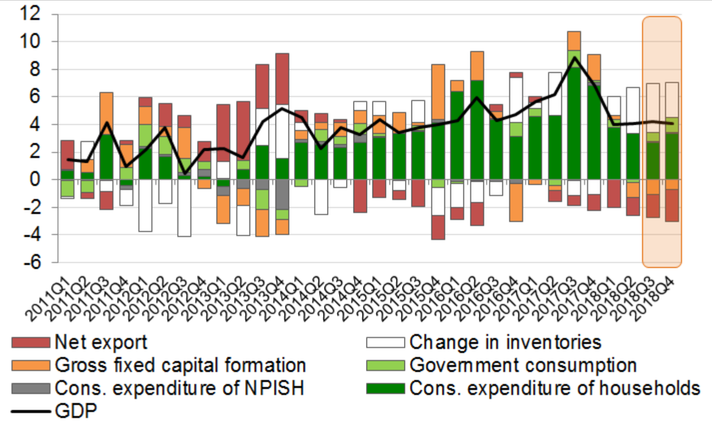
Sources: NIS, OTP Research

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



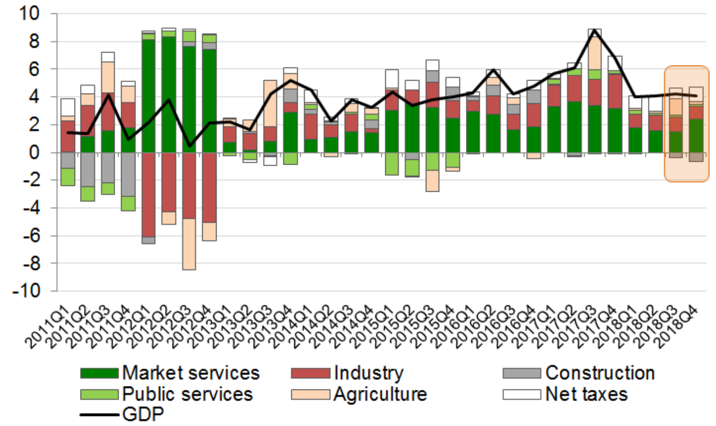
Sources: NIS, OTP Research

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



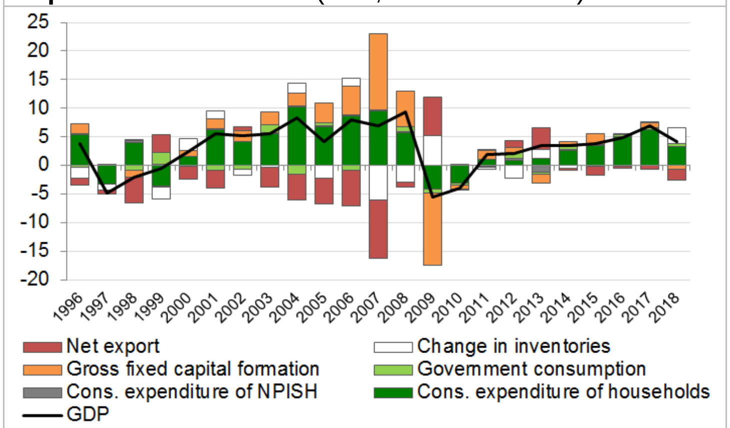
Sources: NIS, OTP Research

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



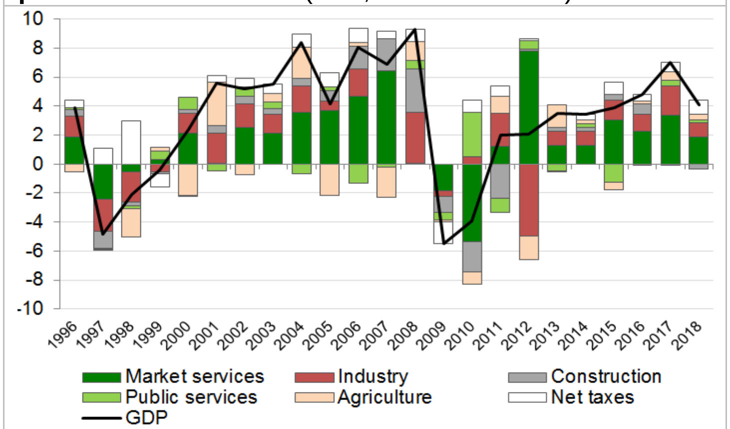
Sources: NIS, OTP Research
Note: in 2012, the sharp increase in market services' and the significant fall in industry's contribution to growth was mainly the result of a methodological change of the NIS

Chart 5: Decomposition of GDP growth by expenditure-side items (YoY, % - annual data)



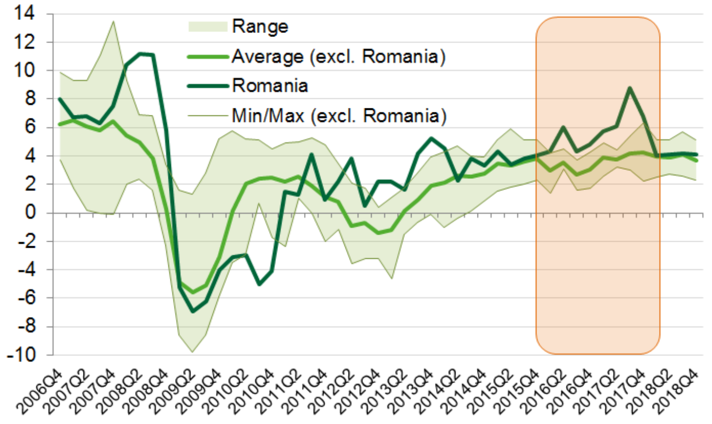
Sources: NIS, OTP Research

Chart 6: Decomposition of GDP growth by production-side items (YoY, % - annual data)



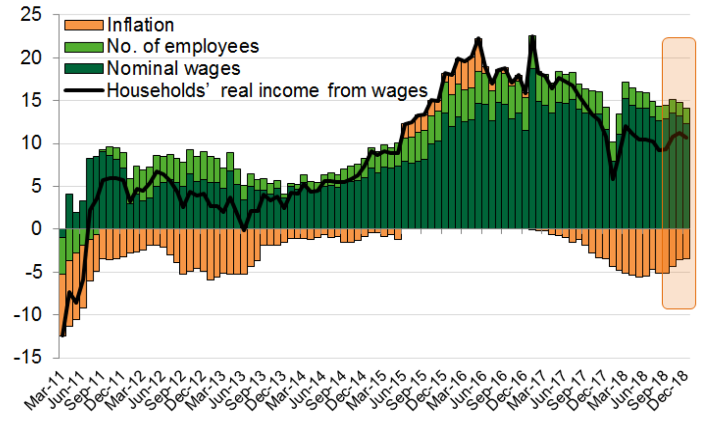
Sources: NIS, OTP Research
Note: in 2012, the sharp increase in market services' and the significant fall in industry's contribution to growth was mainly the result of a methodological change of the NIS

Chart 7: Real GDP growth in CEE
(YoY %)



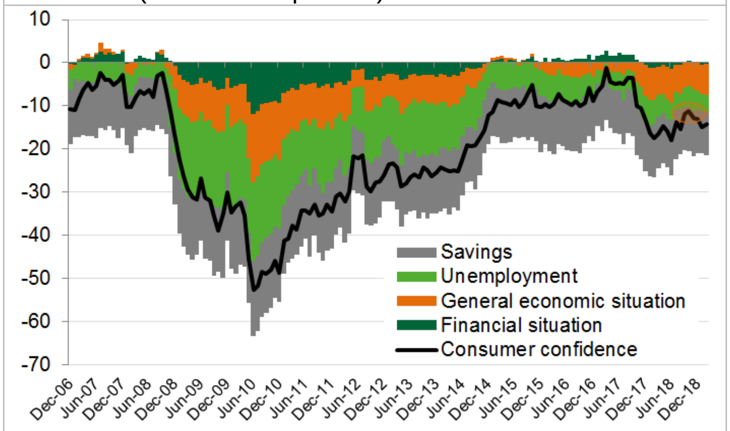
Sources: Eurostat, OTP Research
Note: CEE data includes: Bulgaria, Czechia, Croatia, Hungary, Poland, Slovenia and Slovakia

Chart 8: Decomposition of households' real income from wages (YoY %)



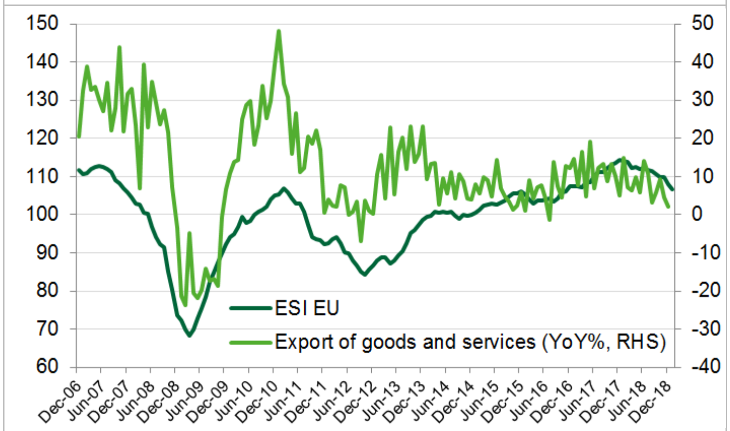
Sources: NIS, OTP Research

Chart 9: Decomposition of consumer confidence indicator (balance of opinions)



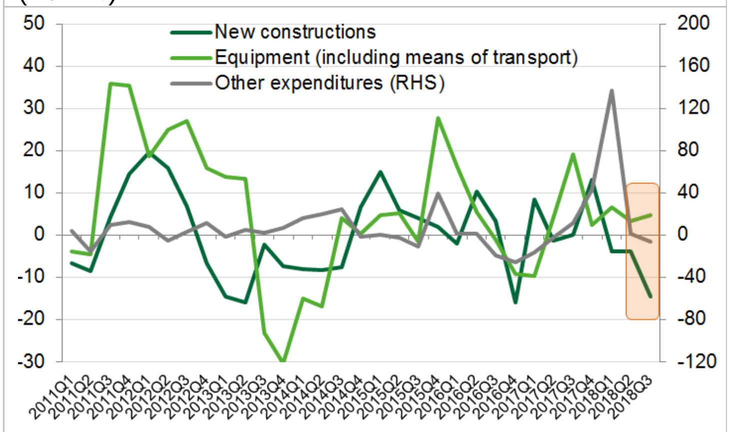
Sources: EC, OTP Research
Note: the components of the consumer confidence indicator reflect the expectation of households over the next 12 months

Chart 10: Romanian exports and EU level economic sentiment indicator



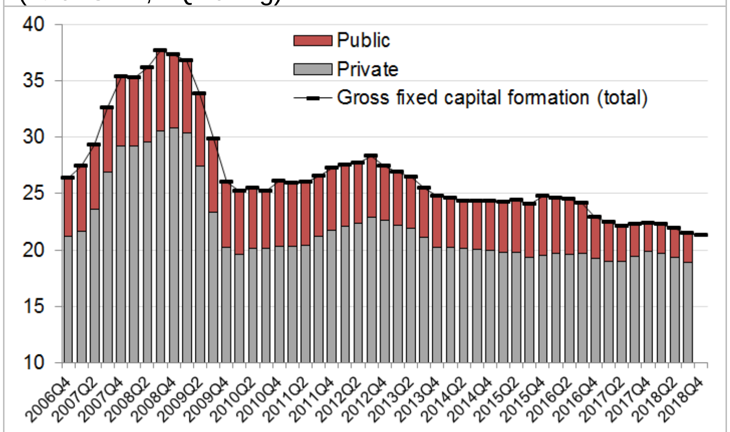
Sources: NBR, EC, OTP Research

Chart 11: Net investment by types
(YoY %)



Sources: NIS, OTP Research

Chart 12: Capital investments by sectors
(% of GDP, 4Q rolling)



Sources: NIS, Eurostat, OTP Research
Note: detailed data for Q4 2018 is not available yet

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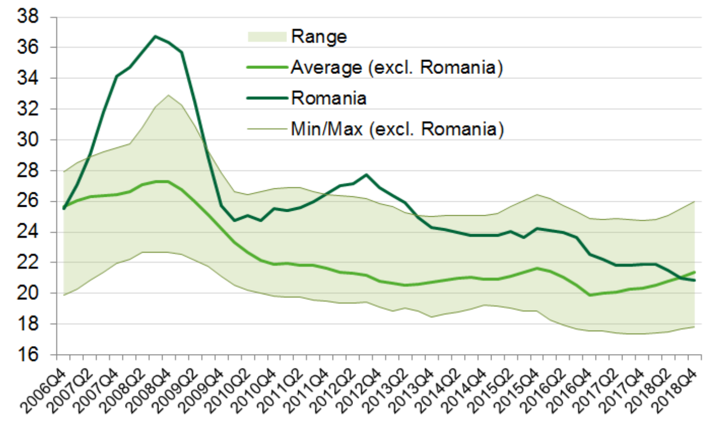
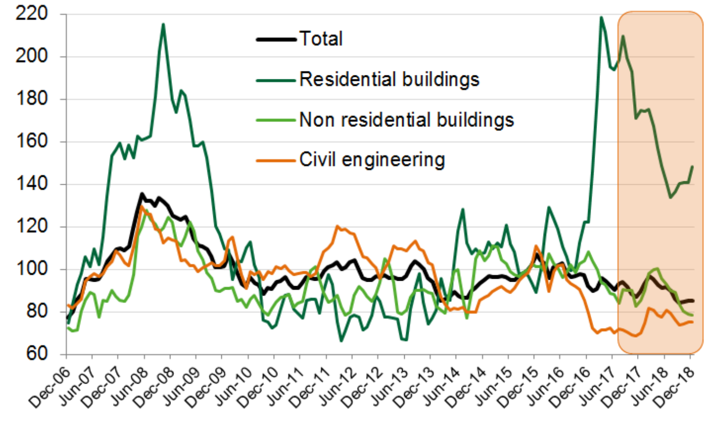
Chart 13: Capital investments in CEE
(% of GDP, 4Q rolling)



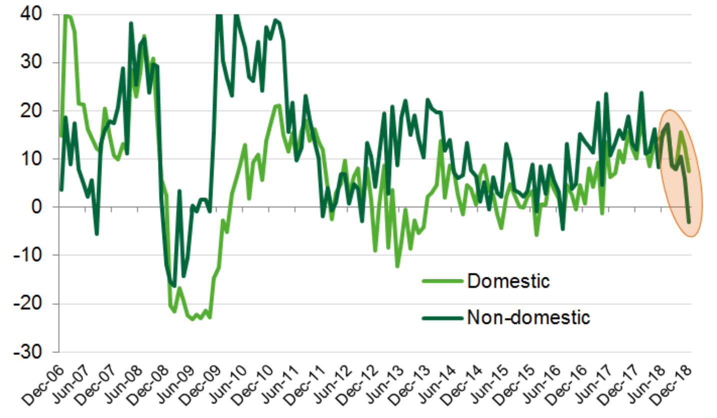
Sources: Eurostat, OTP Research

Chart 14: Construction works
(2015 av.=100, 3M mov. avg.)



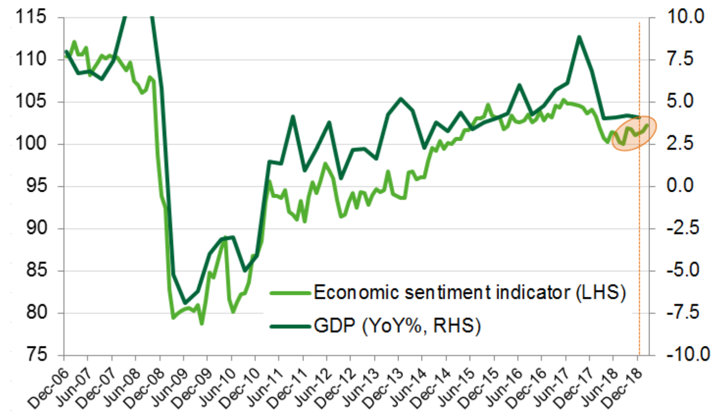
Sources: NIS, OTP Research

Chart 15: Turnover value indices in industry
(YoY%)



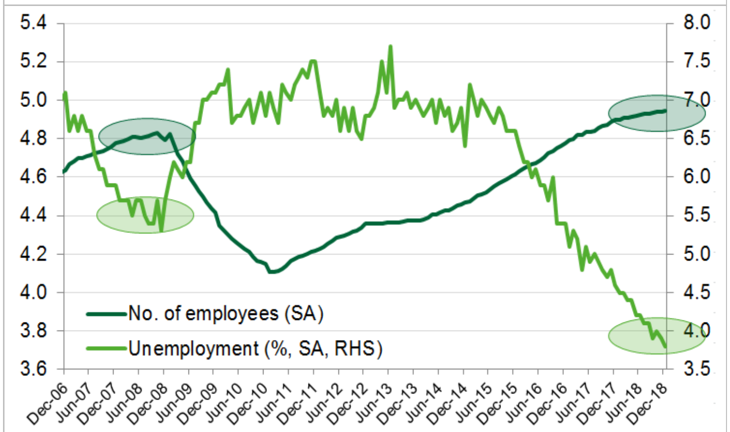
Sources: NIS, OTP Research

Chart 16: GDP growth vs. economic sentiment indicator



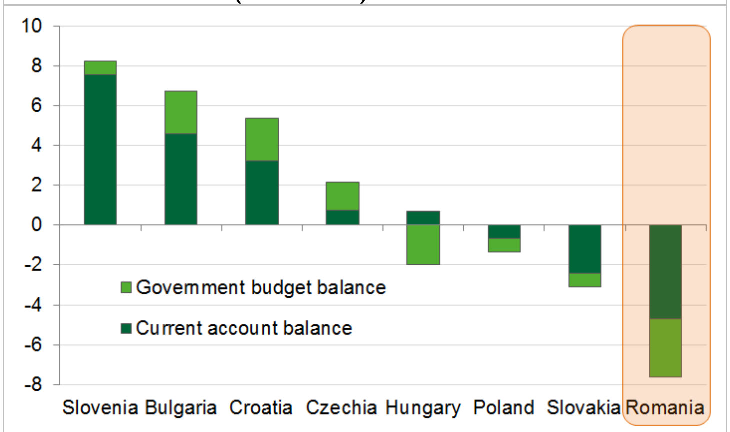
Sources: NIS, EC, OTP Research

Chart 17: Labour market indicators



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

Chart 18: Current account and government budget balances in CEE (% of GDP)



Sources: Eurostat, OTP Research
Note: data as latest available

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