Euler Hermes Economic Research

Country Report

Romania

Robust growth to continue in 2015

General Information

GDP	USD189.6 bn (World ranking 53, World Bank 2013)
Population	19.96 mn (World ranking 58, World Bank 2013)
Form of state	Republic
Head of government	Prime Minister Victor-Viorel PONTA (USL)
Next elections	2016, legislative

Strengths

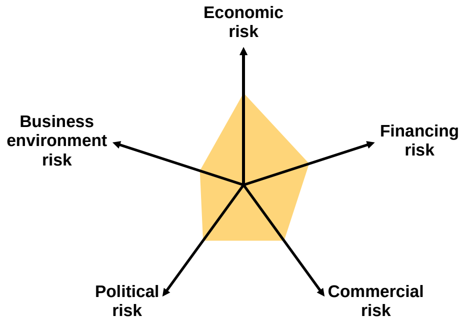
- EU membership and fairly good international relations
- Largely re-balanced economy; improving economic prospects
- Low inflation
- Much reduced exchange rate volatility since 2012
- Ongoing fiscal consolidation and low public debt
- Low current account deficits since 2013 which have been covered in full by net FDI inflows

Weaknesses

- Government instability
- Failure to make progress on EU-required judicial reform and anti-corruption measures
- Still significant public sector arrears
- Banking sector vulnerabilities
- High private-sector debt (notably in foreign currency)
- High external debt burden

Country Rating

B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Germany	18%	1	17%	Germany
Italy	10%	2	11%	Italy
France	7%	3	9%	Hungary
Hungary	6%	4	5%	France
Turkey	5%	5	5%	Russia

By product (% of total)

Exports		Rank		Imports
Electrical Apparatus	10%	1	6%	Electrical Apparatus
Cars And Cycles	6%	2	6%	Crude Oil
Vehicles Components	6%	3	5%	Miscellaneous Hardware
Refined Petroleum Products	5%	4	4%	Plastic Articles
Clothing	5%	5	4%	Pharmaceuticals

Source: Chelem (2012)

Shift to consumption-driven growth in 2014, to continue in 2015

Following the strong rebound of real GDP growth to +3.4% in 2013 (up from +0.6 in 2012), which was supported by a highly successful harvest, the economy moderated somewhat in 2014, posting still robust growth of +2.9%. The breakdown of GDP reveals that the recovery has shifted from export-led growth in 2013 to consumption-driven expansion in 2014. Private consumption growth accelerated to +4.9% (+0.9% in 2013) and public consumption to +3.8% (-1.7% in 2013). However, fixed investment continued to contract by -3.6% in 2014 (-3.3% in 2013), constrained by still tight bank lending. Net exports made no contribution to 2014 growth (+4.2pps in 2013) as export expansion moderated to +8.1% (+13.5% in 2013) while imports picked up to +7.7% (+2.4% in 2013). Euler Hermes expects the growth momentum to continue and forecasts full-year growth of +2.7% in 2015 as domestic consumption should remain robust while the impact of the Russia crisis, though moderate, will weigh somewhat on Romanian exports. Growth in 2016 is forecast at about +2.8%.

Monetary policy easing on the back of rapid disinflation

Monetary policy is officially based on inflation targeting but, in practice, the National Bank of Romania (NBR; the central bank) also aims at a certain degree of currency stability and, since 2009, attempts to steer credit growth and liquidity. Indeed, the key policy interest rate has been steadily lowered since March 2009, despite considerable inflation volatility until mid-2013. Since September 2013, headline consumer price inflation has rapidly fallen and has been below the NBR's inflation target of 2.5%±1pp (set at the start of 2013) since early 2014, reaching 0.4% in January 2015, mainly due to declining food and energy prices. Consequently, the NBR has accelerated monetary easing, cutting its policy rate to 2.25% in February 2015 (down a cumulative 300bps since mid-2013). Euler Hermes expects some further monetary easing to come as inflationary pressures will remain low in H1. From mid-2015, inflation is forecast to pick up slightly.

Exchange rate remains resilient

The RON/EUR exchange rate has been fairly stable during 2012-2014, fluctuating by just ±3.0% around an average 4.43. The EM sell-off in mid-2013 and early 2014 hardly affected the RON – similar to other currencies in CEE. Nonetheless, renewed exchange rate volatility cannot be ruled out with regard to ongoing vulnerabilities in the banking sector and potential political turbulences in the run-up to legislative elections in 2016.

Banking system is improving but remains vulnerable

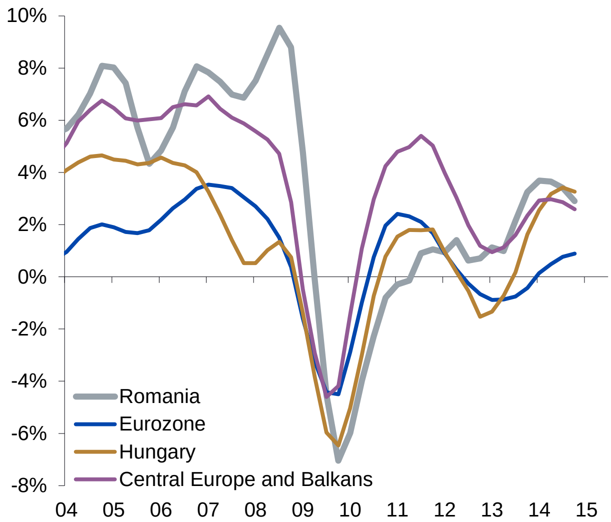
Capital adequacy and liquidity indicators of the banking sector are adequate, and asset quality has improved thanks to a substantial action plan of the NBR which reduced non-performing loans to around 14% of total loans in 2014 (down -8pps), though more needs to be done. The share of loans in foreign currency remains elevated at about 58% of total loans, exposing banks to high credit and exchange rate risk and leaving the banking system dependent on foreign funding. However, pressure from the recent CHF appreciation is manageable as only 5% of total bank lending or 1.7% of GDP is denominated in CHF.

Key economic forecasts

	2013	2014	2015f	2016f
GDP growth (% change)	3.4	2.9	2.7	2.8
Inflation (%, end-year)	1.6	0.8	1.5	2.5
Fiscal balance (% of GDP)	-2.2	-2.1	-2.8	-2.5
Public debt (% of GDP)	37.9	39.4	40.4	41.1
Current account (% of GDP)	-0.8	-0.5	-1.0	-1.2
External debt (% of GDP)	68.0	63.2	63.0	63.5

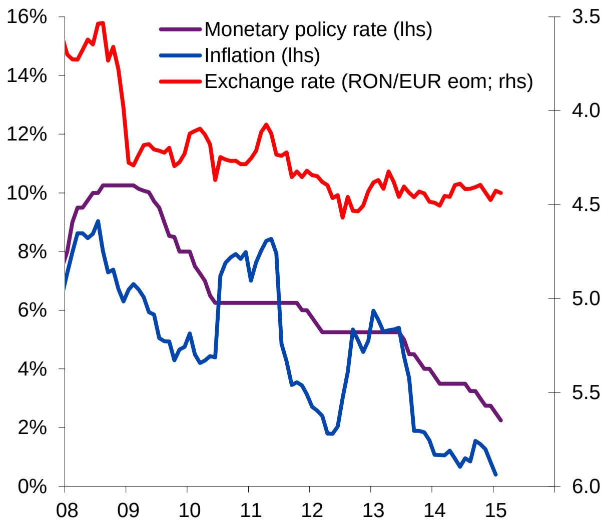
Sources: National sources, IHS, Euler Hermes

GDP growth (% y/y, 4 qtrs cumulated)



Sources: National sources, IHS, Euler Hermes

Monetary policy interest rate (%), inflation rate (y/y, %), and exchange rate



Sources: National sources, IHS, Euler Hermes

Despite monetary policy easing, private sector credit growth has remained negative (-3.8% y/y in January 2015) since early 2013. The high private sector debt burden and still elevated bank lending interest rates hurt credit demand while ongoing parent bank deleveraging (90% of the banking system is foreign-owned) limits credit supply.

Fiscal consolidation continues but tail risks remain

Supported by successive IMF/EU stand-by agreements, Romania achieved impressive fiscal consolidation, having reduced the annual fiscal deficit (ESA-2010 basis) to just over -2% of GDP in 2013-2014 from 9% in 2009. Euler Hermes expects the annual deficit to increase somewhat to -2.8% of GDP in 2015 as the government has proposed tax cuts and is probably not seeking renewal of the IMF/EU support which is expiring in September 2015. Gross public debt has risen from 13% of GDP in 2008 to about 40% currently which, however, is still moderate by EU standards. Nonetheless, tail risks remain, mainly related to arrears of state-owned enterprises (SOEs), estimated at 1.5% of GDP at end-2014 (though down from 4.7% in 2010), which are not included in the above figures. Further restructuring and/or privatising of the SOEs is needed, but progress on this has been slow.

Current account deficit to remain small

Annual current account deficits have been modest in 2013 (-0.8% of GDP) and 2014 (-0.5%) and are forecast to remain small at around -1% of GDP in 2015-2016. Moreover, net foreign direct investment inflows covered the 2013-2014 external deficit more than twice, limiting the reliance on short-term capital inflows for financing the current account shortfall.

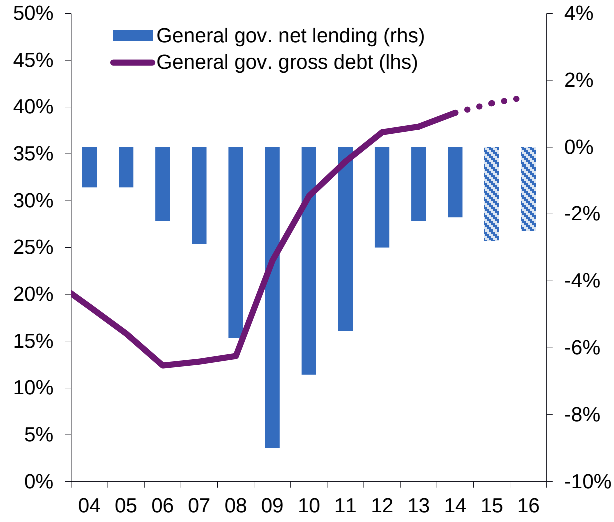
External debt burden remains high

Gross external debt is gradually declining but remains high at about 63% of GDP. Short-term external debt accounts for about 20% of gross debt (EUR19bn at end-2013). The external debt service ratio is estimated at a heavy 35% in 2015.

Foreign exchange reserves stagnate and do not cover all external debt falling due in the next 12 months

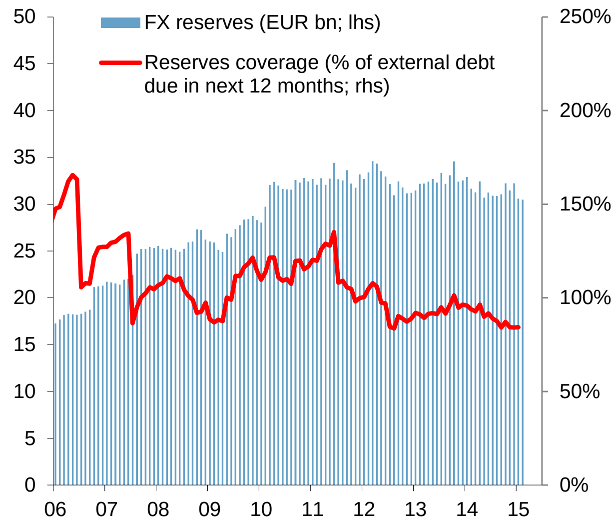
Foreign exchange reserves have moved sidewards over the past five years, in the range of EUR30-35 bn, and are expected to broadly stagnate in 2015 as well. The current level of reserves is comfortable with regard to import cover (more than five months). However, reserves cover just about 80% of the estimated external debt payments due in the next 12 months, which is down from 96% a year ago and now well below an adequate level of at least 100%.

Public finances (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves and import cover



Sources: National sources, IHS, Euler Hermes

Last review: 2015-03-06
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