Euler Hermes Economic Research

Country Report

Romania

Strong growth ahead thanks to fiscal stimulus

General Information

GDP	USD199.0bn (World ranking 53, World Bank 2014)
Population	19.9mn (World ranking 58, World Bank 2014)
Form of state	Republic
Head of government	Dacian CIOLOS (Prime Minister)
Next elections	December 2016, legislative

Strengths

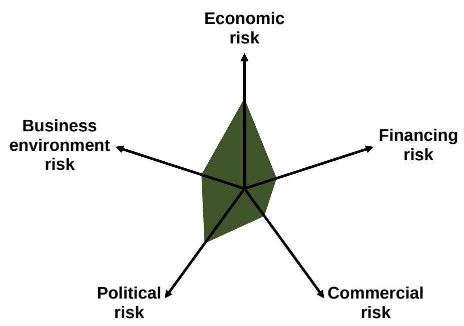
- EU membership and fairly good international relations
- Largely re-balanced economy; improving economic prospects
- Prudent monetary policy
- Much reduced exchange rate volatility since 2012
- Low public debt
- Low current account deficits since 2013 which have been covered in full by net FDI inflows

Weaknesses

- Government instability
- Failure to make progress on EU-required judicial reform and anti-corruption measures
- Arrears of state-owned enterprises
- Banking sector vulnerabilities
- High private-sector debt (notably in foreign currency)
- High external debt burden

Country Rating

B1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Germany	19%	1	18%	Germany
Italy	7%	2	10%	Italy
France	6%	3	8%	Hungary
Hungary	6%	4	6%	France
Turkey	5%	5	5%	China

By product (% of total)

Exports		Rank		Imports
Electrical Apparatus	12%	1	7%	Electrical Apparatus
Vehicles Components	7%	2	6%	Crude Oil
Cars And Cycles	6%	3	5%	Miscellaneous Hardware
Refined Petroleum Products	5%	4	5%	Plastic Articles
Engines	5%	5	5%	Engines

Source: Chelem (2014)

Economic Overview

Domestic demand-driven growth to strengthen further in 2016

The Romanian economy became one of the fastest growing in the EU in 2015, with real GDP growth accelerating to +3.8%, up from +3% in 2014, thanks to considerably strengthening domestic demand. Fixed investment surged by +8.8% in 2015 (+2.5% in 2014) and private consumption by +6.1% (+3.8 in 2014) while government consumption picked up more moderately by +1.6% (+0.3% in 2014). Inventory destocking subtracted -0.8pps from overall 2015 growth. External demand weakened in 2015, with export growth slowing to +5.5% (+8.6% in 2014) while import expansion remained strong at +9.1% (+8.9% in 2014). As a result, net exports made a negative contribution of -1.5pps to 2015 growth (-0.2pps in 2014).

In Q1 2016, the gap between domestic and external demand widened further. Real GDP grew by +4.3% y/y (up from +3.8% y/y in Q4 2015). Fiscal stimulus measures helped private consumption rise by +9.2% y/y and government consumption by +2.8% y/y. Fixed investment grew by +7% y/y while inventories subtracted -0.6pps from Q1 growth. External demand weakened further in Q1, with exports up by just +1.2% y/y while the strong domestic demand supported the +8% y/y increase in imports. As a result, net exports subtracted -2.8pps from Q1 growth. Euler Hermes expects these trends to continue over the next few quarters and forecasts full-year growth of +4% in 2016, followed by +3.6% in 2017.

Deflation expected to fade in H2 2016

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. Moreover, inflation fell into negative territory in June 2015 as a result of the 9pps VAT cut for food. The deflation has deepened since January 2016, reflecting the further 4pps across-the-board VAT cut at the start of the year, and reached a historical low of -3.5% y/y in May.

Well aware that the impact of these one-off tax cuts will wane after a year, the NBR has kept its policy rate steady at 1.75% since May 2015. Going forward, buoyant domestic demand and the May 2016 minimum wage hike should exert some upward pressure on prices. Euler Hermes expects positive inflation to return in H2, reaching about +0.5% at end-2016 and +2% at end-2017.

Exchange rate to remain resilient

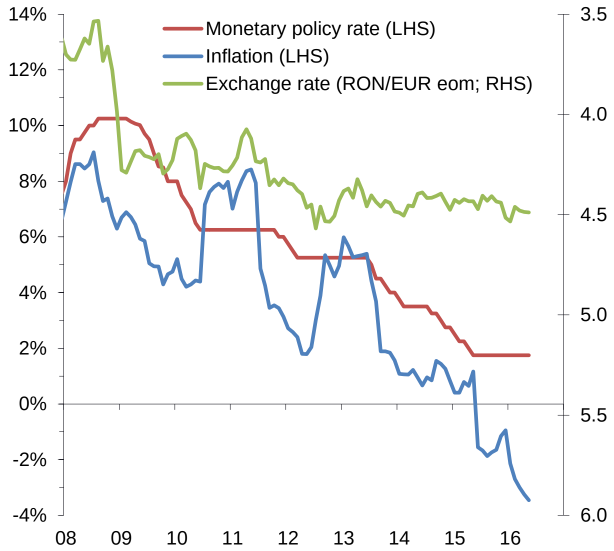
The RON/EUR exchange rate has been fairly stable since 2012, fluctuating by just ±4.5% around an average 4.45. The Emerging Markets sell-off in mid-2013 and early 2014 hardly affected the RON – similar to other currencies in CEE. Nonetheless, renewed exchange rate volatility cannot be ruled out entirely with regard to ongoing vulnerabilities in the banking sector and potential political turbulences in the run-up to legislative elections in late 2016.

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	3.0	3.8	4.0	3.6
Inflation (%, end-year)	0.8	-0.9	0.5	2.0
Fiscal balance (% of GDP)	-0.9	-0.7	-3.0	-3.5
Public debt (% of GDP)	39.8	38.4	40.0	42.0
Current account (% of GDP)	-0.5	-1.1	-2.0	-2.2
External debt (% of GDP)	63.6	57.1	55.0	54.0

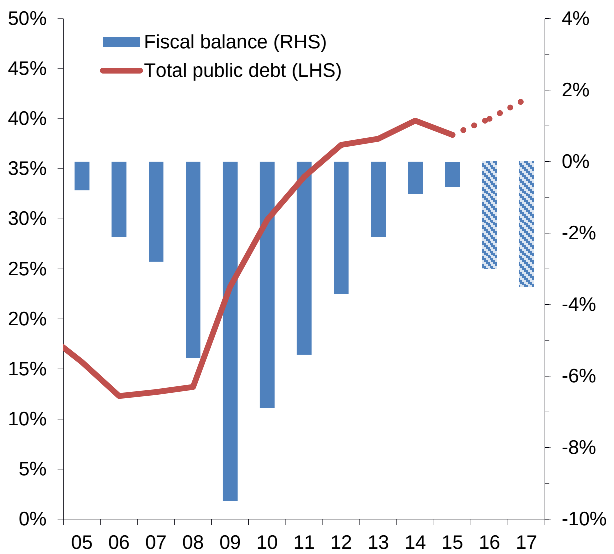
Sources: National sources, IHS, Euler Hermes

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



Sources: National sources, IHS, Euler Hermes

Public finances (% of GDP)



Sources: National sources, IHS, Euler Hermes

Fiscal policy to turn more supportive

Supported by successive IMF/EU stand-by agreements, Romania achieved impressive fiscal consolidation, having reduced the annual fiscal deficit (ESA-2010 basis) to less than -1% of GDP in 2014-2015 from -9.5% in 2009. Sound growth of tax revenues more than offset the impact of tax cuts such as the June 2015 VAT cut for food. The government has not sought renewal of the latest IMF programme which expired in September 2015.

Going forward, the fiscal deficit is likely to rise again as a result of further tax cuts and spending increases, despite strong economic growth. Euler Hermes forecasts the annual fiscal shortfall to reach about -3% of GDP in 2016 and -3.5% in 2017. For now, however, this does not appear critical. Gross public debt – although up from 13% of GDP in 2008 to 38% in 2015 and forecast at 42% at end-2017 – is still moderate by EU standards.

Still, some tail risks remain, mainly related to debt of state-owned enterprises (SOEs), currently estimated at 7.5% of GDP (not included in the above debt figure) some of which is in arrears. This is unlikely to cause a problem in the near future, but further restructuring and/or privatising of the SOEs is needed. However, progress on this has been slow.

Current account deficit to stay adequate

The annual current account deficit has been modest since 2013. It is expected to widen moderately to around -2% of GDP in 2016-2017 which is still adequate. Moreover, net foreign direct investment inflows covered the 2013-2015 external deficit more than twice, limiting the reliance on short-term capital inflows for financing the current account shortfall.

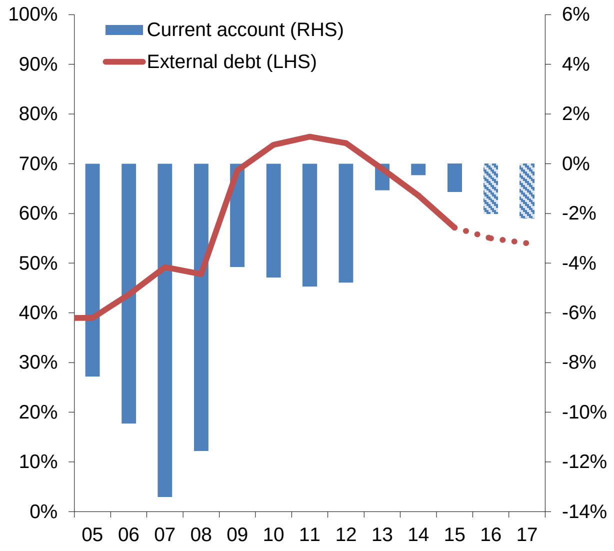
External debt burden to remain high

Gross external debt is gradually declining but remains high at about 57% of GDP. Short-term external debt accounts for about 21% of gross debt (EUR19bn at end-2015). The external debt service ratio is estimated at 25% in 2016, still considerable but down from 34% in 2013.

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

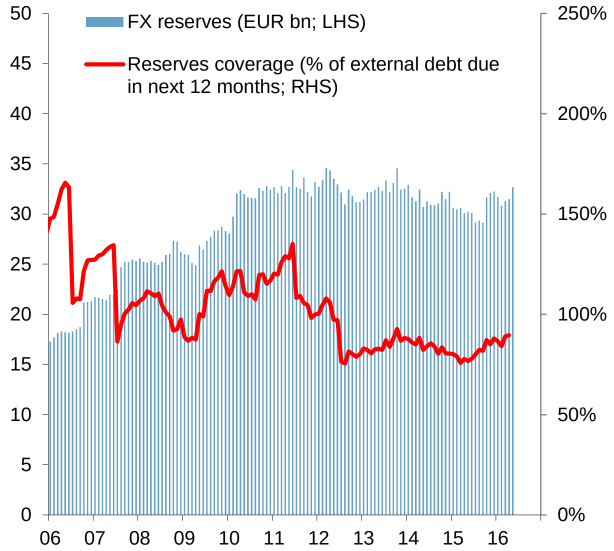
Foreign exchange reserves have moved sidewards over the past six years, in the range of EUR29-35 bn, and are expected to remain so in 2016. The current level of reserves is comfortable with regard to import cover (about five months). However, reserves cover just about 90% of the estimated external debt payments due in the next 12 months. Positively, this is up from 78% a year ago, however, it is still below an adequate level of at least 100%.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves and coverage of external debt payments falling due within 12 months



Sources: National sources, IHS, Euler Hermes

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