Romania: a new chance

Making the most of the current challenges

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November 2020

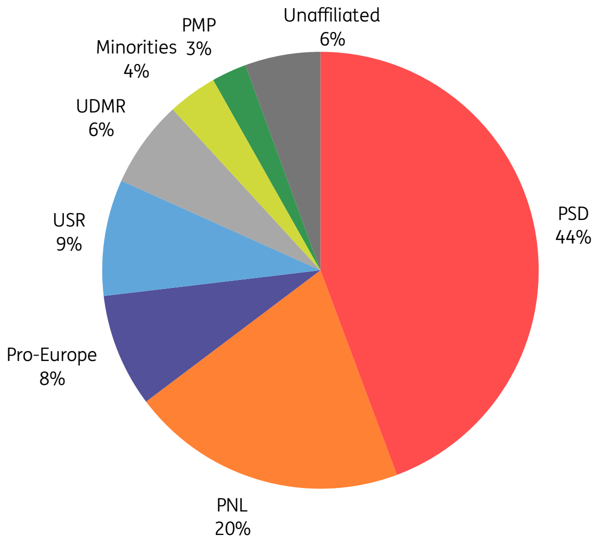
ING

Summary

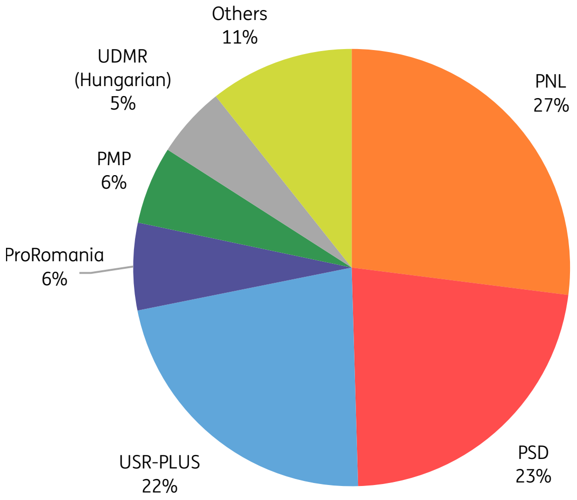
Data sources: Eurostat, EC, NIS, NBR, Brugel, MinFin, CompNet, EIB, ECB, OECD, WEF, Reuters, Bloomberg, ING

Politics: unfortunate electoral timing

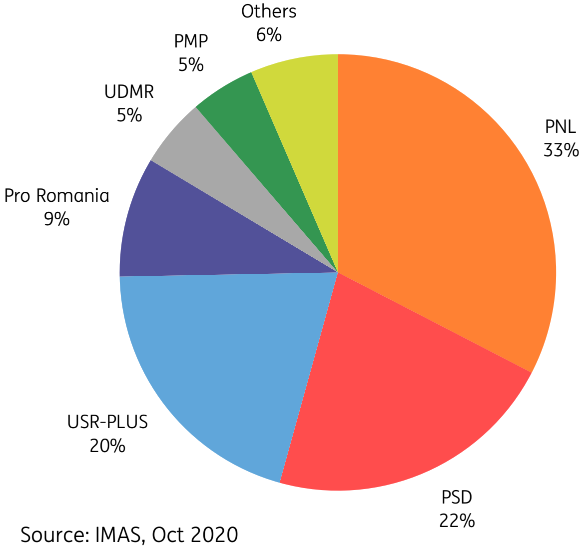
Current structure of the Parliament (2016)



European elections: >49% turnout shifts power (2019)



Latest opinion polls still show PNL scoring very high



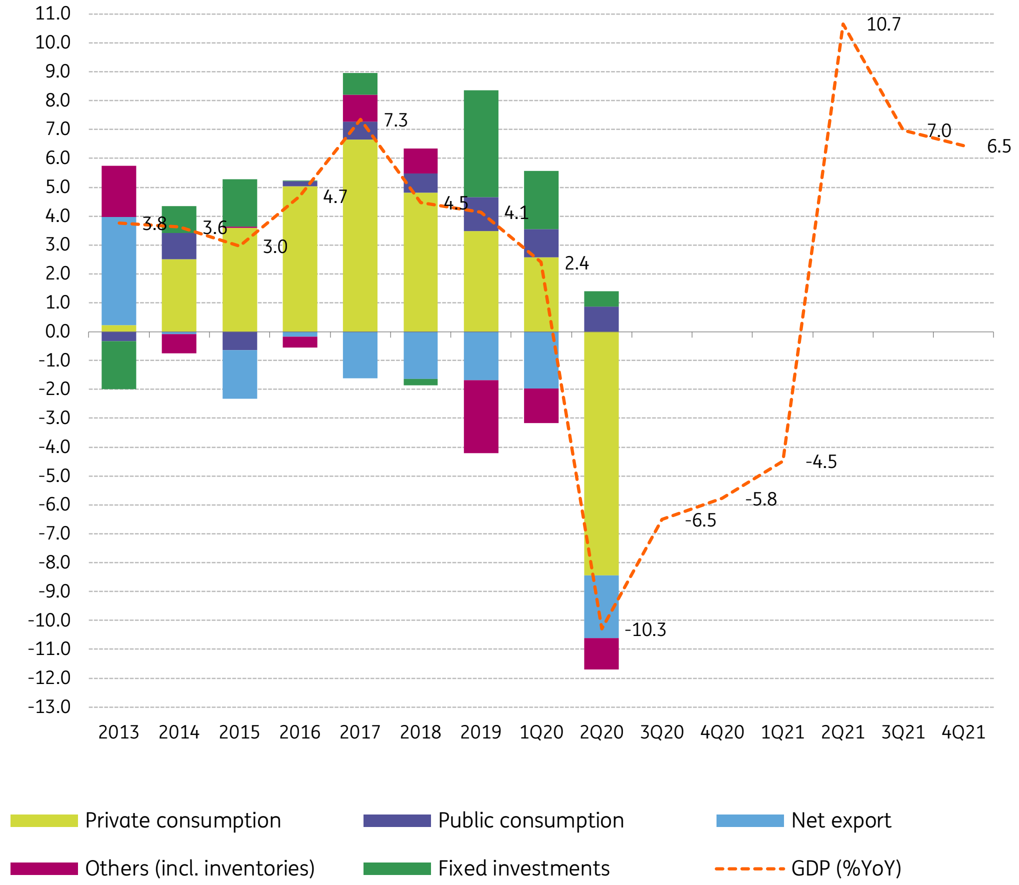
Source: IMAS, Oct 2020

1. Macroeconomic assessment

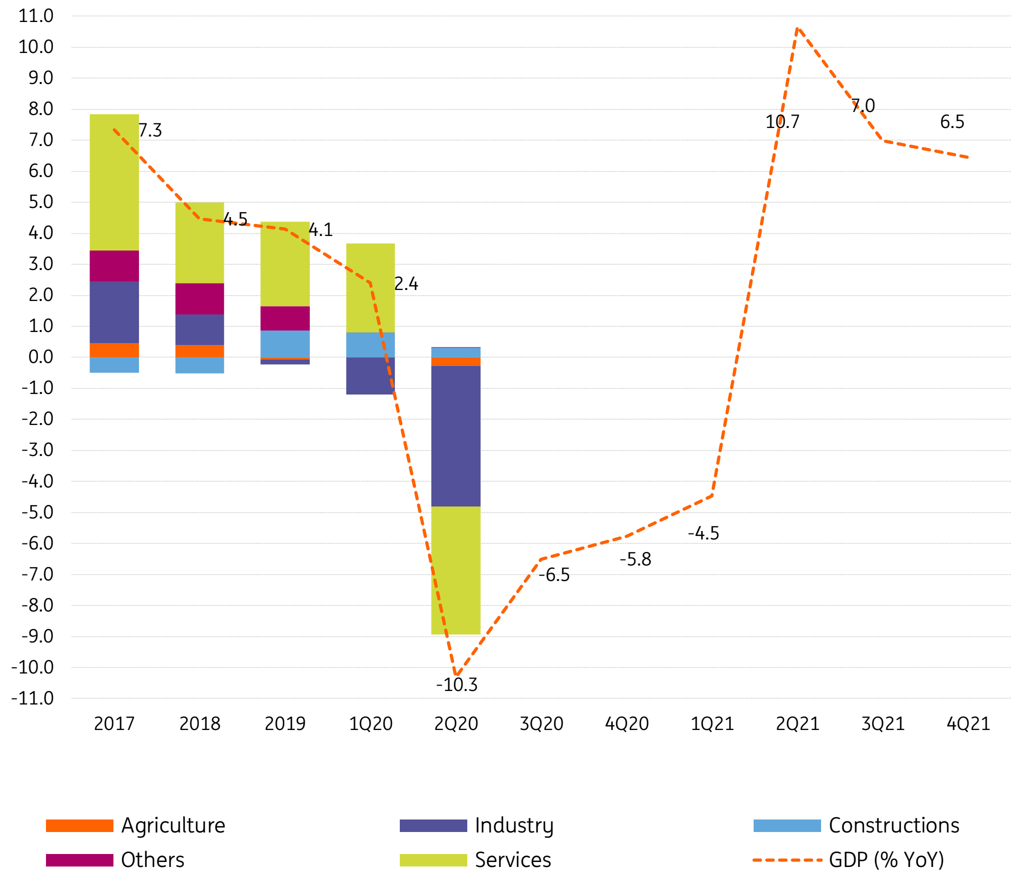
1.1. Growth structure & dynamics

GDP growth structure: imbalanced but improving

Investments made a nice comeback in 2020 so far. Net exports will remain a drag for growth as the trade deficit widens despite contracting demand

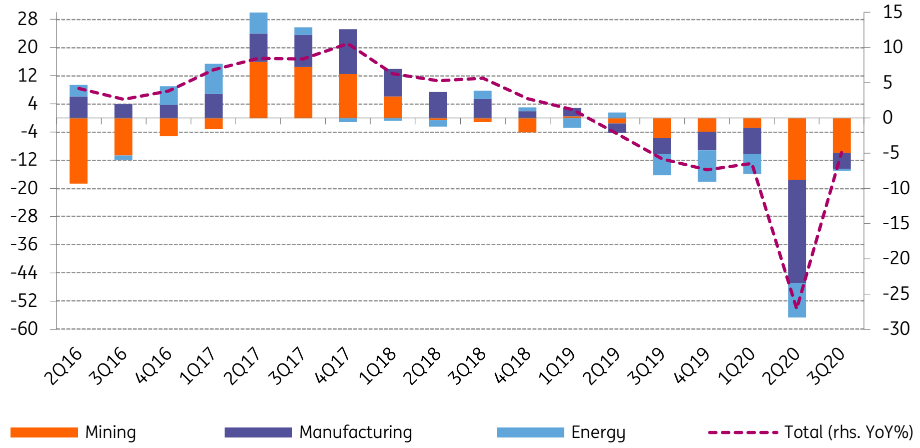


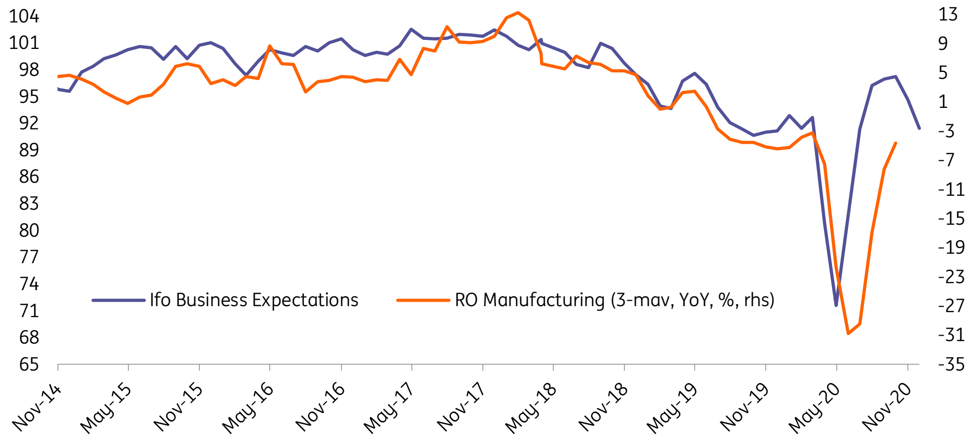
Supply side: the lockdown severely impacted private services. Industry was already in contraction since 2019. Constructions could keep the flag up in 2020



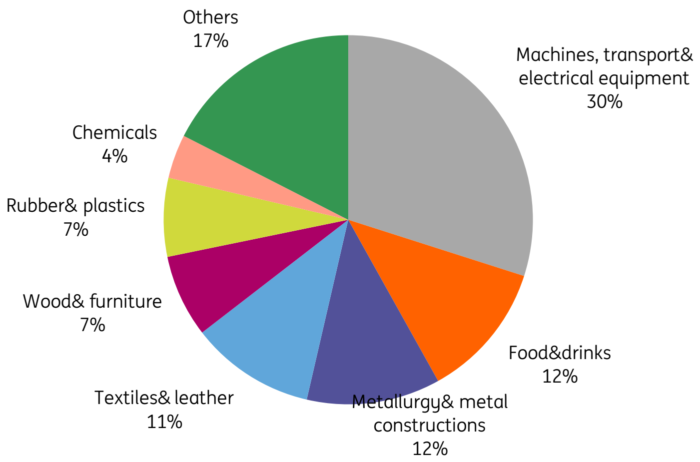
Industry continues to underperform

The industrial production began to contract in 2019 and prospects remain weak despite reopening





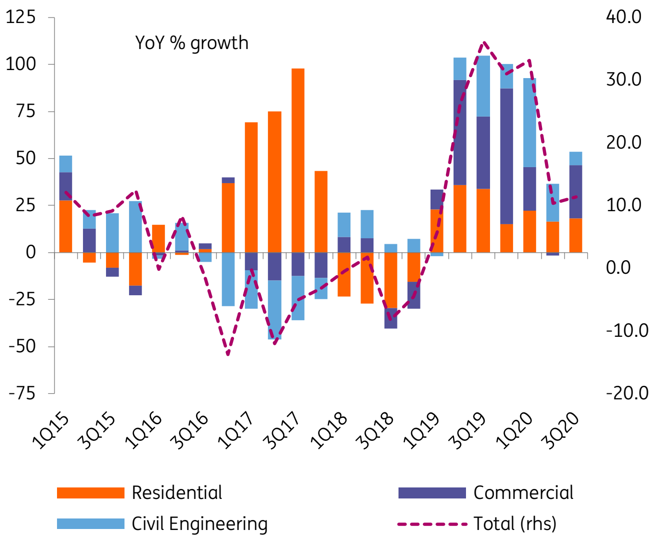
Automotive and textiles are losing most of the jobs



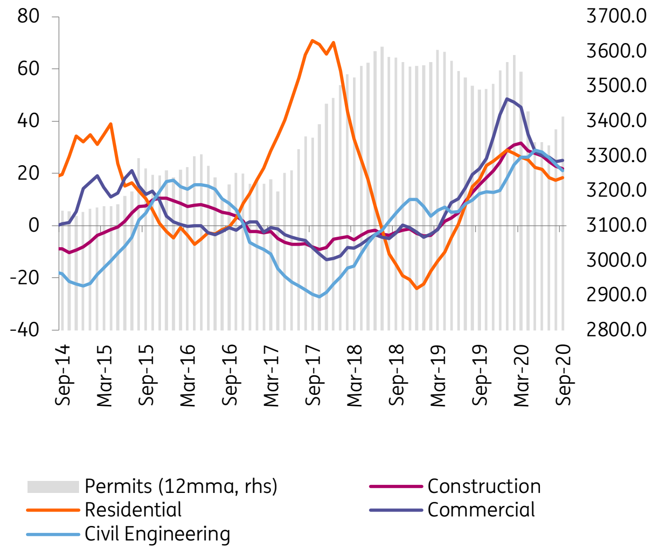
	% of total production	% of manufacturing jobs	1H20 vs 1H19 growth (%)	Net job creation (1H20 vs 1H19)
Machines& transport equipment	30%	28%	-20	-12200
Food&drinks	12%	16%	-2	0
Metallurgy& metal constructions	12%	10%	-14	1000
Textiles& leather	11%	16%	-26	-12700
Wood& furniture	7%	9%	-21	-2800
Rubber& plastics	7%	6%	-3	1900
Chemicals	4%	2%	2	0

Constructions stay in green

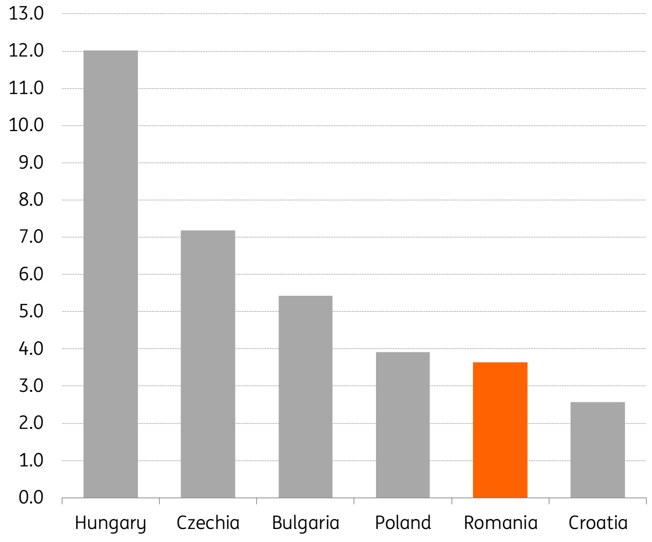
Commercial constructions slowing down but others offset



New building permits stay strong



House price index 2014-2019



Constructions still expanding…

…on lagged effects from previous quarters and strong public spending boost

Public works to keep the flag up

Governments commitment to boosting the public infrastructure investments could act as a backstop for the entire sector

Lagging behind

Despite years of double digit wage increase, the strong negative fundamentals are taking their toll (e.g. ageing population, migration)

Services: IT bearing the growth burden

Transports

- The sector has contracted by 5% vs 2019 and has lost over 9k jobs. Commercial vehicles registration was down 35% at mid-year, pointing to sluggish recovery.

IT

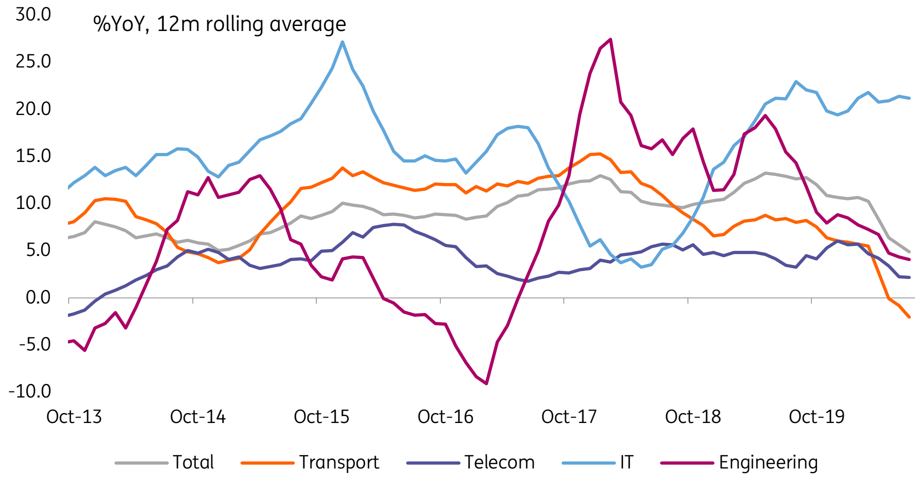
- Thriving sector (turnover up 25%, wages up 15% at mid-year), as companies boost digitalisation and work-from-home schemes.

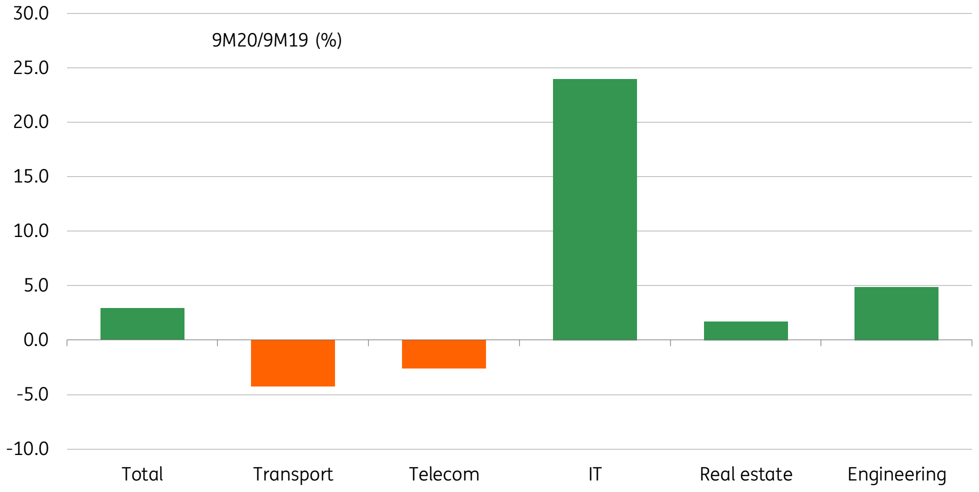
Engineering

- Normally a good indicator of future investments. Likely to corelate better with public works rather than private investments.

Telecom

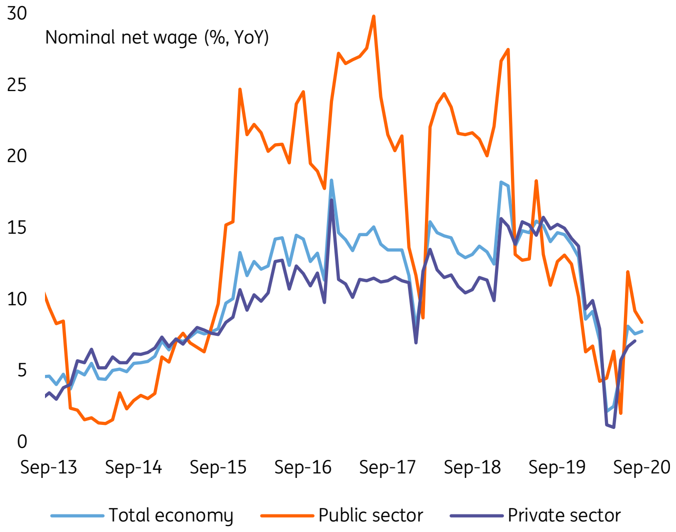
- Usually less sensitive to economic cycles



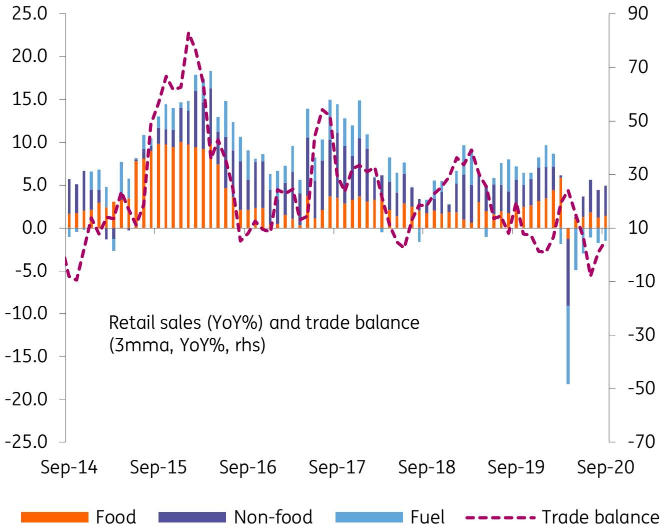


Consumer sector

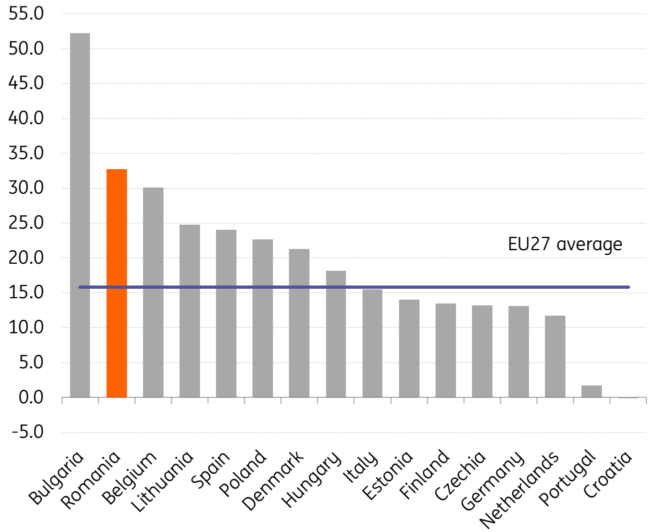
Wages will NOT contract in 2020



Retail sales and the trade balance: hand in hand



Online sales dynamic: impressive



Wage growth remains positive…

…but statistical effects are likely distorting the picture as lower paid workers are dropped off the base

Sales are back to pre-crisis level…

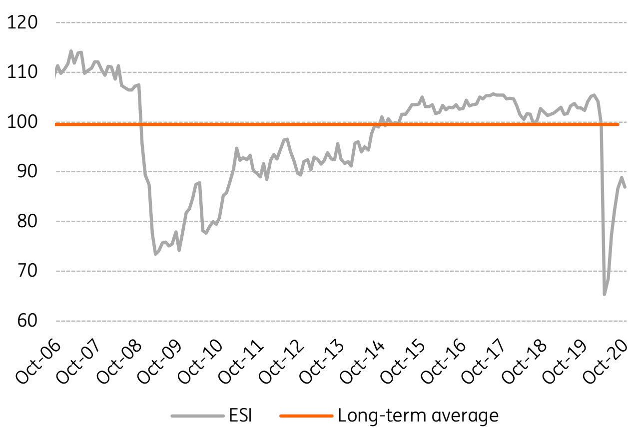
…and the trade balance follows. Despite a contracting demand in 2Q20, the trade balance deficit has widened to new historical highs

Romanian consumers turn digital

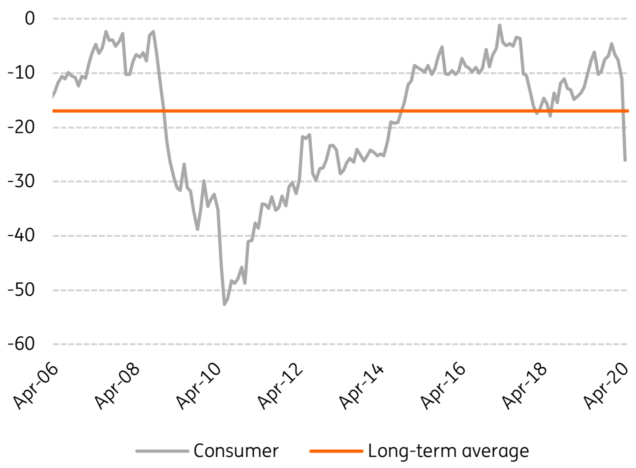
Online sales have boomed this year, Romania being among the few countries experiencing uninterrupted monthly growth in the post-lockdown period

Confidence data

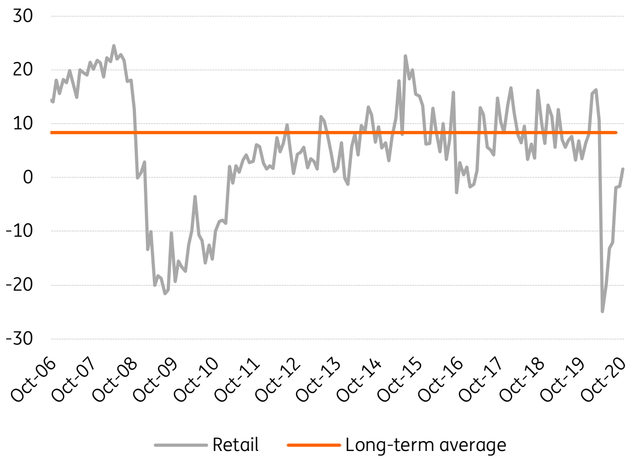
Economic sentiment



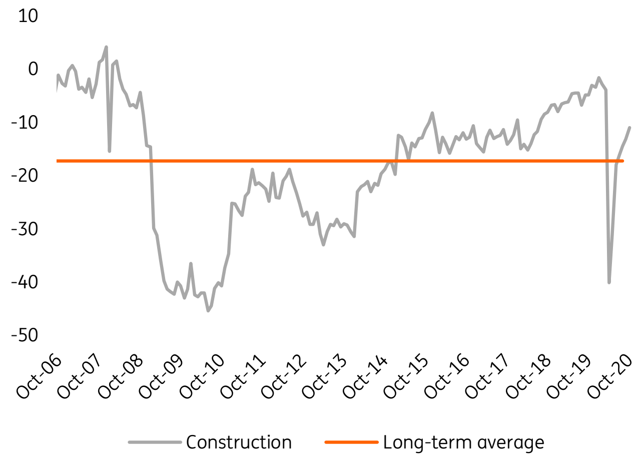
(!) Consumer confidence



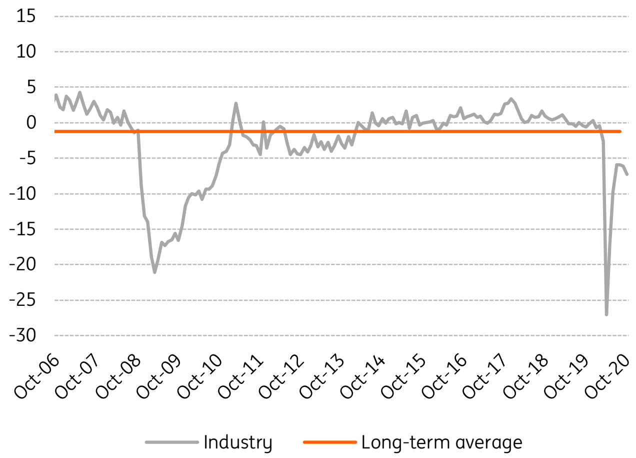
Retail



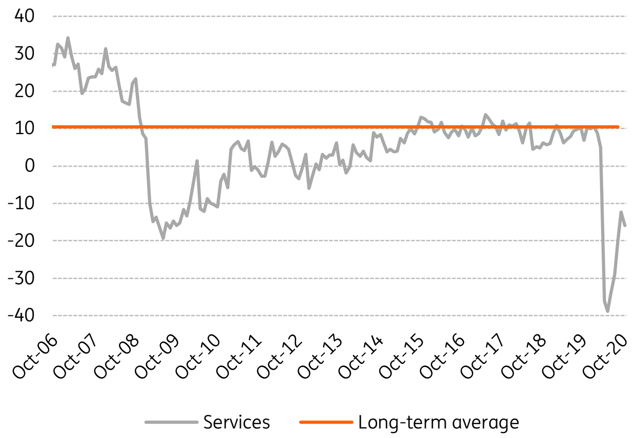
Constructions



Industry



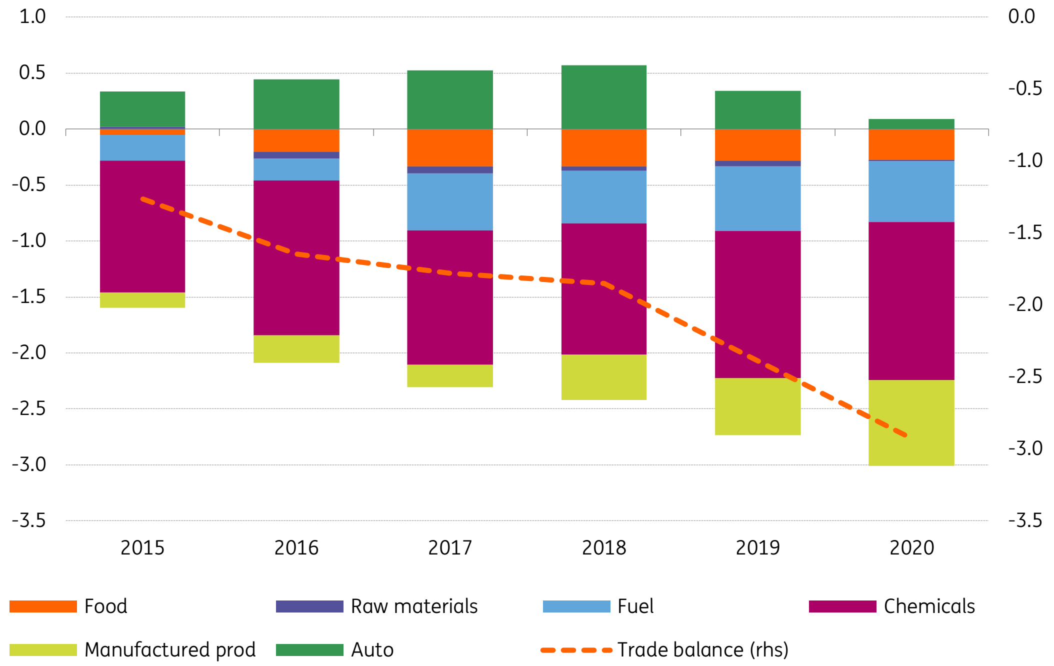
Services

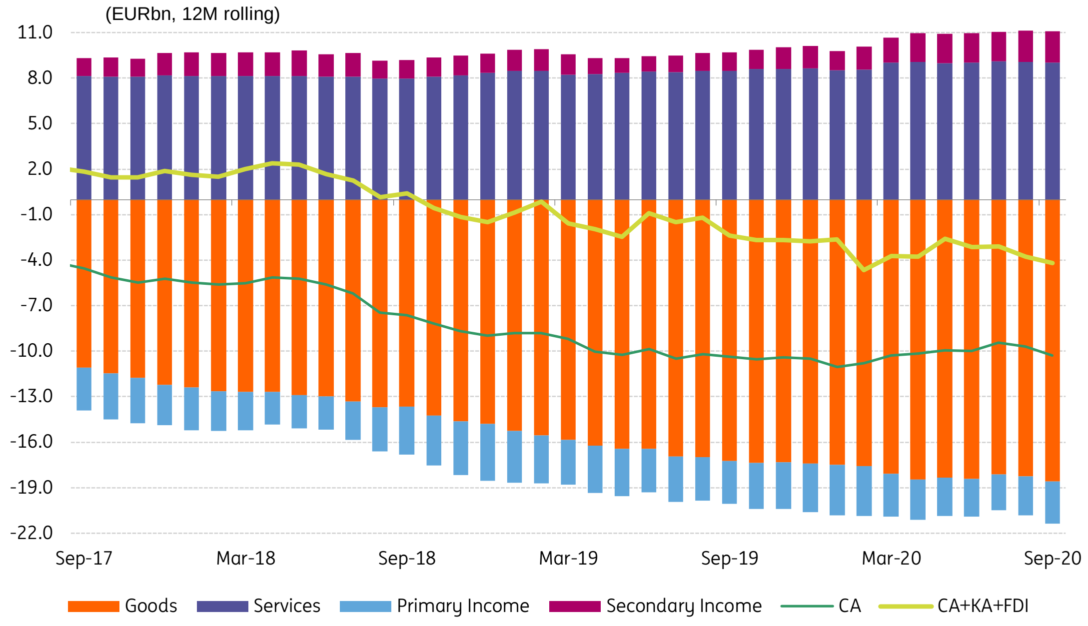


1. Macroeconomic assessment

1.2. External (im)balances

Deteriorating external picture





Trade deficit still widening

- The surplus on the auto sector has been shrinking constantly, to the point of becoming irrelevant. The sector could end the year in a deficit for the first time after 7 years of consistent surpluses
- We expected a rebalancing of the trade picture but the reliance on imports seems to be more structural than estimated.

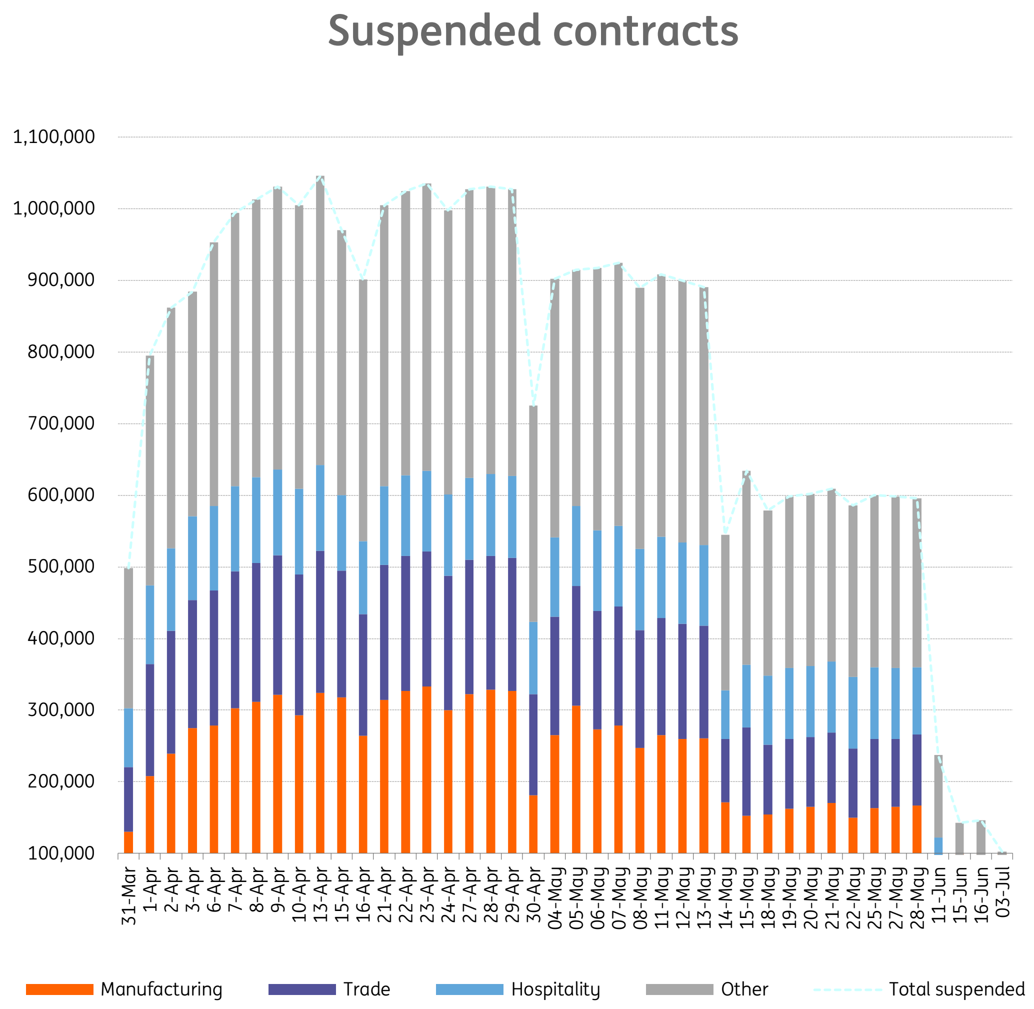
Current account deficit to remain a headache

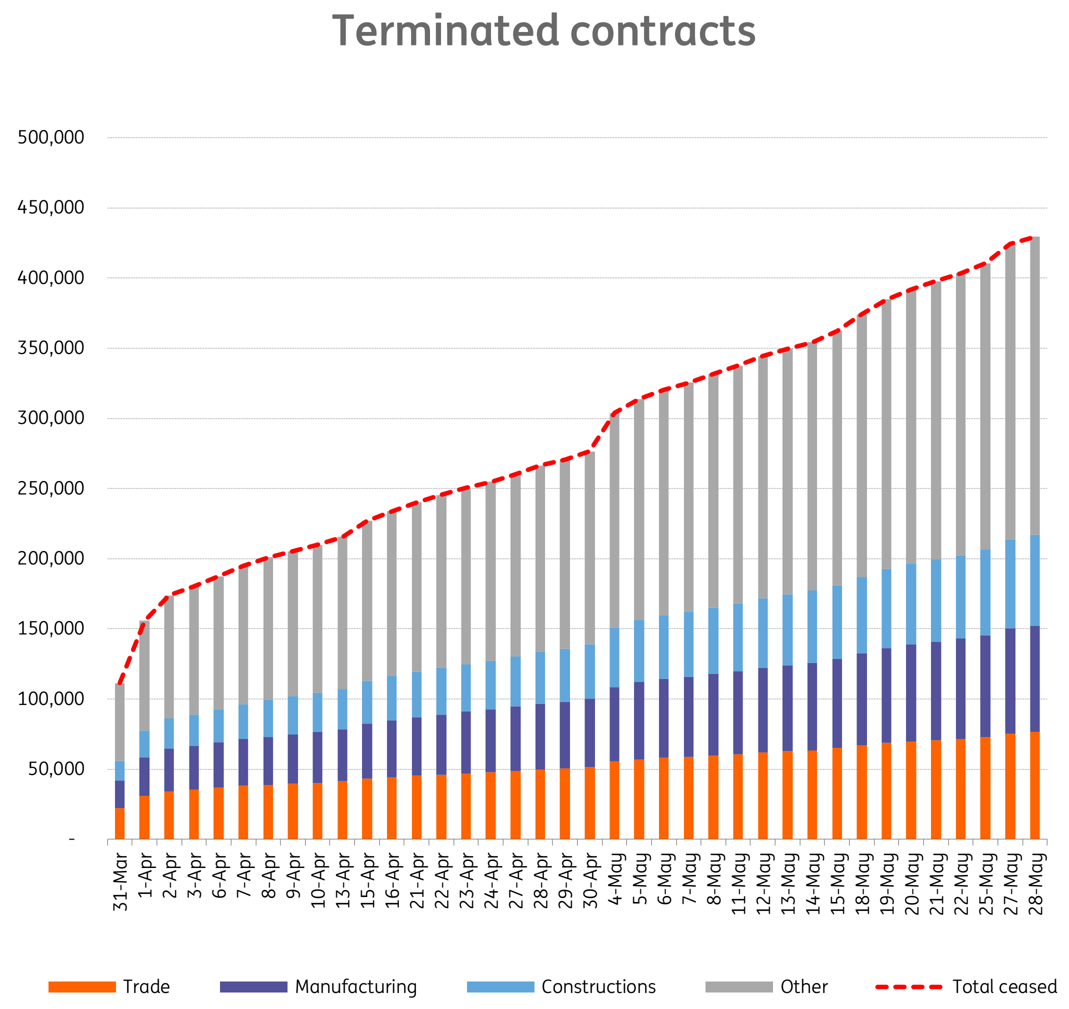
- In the absence of meaningful FDIs, financing the external shortfall remains reliant on NBR's FX reserves
- We see the C/A deficit at 4.5% of GDP in 2020, same as in 2019, with the higher trade deficit likely to be offset by EU funds inflow to a larger extent than in the previous years
- Even if the C/A deficit improves, its financing structure will weaken

1. Macroeconomic assessment

1.3. Labour market

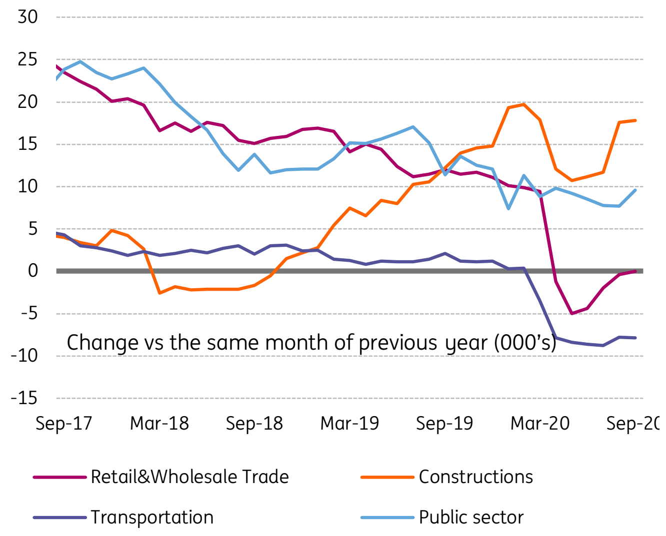
Lockdown impact on the job market



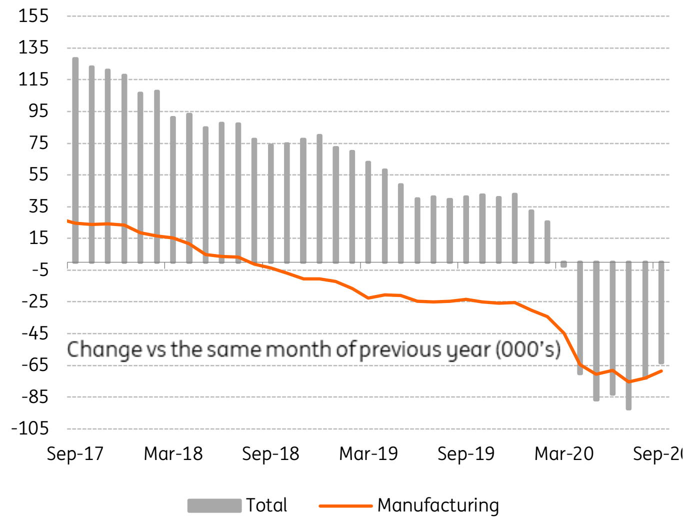


Job creation: not succumbing but not a great story either

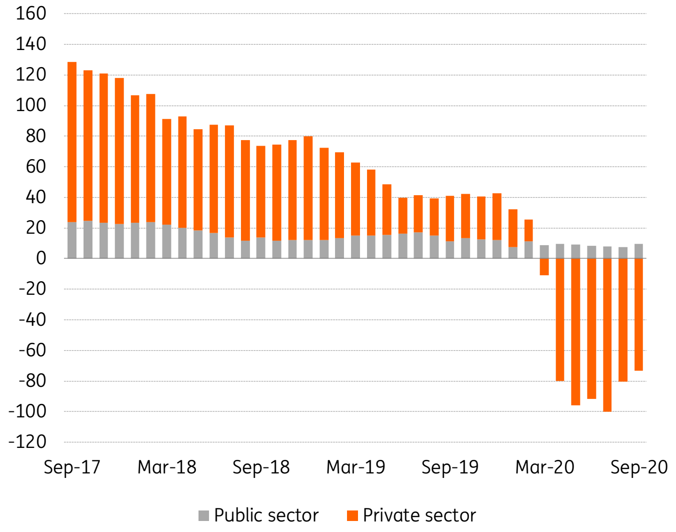
Monthly net job creation per selected sectors



Manufacturing job creation contracting since mid-2018



Number of workers in the public sector continues to grow

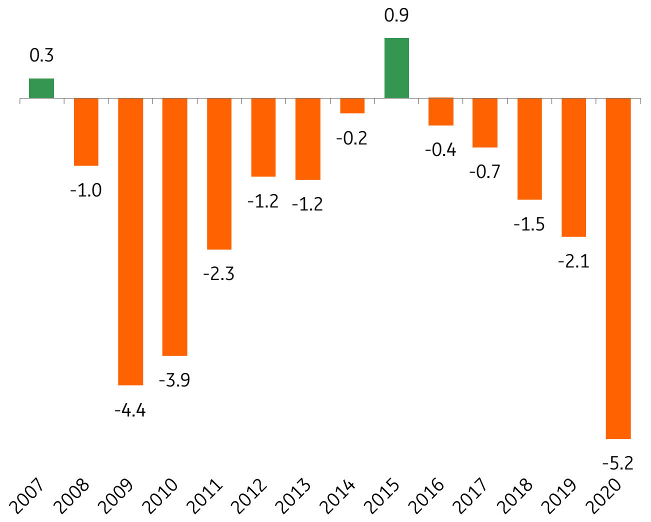


2. Fiscal outlook

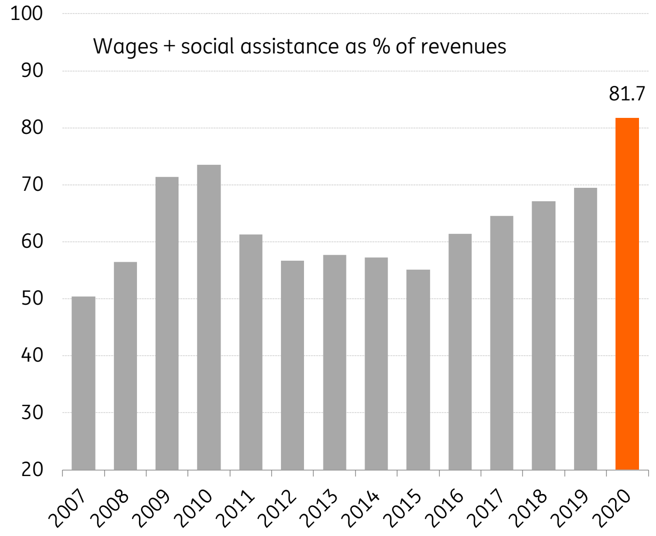
Sooner or later...

Budget deficit on the skids

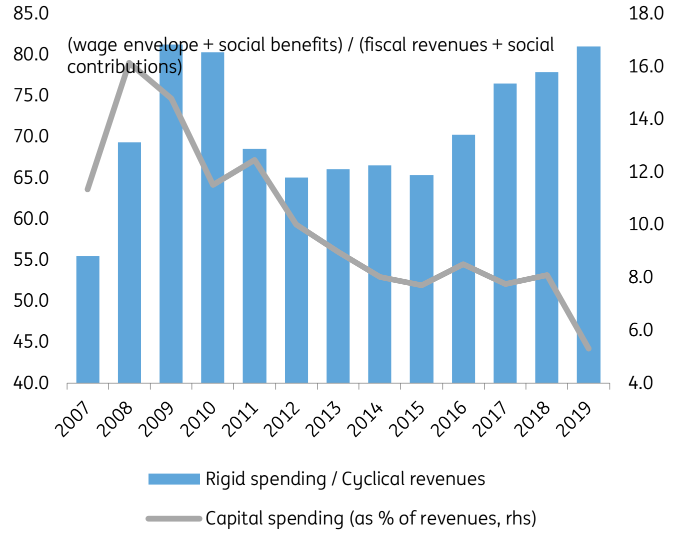
January-September execution (% of GDP)



Rigid spending seizing most resources



Higher rigid spending = higher taxes...eventually



Understandably high this time

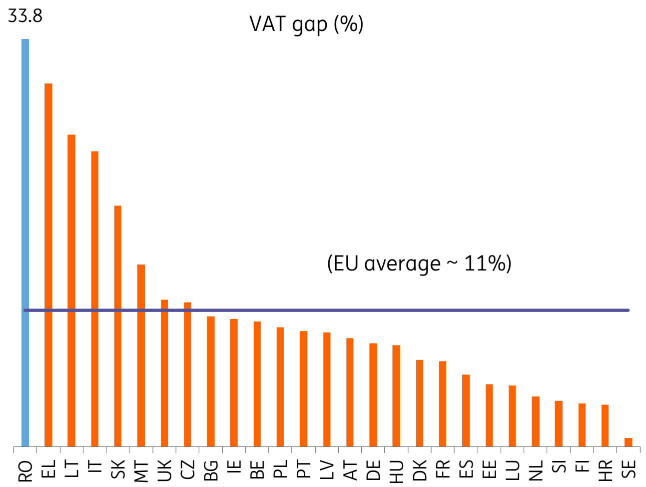
As of July-2020 the budget deficit already exceeded the full 2019 gap. Around half of it is crisis related

Hard to scale back

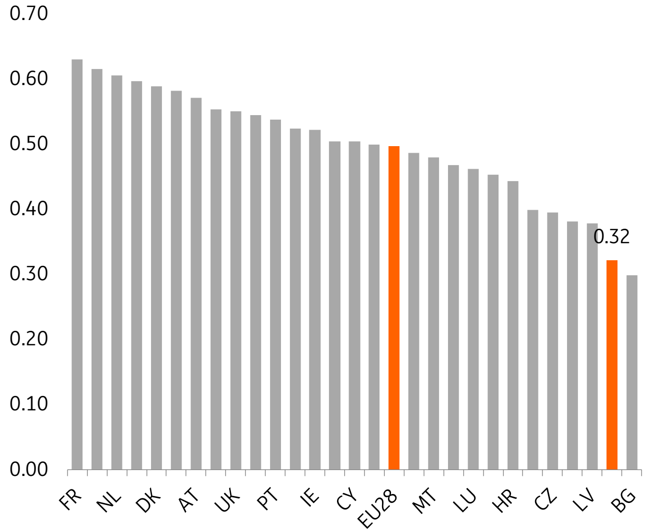
Public wages and social spending (mainly pensions) takes the structural deficit to record levels

Medium-term fiscal outlook

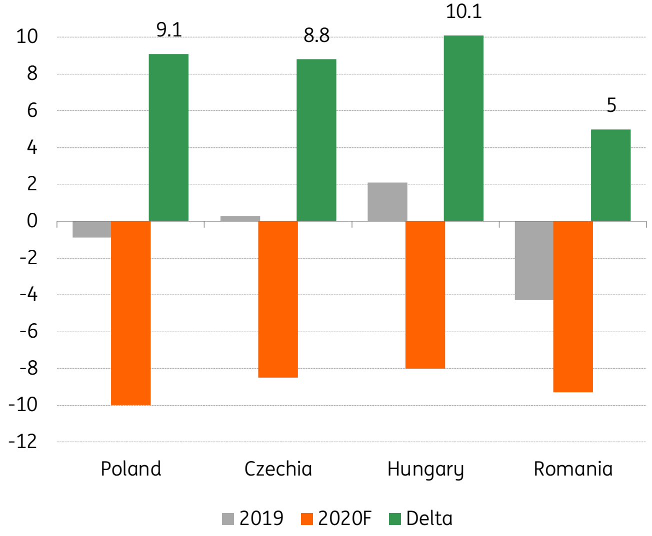
Largest VAT gap in Europe



Lack of automatic stabilizers leads to discretionary policy



Fiscal impulse limited in Romania by the weaker starting point



Untacked tax evasion

Low compliance rate, WB program for ANAF declared off-track, large share of self-produced consumption in GDP

Limited room

The budgetary semi-elasticity indicates by how much the budget balance changes as % of GDP when the output gap increases by 1ppt.

Fiscal impulse - lowest in Romania

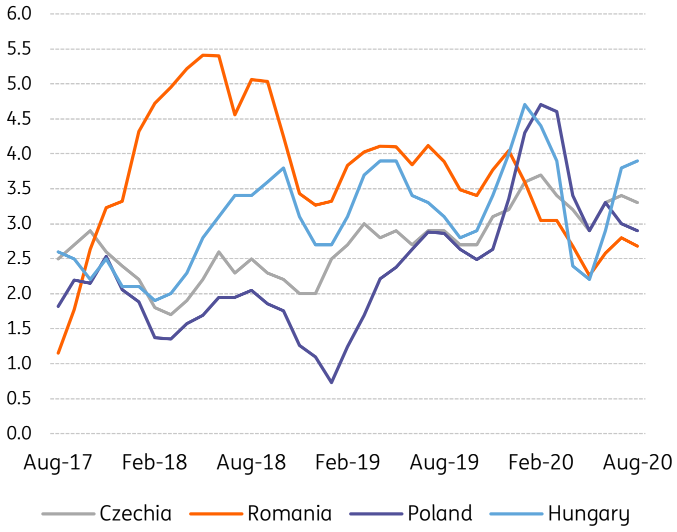
By regional standards, the budget gap will not look overly negative, but its inherent rigidity is the main problem

3. Monetary policy

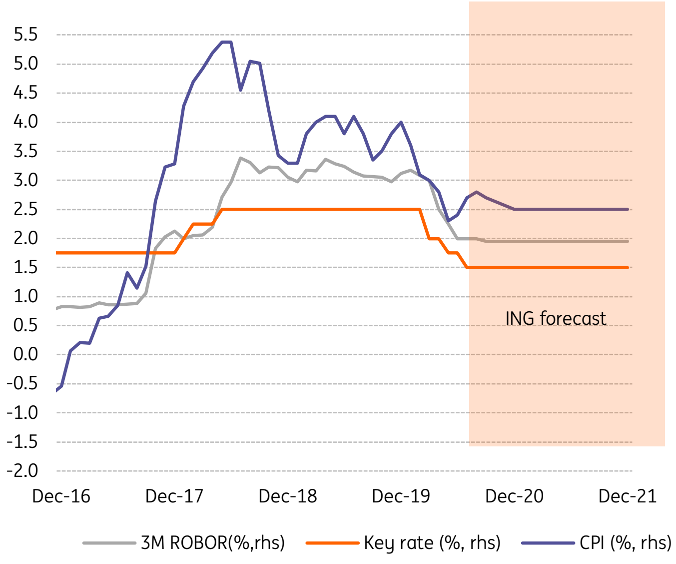
Keeping many balls in the air

Done with rate cuts

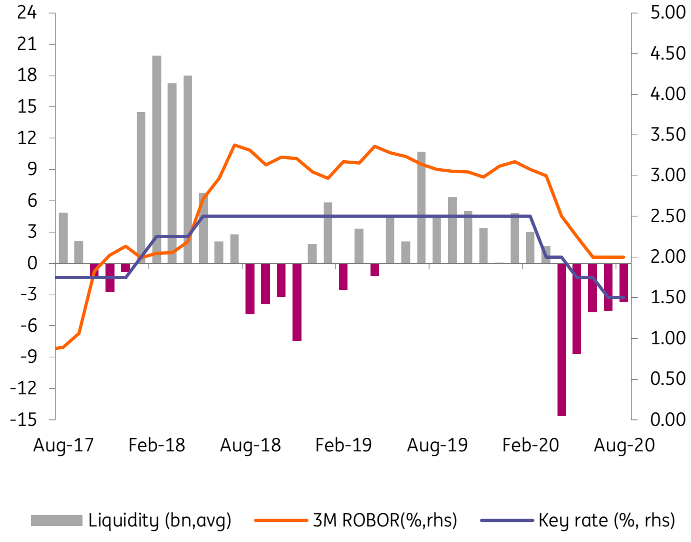
Romania: calmer inflation profile



Inflation to stabilise around the 2.50% target for an extended period

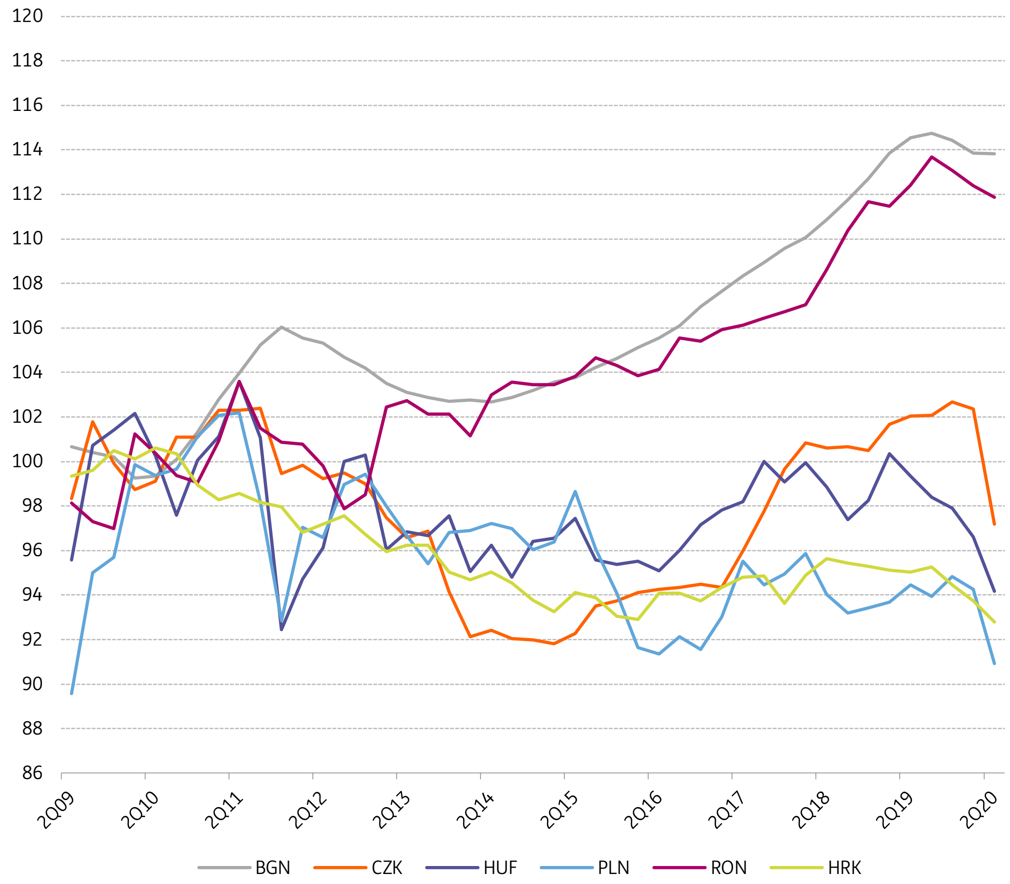


Liquidity management remains a tool of choice



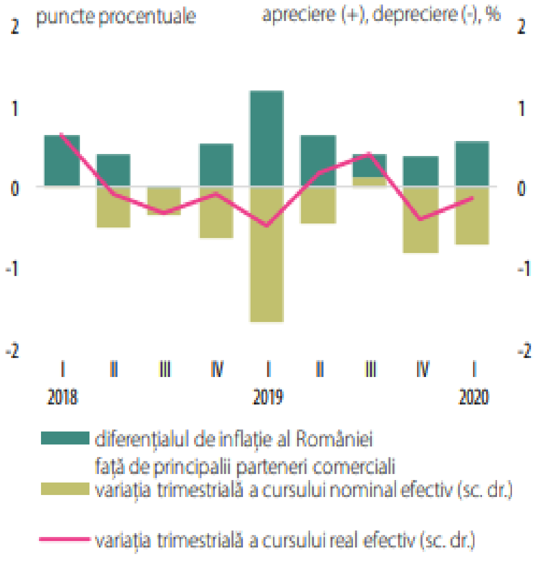
RON: getting more and more expensive

Real effective exchange rate (price deflator GDP, market prices)



May-19 Inflation Report: real effective exchange rate is likely to appreciate

Grafic 4.9. Variația trimestrială a cursului de schimb efectiv

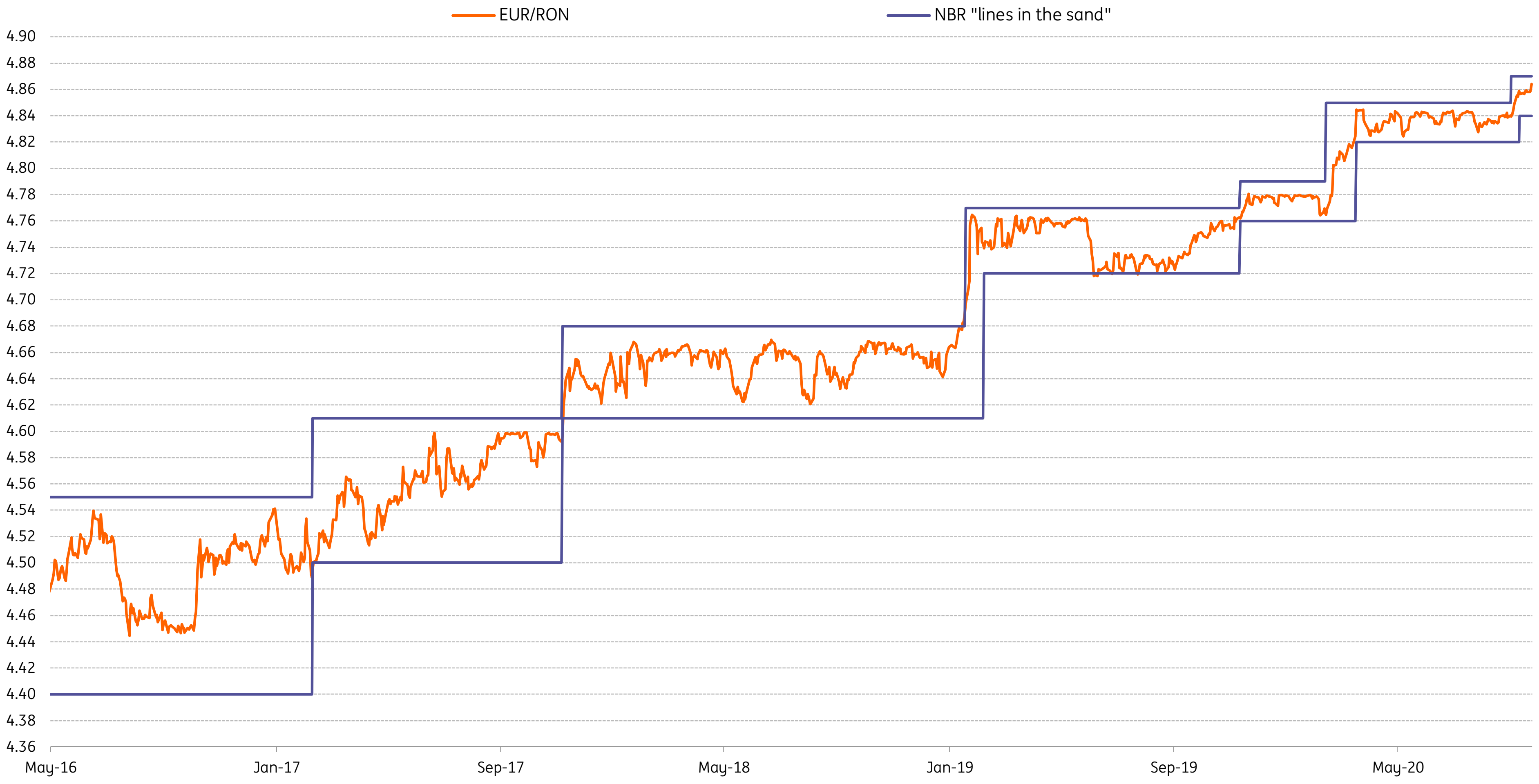


Sursa: Eurostat, U.S. Bureau of Labor Statistics, BNR, calcule BNR

Componenta aferentă efectului cursului de schimb real efectiv (Grafic 4.9), prin intermediul canalului exporturilor nete, este estimată a înregistra în continuare o contribuție în sensul atenuării gradului de stimulativitate a condițiilor monetare reale în sens larg, pe seama aprecierii anticipate în termeni reali a monedei naționale pe cvasitotalitatea intervalului de prognoză, sub impactul diferențialului de inflație față de partenerii comerciali[92].

Efectul de avuție și de bilanț este estimat a exercita un impact restrictiv asupra condițiilor monetare reale în sens larg în prima jumătate a intervalului de prognoză și unul cvasineutru ulterior. În structură, se remarcă, pe de o parte, poziționarea favorabilă a ratei reale a dobânzii externe (EURIBOR la 3 luni). Pe de altă parte, însă, se evidențiază efectul mai marcant și nefavorabil al creșterii anticipate a primei de risc suveran[93] în prima parte a intervalului de prognoză,

A new 4.8500-4.8800 range is shaping-up, NBR still on top



4. Sovereign rating outlook

Delaying the unavoidable?

Few months to breathe, but Fitch will be at least as tight as S&P

Factors that could lead to an upgrade or downgrade

Agency (review date)	Upgrade Drivers	Downgrade Drivers
Moody's Baa3 neg (23 Oct)	For outlook back to stable: • Successful halt and – over the medium-term – reversal of the structural deterioration in **public finances** • Improved **fiscal sustainability** driven by structural fiscal consolidation in the medium-term (higher tax collection and lower share in current expenditure) • Steady reduction in the **structural current-account deficit** and increased coverage by non-debt generating flows, together with a rebalancing towards higher investment expenditure	Resolution of negative outlook expected over the next 12-18 months absent further severe shocks to the economy and/or intensification of financial risks: • Continued structural deterioration in **fiscal strength** while **external imbalances** remain at an elevated level • Weaker assessments of **institutional and governance strength**, driven by the absence of a determined and effective policy response to structural challenges in the medium-term (incorporates policy agenda after 2020/21 elections)
S&P BBB- neg (4 Dec)	For outlook back to stable: • Government makes headway in anchoring **fiscal consolidation**, leading to stabilisation of public finances and external position	• **Fiscal and external imbalances** remain elevated for longer than anticipated, with absence of fiscal consolidation resulting in higher public and external debt or a wider interest bill than forecasted • Lack of **economic policy synchronization** leading to increased exchange rate volatility, with potential negative repercussions on public- and private-sector balance sheets
Fitch BBB- neg (30 Oct)	• Confidence that **general government debt/GDP** will stabilise over the medium-term (e.g. due to post-pandemic fiscal consolidation) • Sustained improvement in **external debt ratios**	• Sharp deterioration in **medium-term debt sustainability** (e.g. due to failure to offset or delay increases in recurrent expenditure and/or implement a credible medium-term consolidation strategy post-pandemic shock) • Weaker **medium-term growth prospects** (e.g. reflecting a more pronounced or longer period of economic contraction that leads to permanent sectoral damage)

Comparison of INGF and rating agency forecasts

		2019	2020F	2021F	2022F
GDP growth (% YoY)	ING	4.1	-5.5	5.2	5.0
	Moody's (Apr 20)	4.1	-5.0	4.0	
	S&P (Jun 20)	4.1	-5.5	4.0	3.0
	Fitch (Apr 20)	4.1	-5.9	5.3	4.0
CPI (% YoY)	ING	3.8	2.8	2.5	3.0
	Moody's (Apr 20)	4.0	2.8	3.0	
	S&P (Jun 20)	3.9	2.5	3.5	3.7
	Fitch (Apr 20)	3.9	2.5	3.2	
General government balance (% of GDP)	ING	-4.6	-9.3	-6.3	-3.3
	Moody's (Apr 20)	-4.3	-7.7	-6.2	
	S&P (Jun 20)	-4.3	-8.0	-4.0	-3.0
	Fitch (Apr 20)	-4.3	-7.9	-4.2	
General government primary balance (% of GDP)	ING	-3.5	-7.8	-4.8	-2.9
	Moody's (Apr 20)	-3.1	-6.3	-4.8	
	S&P (Jun 20)	-3.1	-6.5	-2.3	-1.3
	Fitch (Apr 20)	-3.1	-6.5	-2.8	-2.5
General government debt (% of GDP)	ING	35.4	45.9	48.8	48.4
	Moody's (Apr 20)	35.2	43.7	46.8	
	S&P (Jun 20)	35.2	46.2	46.7	46.6
	Fitch (Apr 20)	35.2	44.6	44.9	46.1
Current account balance (% of GDP)	ING	-4.6	-3.5	-3.5	-3.5
	Moody's (Apr 20)	-4.6	-3.4	-2.4	
	S&P (Jun 20)	-4.6	-4.8	-4.4	-4.4
	Fitch (Apr 20)	-5.0	-3.0	-3.8	

Forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020F	2021F	2022F
Activity													
Real GDP (%YoY)	-3.9	1.9	2.0	3.8	3.6	3.0	4.7	7.3	4.5	4.2	-5.5	4.1	5.0
Private consumption (%YoY)	-4.6	1.5	1.8	0.5	4.6	5.8	8.2	9.8	10.1	6.0	-3.3	4.5	4.0
Government consumption (%YoY)	-1.6	-1.2	7.4	-1.6	6.1	-3.8	0.0	4.4	3.3	6.0	3.9	3.0	3.0
Investment (%YoY)	-2.8	6.1	3.1	-5.9	3.8	7.0	-0.1	3.5	2.5	-2.6	3.0	5.5	5.0
Industrial production (%YoY)	4.9	8.1	3.0	7.7	6.4	2.7	3.1	8.7	4.4	-3.2	-11.0	4.9	3.7
Unemployment rate (year-end, %)	7.0	7.1	6.9	7.0	6.8	6.8	5.9	5.0	4.2	3.9	5.3	5.3	4.8
Nominal GDP (RONbn)	529	559	592	635	670	712	764	858	952	1060	1052	1130	1210
Nominal GDP (€bn)	126	132	133	144	151	160	170	188	205	223	222	231	246
Nominal GDP (US$bn)	166	185	171	191	199	176	187	214	241	248	255	284	303
GDP per capita (US$)	8,200	9,200	8,500	9,600	10,000	8,900	9,500	10,900	12,400	12,800	13,300	14,900	16,100
Gross domestic saving (% of GDP)	20.7	22.3	21.8	24.8	24.2	24.5	22.4	21.0	19.4	19.1	21.5	21.6	21.4
Prices													
CPI (average, %YoY)	6.1	5.8	3.3	4.0	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	2.2	2.4
CPI (year-end, %YoY)	8.0	3.1	5.0	1.6	0.8	-0.9	-0.5	3.3	3.3	4.0	2.0	2.6	2.5
Wage rates (nominal, %YoY)	2.5	5.0	5.0	5.0	5.3	8.4	13.0	14.2	13.1	14.9	6.4	5.0	5.0
Fiscal balance (% of GDP)													
Consolidated government balance	-6.9	-5.4	-3.7	-2.1	-1.2	-0.6	-2.6	-2.6	-2.9	-4.4	-9.6	-7.3	-5.5
Consolidated primary balance	-5.4	-3.8	-1.9	-0.3	0.5	1.0	-1.1	-1.4	-1.8	-3.2	-7.9	-6.3	-4.1
Total public debt	29.6	34.0	37.1	37.6	39.2	37.8	37.4	35.1	34.7	35.3	45.9	49.7	51.5

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