ROMANIA

Economic Outlook

Autumn Report

November 2016

BRD

GROUPE SOCIETE GENERALE

Motto: "Il n'est pas certain que tout soit incertain"
Blaise Pascal

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I. Executive Summary

Gross Domestic Product: Shaky gyroscope. Private Consumption looks set to remain the backbone of economic growth, propelled by a new round of fiscal stimulus. Positive private demand prospects, low borrowing costs and restrained input costs will most likely constitute an impetus for companies to further increase investment spending. Meanwhile, net exports are expected to continue to detract from growth, as rising domestic demand fuels imports while exports expansion shall remain moderate.

We revised our average 2016 growth forecast to 4.7% (vs. 3.9% prev.). For 2017 and 2018, we expect a growth rate of 3.8% and 3.9%, respectively.

Inflation: Getting "ought" from "is". We expect domestic inflation to increase gradually in the coming quarters, on account of several factors: i) consumption-driven widening of output gap, ii) ongoing increase in wage pressures, iii) waning drag from past declines in commodity prices, corroborated with upward base effects, iv) fading out of the effect of past indirect tax cuts. We estimate annual inflation rate to reach -0.5% at end-2016 and to increase to 1.5% at end-2017 and further to 2.7% at end-2018.

Labour market: On the edge. Employment growth is expected to continue, although at a more modest pace, taking into account persistent rigidities in the labour market. Accordingly, we envisage ILO unemployment rate to average 6.2% in 2016 and to settle at 6.1% in 2017/2018.

Average nominal net wage is likely to record steady growth in the following quarters, albeit at a slower pace, underpinned by the current tightening labour market and deepening skill mismatches, which are likely to induce stronger competition both between companies and sectors in order to attract and retain workforce.

External Sector: Tacking against the wind. We project current account deficit to widen to 2.0% of GDP this year. Over the next two years, current account shortfall is expected to increase further, as growing domestic demand shall maintain import growth at strong levels, thus weighing on the trade balance. That said, we currently envisage current account gap to rise to 2.4% of GDP in 2017 and 2.7% of GDP in 2018, levels deemed sustainable and consistent with the necessity of attracting external savings to ensure real convergence.

Fiscal Policy and Public Debt: A no slam dunk case. We see the risk of budget deficit exceeding the target as relatively low this year, but it increases considerably next year, given the expected reduction in budget revenues and the potential overshooting of the projected level of expenditures, taking into account policy loosening measures that are currently envisaged. Hence, estimating fiscal gap for next year is a daunting task, with our expectations spanning from 2.5% to 4.5% of GDP. In a worst case scenario, assuming all promises are kept, fiscal deficit might head towards the upper bound of the aforementioned interval. Meanwhile, a prudent fiscal approach is the right way towards complying with Maastricht criteria.

Money market and Monetary policy: Walking on quicksand. Taking into account the lower than previously forecasted inflation trajectory, the frail lending growth, the accommodative stance of ECB and other regional banks, as well as ongoing uncertainties surrounding future macroeconomic/financial developments, we assess a low probability of a policy rate hike next year, with a higher likelihood of a rate increase associated with 2018.

However, in case the risk of consistently exceeding the inflation target in the medium term builds up, it could be appropriate to raise the interest rates sooner, during the second half of 2017.

In the meantime, in view of the pro-cyclical fiscal stance and the high wage growth, NBR could signal a tightening bias through a narrowing of interest rate corridor.

The evolution of interbank rates will continue to be determined by the following factors: NBR's liquidity management policy, MinFin issuance strategy and external developments. We currently do not assess a significant deviation from present levels in the coming quarters.

Forex market: Beyond the noise. RON is likely to remain under pressure (trading around 4.50 against the EUR) until year-end and witness some episodes of higher volatility than usual.

Throughout 2017, we see EURRON evolution as being influenced by several factors: i) further real convergence of the economy, subdued domestic and imported inflation, capital inflows, which should support RON strengthening; ii) ongoing risks of fiscal slippages, further deterioration of external position, uncertainties related to external environment which could trigger renewed bouts of risk aversion, generating depreciation pressures. We thus expect EURRON to trade closer to the top of the 4.40-4.50 range for most of 2017, recording an average level of 4.48. For 2018, we expect EURRON to post an average level of 4.46.

Capital market: Ending a disappointing year, lacking new comers to stock exchange ring. In the past six months the performance of the local stock exchange was affected by local and international events, which increased the volatility of the equity markets and diverted funds toward safer assets. The listing of remaining state companies was again postponed to 2017, while private companies continued to prefer other financing sources. At the end of September, Bucharest Stock Exchange announced the inclusion of the stock exchange on the watch list for promoting to Secondary Emerging Category by FTSE Russell. The promotion to a superior market category would put the local stock exchange on the radar of new investors following emerging markets and could translate in a significant increase of funds flows towards local equities, thus enhancing both liquidity and capitalisation of the market.

Banking sector: Dynamic environment raises challenges. On short run, one of the main challenges for local banking sector is related to the interference of political factor into free market mechanism, which might hamper banks' solid capital position and performance prospects. We revised downwards non-governmental loans growth estimations for 2016 and 2017, such as: +1.9% y/y (nominal terms) end-Dec'16 (vs. +3% y/y, previously), +3.0% y/y (nominal terms) end-Dec'17 (vs. +3.5% y/y, nominal terms, previously) and +3.7% y/y end-Dec'18, with major driver remaining households borrowing demand. Contrary to the feeble growth of lending, deposits record strong increases, exceeding all our expectations. We believe that at some point households propensity towards savings might decrease, directing investments into more risky assets. We reviewed upwards our deposits growth from our previous report to approx. +5.1% y/y (nominal terms) as of end-Dec'16 from +3.3% y/y (nominal terms) and we modified downwards to +0.6% y/y (nominal terms) end-Dec'17 from +3.6% y/y (nominal terms). For 2018, we estimate a decrease of deposits (-2.1% y/y, nominal terms) as we expect loans to deposits ratio to improve up to 0.9 as of end-Dec'18 vs. 0.85 as of end-Dec'15.

II. Macroeconomic Outlook

II.1. Gross Domestic Product – Shaky gyroscope

Ioan Mincu
george.mincu-radulescu@brd.ro

In H1'16 domestic GDP recorded a brisk performance (+5.2% y/y), boosted by a surprisingly strong print in Q2'16 (+6.0% y/y), mostly thanks to vigorously rising private consumption, which benefited from higher real disposable incomes, lax fiscal policy, improving labour market and accommodative financing conditions. Stronger investment activity was also pushing economic growth up, but to a smaller extent. Meanwhile, rapidly increasing imports deepened the negative contribution of trade to GDP growth. On supply side, GDP advance was primarily underpinned by growth in market services' sector, while the other major economic branches brought only marginal contributions.

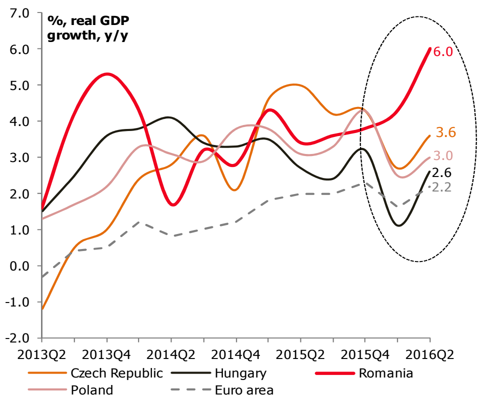
Romania was a clear positive outlier among CEE peers in terms of growth performance during the first half of 2016. The rest of the region experienced a marked slowdown, mainly due to a decline in fixed capital formation, linked with a temporary drop in EU funds absorption at the beginning of the new budget planning period for 2014 – 2020 (particularly in Hungary, Poland – the largest beneficiaries). Besides the reduced absorption of EU funds, subdued investment growth can be traced to increased foreign demand uncertainty, related to the protracted weakness in the global economic environment.

GDP – breakdown by components

Q2 2016	Share in GDP (%)	Contribution to growth (percentage points)
Supply side/Resources		**6.0**
Industry	**23.1**	**0.7**
Agriculture	**2.3**	**0.4**
Constructions	**5.1**	**0.3**
Services	**58.4**	**4.2**
Retail, Tourism, Transport	18.5	2.1
Information and communication	7.1	1.1
Financial Services	3.7	0.1
Real Estate Transactions	7.9	0.1
Professional, Scientific Activities	7.2	0.3
Public administration	11.1	0.4
Other services	2.9	0.1
Gross value added	**88.9**	**5.6**
Net taxes	**11.1**	**0.4**
Demand side/Uses		**6.0**
Final consumption	**79.3**	**7.5**
Households	71.5	6.8
Public sector	7.8	0.7
Gross Fixed Capital Formation	**24.9**	**2.6**
Inventories	**-3.3**	**-1.9**
Net exports	**-0.9**	**-2.2**
Exports	43.9	3.8
Imports	44.8	5.0

Source: NIS, BRD-GSG Research

Romania – outperforming regional peers in Q2 2016



Source: Eurostat, BRD-GSG Research

The higher than expected first quarter GDP fostered an early reversal of the cyclical position of the economy, the shift to a positive output gap taking place in Q1'16. Looking ahead, according to NBR's August projections, the positive output gap is projected to widen gradually, mirroring the impact of fiscal stimulus and real wage increases, in a context of accommodative monetary conditions. Opposite influences are expected to be exerted by the unfolding story of Brexit and its likely negative spillover effects, geopolitical uncertainty, slow moving trends (i.e. demographics, productivity), changes in domestic banking legislation.

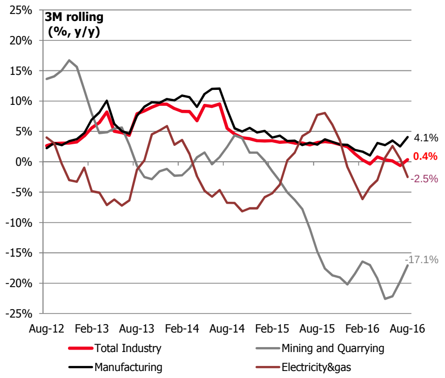
Supply side

Industry gained pace in the second quarter and rose by 2.7% y/y (vs. +0.6% y/y in Q1'16). The expansion was mostly underpinned by manufacturing activity (+3.5% y/y in Q2'16, seasonally adjusted), with improved annual dynamics being reported by most manufacturing sub-sectors. Noteworthy contributions came from food industry, manufacture of electrical equipment, road transport means, furniture and non-metallic mineral products. Besides manufacturing sector, growth in industry was also supported by the rise in energy production (+2.6% y/y). By contrast, mining and quarrying decline deepened (-22.2% y/y).

In terms of use, durable goods output added +9.7% y/y in Q2'16, intermediate goods increased by 2.8% y/y and non-durable goods advanced by 2.7% y/y. Conversely, capital goods production retrenched by 0.9% y/y.

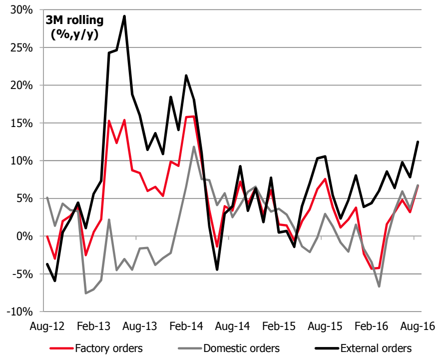
Surprising at first sight, the discrepancy between the strong rise in retail trade turnover and the much slower growth in industrial sector, partially lies in the fact that the spike in consumer demand was mainly covered by imports, while domestic producer sales recorded more modest advances. This development is explained among others by greater import competition, increasing consumers' quality consciousness and shifting consumption preferences towards more sophisticated products, linked with higher disposable incomes.

Industrial output – lackluster evolution



Source: NIS, BRD-GSG Research

Factory orders - picking up



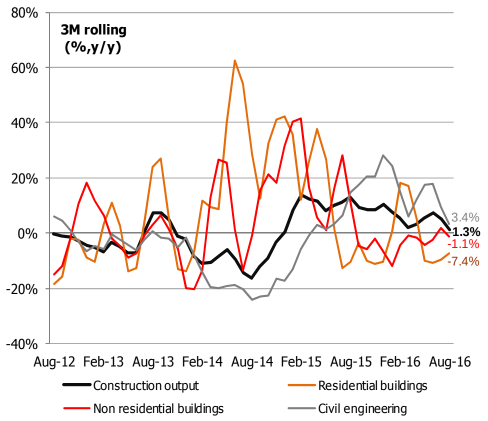
Source: NIS, BRD-GSG Research

The second half of the year could see industry performing stronger, judging by the swift increase in factory orders, both domestic and external, between Jul-Aug'16 (+8.0% y/y) and the positive readings recorded by industrial confidence index.

Agriculture rebounded after a weak first quarter and expanded by 17.9% y/y. According to European Commission's autumn estimates, domestic cereal production is projected to decrease slightly by 0.3% y/y in 2016, from 18.62m to 18.57m tones, while crop yield is seen remaining flat at 3.4 tonnes/ha.

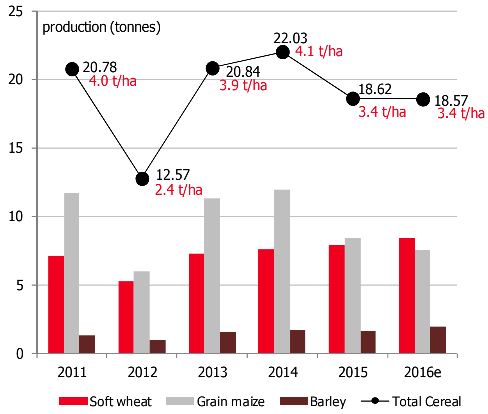
Constructions gathered steam in Q2'16 (+7.0% y/y vs. +1.8% y/y in Q1'16). Q2'16 advance captures the double-digit increase in Civil engineering works (+18.0% y/y in Q2'16), consistent with larger Capital expenditures from the general consolidated budget through H1'16 (+31.4% y/y). Meanwhile, construction of Residential (-10.9% y/y) and Non-residential buildings (-2.5% y/y) registered a contraction in the second quarter.

Construction sector – losing steam in Q3'16



Source: NIS, BRD-GSG Research

Crop production – to stay almost flat



Source: EC Autumn estimates, BRD-GSG Research

The July and August data showed a turnaround in construction output, which recorded a pronounced slowdown, with annual dynamics crossing into negative territory in Aug'16 (-1.3% y/y). This is mainly attributable to a sharp drop in the annual growth rate of civil engineering works (-2.7% y/y in Aug'16 vs. +9.8% y/y in Jun'16). Construction of residential buildings remained slanted into the negative (-7.9% y/y in Aug'16), while the increase in non-residential buildings was only modest (+0.9% y/y).

As regards forward-looking indicators, the number of building permits issued spiked in Sep'16 (+15.9% y/y), but overall dynamics for Q3'16 were negative (-5.2% y/y). Construction confidence index weakened in Oct'16 (-13.1 vs. -11.9 in Sep'16).

Non-residential construction might expand at a stronger pace in the future, with office and retail construction being the largest contributors to this growth, based on Romania's increased attractiveness as an outsourcing destination and the ongoing expansion of the distribution networks of large, modern retailers. In the meantime, outlook for residential buildings is riddled with uncertainties stemming from debt discharge law and the future of "First Home Program". Turning to civil engineering works, they are likely to remain subdued until year end, but could see an upshot in 2017/2018 given the dire need for infrastructural upgrades and a quickening in EU funds absorption.

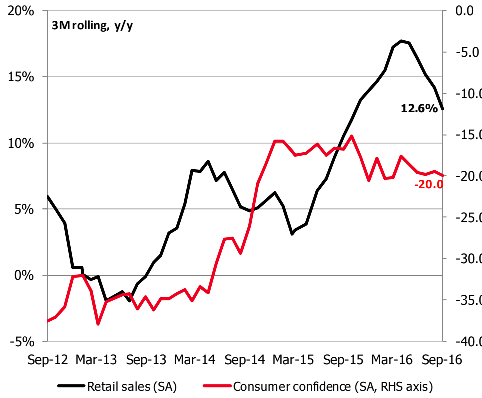
Gross value added growth in the **service sector** accelerated significantly. In addition to the steady expansion in Trade, hotels and restaurants and transport (+11.9% y/y), a general expansion was observed in the other subsectors. IT&C posted a stellar performance, bouncing to +17.3% y/y. Public Administration services (+4.4% y/y) and Professional, scientific, technical and administrative activities (+4.3% y/y) performed well too.

Positive sentiment of service sector companies and the strong consumer demand outlook should further support the services activity in the next quarters.

Demand side

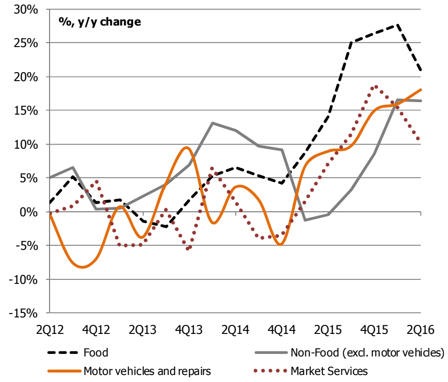
Private consumption rose at a sturdy pace of 9.5% y/y in Q2'16 (vs. 8.3% y/y in Q1'16). The surge was fostered by high wage growth, low inflation, enacted VAT cuts and easy financing conditions. Growth in consumption expenditure was channeled into all the monitored categories, being primarily driven by short term consumption, but there was a significant rise in sales of durables as well (i.e. motor vehicles).

Retail sales – high, but fading momentum



Source: Eurostat, NIS, BRD-GSG Research

Household consumption expenditure increased in all categories

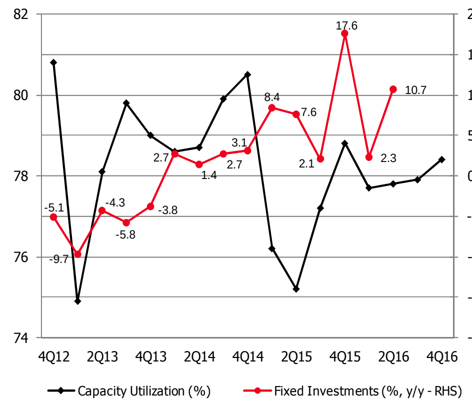


Source: NIS, BRD-GSG Research

Along with households' consumption expenditures, the increase in public consumption and transfers in kind from the government contributed to the expansion in final consumption. Growth in **real government final consumption** expenditure stood at 9.8% y/y in Q2'16, bringing 0.7 percentage points to GDP growth.

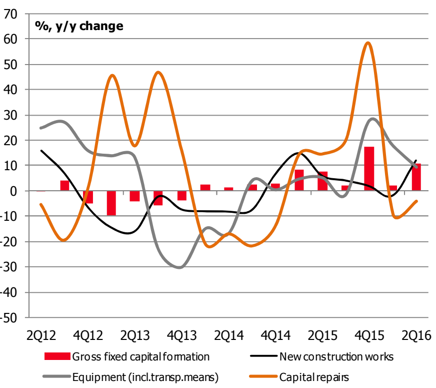
Annual growth in **Gross fixed capital formation** was upbeat in Q2'16 (+10.7% y/y vs. 2.3% y/y in Q1'16). Both new construction works and spending on machinery & equipments recorded positive dynamics, increasing by 11.9% y/y and 9.3% y/y, respectively.

Investment accelerated in Q2'16



Source: Eurostat, NIS, BRD-GSG Research

Investment structure



Source: NIS, BRD-GSG Research

Net exports of goods and services weighed on economic activity, shaving off 2.2pp, as exports growth (+8.5% y/y) lagged behind imports' one (+13.5% y/y).

GDP prospects:

Private Consumption looks set to remain the backbone of economic growth, propelled by a new round of fiscal stimulus. Yet, the peak might be already behind us, taking into account the slowing momentum in retail sales, the expected increase in inflation and slower growth in employment.

Positive private demand prospects, low borrowing costs and restrained input costs will most likely constitute an impetus for companies to further increase investment spending. On the flip side, curbing investment growth, could act the protracted period of uncertainty related to Brexit.

Meanwhile, net exports are expected to continue to detract from growth, as rising domestic demand fuels imports, while exports expansion shall remain moderate.

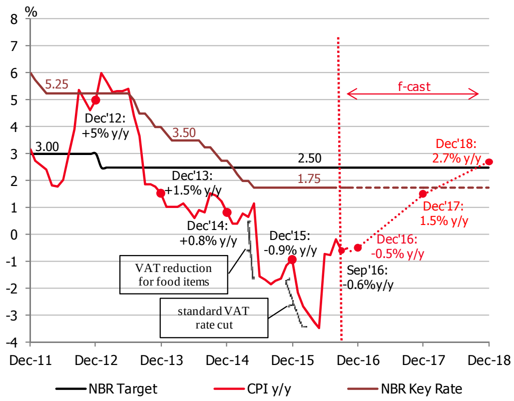
Given the upside surprise in domestic growth in Q2'2016, we revised our average 2016 growth forecast to 4.7% (vs. 3.9% prev.). For 2017 and 2018, we expect a growth rate of 3.8% and 3.9%, respectively.

II.2. Inflation – Getting "ought" from "is"

Ioan Mincu
george.mincu-radulescu@brd.ro

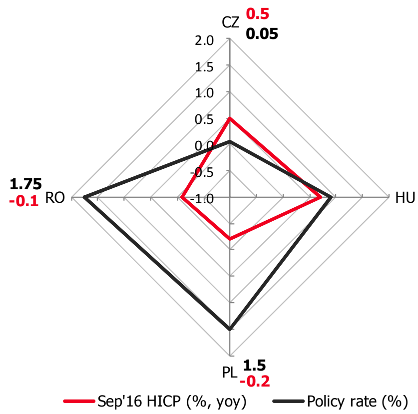
Annual inflation rate has been stuck in negative territory since June'15, due to a combination of exogenous deflationary shocks (successive cuts in indirect taxes, supply-side shocks, management of administered prices), which mask the build-up in underlying inflationary. The effects of the aforementioned shocks permeated into inflation either directly (i.e lower energy and fuel prices), or indirectly, through a reduction of production and import costs. Given the transient nature of these exogenous shocks (usually lasting for a one year period), NBR's response was to accommodate the temporary deviation from the inflation target, while actively seeking to counter the risk posed by second round effects.

Annual CPI – expected to embark on an upward trajectory



Source: NBR, NIS, BRD-GSG Research

Subdued inflation in the region



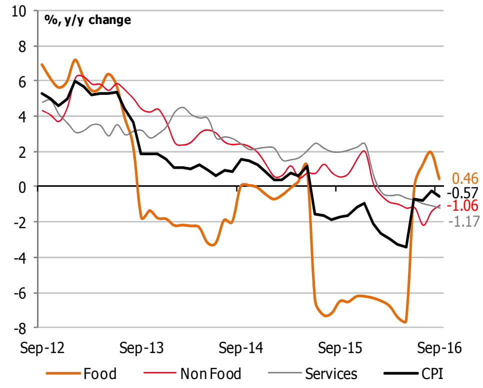
Source: Eurostat, BRD-GSG Research

Annual inflation rate hit rock-bottom in May 2016 (-3.5% y/y), but rebounded thereafter given the dropping-out of the first-round effect of the VAT rate cut for food products (implemented in June 2015) from its calculation.

According to the latest reading released by NIS, annual CPI rate stood at -0.6% in Sep'16. The figure was slightly below the one projected in the August Inflation Report (-0.4%), due to the lower-than-forecast price dynamics of unprocessed food. Meanwhile, average annual HICP inflation printed at -1.3% in Sep'16, registering a negative gap versus the EU-wide average inflation of 1.4 percentage points.

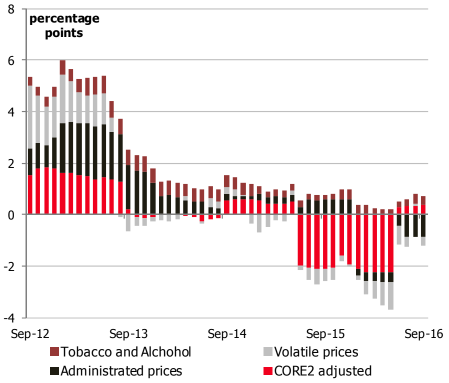
Looking at the breakdown by components, only Food prices are experiencing a positive annual rate of change (0.46% y/y in Sep'16), while Non-food (-1.06% y/y) and Services (-1.17% y/y) price dynamics remain slanted into the negative.

CPI – breakdown by components



Source: NIS, BRD-GSG Research

Administered prices – main drag on annual CPI

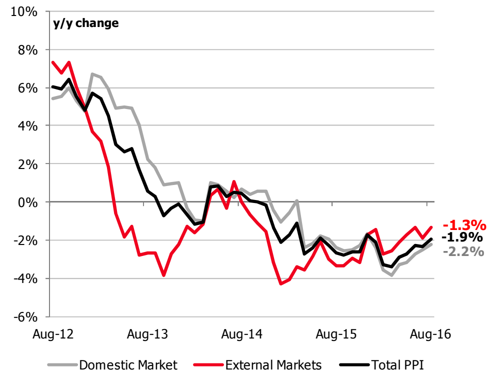


Source: NIS, BRD-GSG Research

Adjusted CORE2 inflation rate re-entered positive territory starting with Jun'16 and increased gradually to 0.55% y/y in Sep'16, its trajectory being shaped by divergent developments across its main drivers: continuing wage growth and strong domestic demand pushed it up, while low imported inflation and subdued inflation expectations restrained its advance.

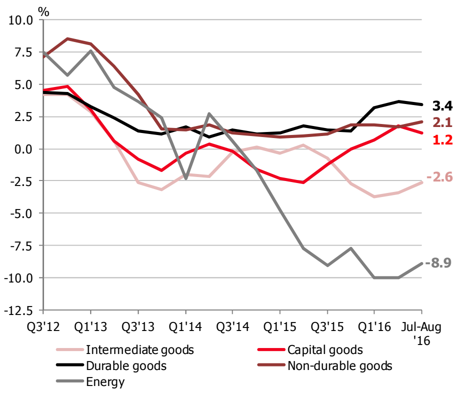
The long-running annual decline in industrial producer prices started to moderate beginning with Q2'16, narrowing to -1.9% in Aug'16 (vs. -3.4% in Mar'16), in line with the partial recovery in international prices of some commodities (oil, metals, agricultural). The year-on-year decline in prices slowed for both domestic (-2.2% in Aug'16 vs. -3.8% in Mar'16) and imported (-1.3% in Aug'16 vs. -2.6% in Mar'16) inputs.

Moderating decline in producer prices



Source: NIS, BRD-GSG Research

... in all industrial groups



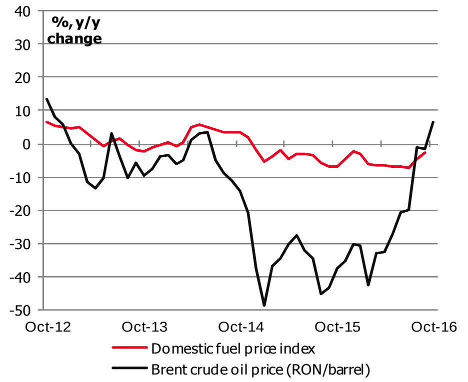
Source: NIS, BRD-GSG Research

A closer look at the individual industries within the producer price index reveals sizeable differences between its components. Prices of electricity, gas, steam and air-conditioning have been falling at an annual pace of around 6%, as a result of lower electricity distribution tariffs and of the fall in electricity prices on the deregulated market. The decline in producer prices in the manufacture of coke and refined petroleum products eased considerably, yet remained sharp (-17.9% y/y in Aug'16). Significant decreases in producer prices were also reported by manufacture of chemical products (-12.0% y/y in Aug'16), basic metals (-3.9% y/y), fabricated metal products (-2.9% y/y) and mining and quarrying (-2.5% y/y). On the other hand, positive growth rates were recorded in the case of consumer goods prices (+3.4% y/y for durables and +2.1% y/y for non-durables), mirroring the influence of both domestic factors (robust demand, higher unit wage costs) and external ones (i.e lower disinflationary pressures from external prices of some agri-food items). The dynamics of producer prices for capital goods slowed down, owed to exchange rate movements, staying in slightly positive territory (0.9% y/y in Aug'16).

The risk factors for the inflation outlook are related to both the external and domestic economic environment. Externally, they are largely associated with the economic, political and institutional uncertainty around Brexit negotiations, which may lead to deteriorating confidence and lower economic activity in the euro area over the projection horizon. This would impact domestic inflation both through import prices, but also through the negative reverberations on economic activity, transmitted via foreign trade, financial and confidence channels.

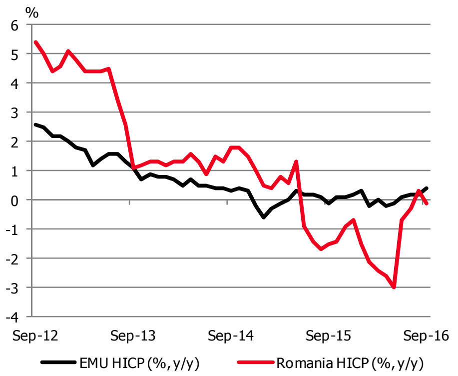
Moreover, similar effects might stem from the persistent uncertainties concerning global growth outlook, geopolitical tensions, the increasing pressure for inward looking-policies, ongoing realignments (rebalancing in China and the adjustment of commodity exporters to a protracted decline in the terms of trade) and the challenges in the EU banking system.

Domestic fuel prices and crude oil prices



Source: EIA, NIS, BRD-GSG Research

Eurozone vs. domestic HICP



Source: NIS, Eurostat, BRD-GSG Research

Oil price outlook remains a source of uncertainty for inflation trajectory. Since end-September 2016, markets moved sideways, with ICE Brent trading range bound between USD 48-53/barrel throughout October, primarily driven by expectations that the deal reached in Algiers will be finalised and implemented at OPEC meeting in Vienna at end-November. The agreement implies a cut in daily output to 32.5-33.0 million barrels (vs. an estimated record level of 33.6mb/d in Sep'16). However, some key details, such as country quotas, whether Iran would be allowed an output increase, or if Nigeria and Libya will be exempt from cuts in order to recover from disruptions are yet to be settled. According to IEA Oil Market Report for October, non-OPEC supply is forecast to drop by 0.9mb/d in 2016, but to rebound by 0.4mb/d in 2017. Annual global oil demand growth is projected to expand at around 1.2mb/d in 2016/2017, the slowest pace in four years. Consequently, the reduction in OPEC output has become increasingly important now, given that fundamental outlook became less bullish and rebalancing process could tip over. According to SG analysts, ICE Brent prices are forecast at USD 50 in Q4'16, USD 52.50 in Q1'17, and USD 56.3 on avg. for 2017. Yet, much depends on the outcome of OPEC November's meeting.

Noteworthy risks stemming from domestic developments are represented by:

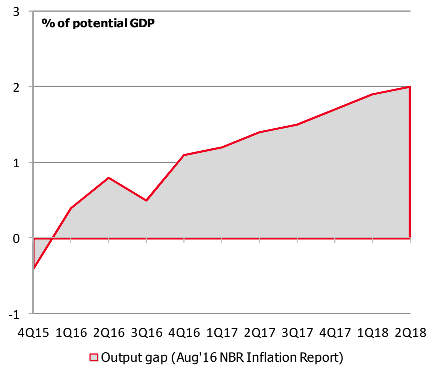
i) <u>future fiscal and income policy stance</u> – new additional easing measures would foster the buil-up of inflationary pressures.

ii) <u>legislative changes in the banking sector</u>, which can have a contractionary effect on lending activity and domestic economic activity, exhibiting downside pressure on inflation.

iii) administered price evolution, which is seen as posing relatively balanced risks to projected CPI path. The price liberalization timetable for natural gas from domestic production for household consumers is currently frozen. Meanwhile, the further liberalization of electric energy market could entail new downward adjustments in electricity prices, given that the competitive price is currently lower than the regulated one.

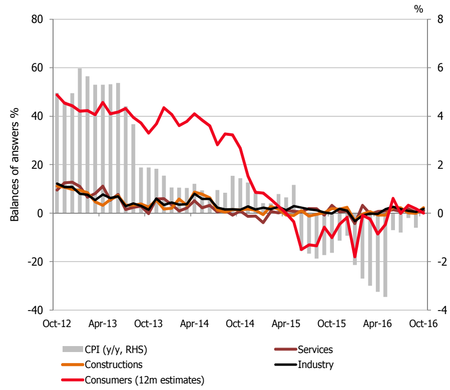
iv) domestic volatile food price developments – potential price hikes in case of adverse weather conditions, magnified by a low base effect.

Build-up in underlying inflationary pressures



Source: NBR, BRD-GSG Research

Subdued inflation expectations



Source: Eurostat, BRD-GSG Research

The expectations regarding domestic price developments over the next three months increased slightly in October across all main economic sectors, remaining low, yet positive. Meanwhile, consumer inflation expectations weakened from 1.8 in Sep'16 to 0 in Oct'16, which may simply reflect rounding, with consumers actually expecting a very low rate of inflation and not price declines.

CPI prospects:

Inflation in the euro area, which is playing an increasingly important role in domestic price setting, given the high import intensity of local consumer demand shall remain moderate*, the open output gap, the low cost environment and the fragile economic growth in the euro area.*

According to the most recent forecast of the European Central Bank, euro-area inflation is projected to average 0.2% in 2016 and to rise to 1.2% and 1.6% in 2017 and 2018 respectively, hence staying below the medium-term target.

We expect domestic inflation to increase gradually in the coming quarters*, on account of several factors: i) consumption-driven widening of output gap, ii) ongoing increase in wage pressures, iii) waning drag from past declines in commodity prices, corroborated with upward base effects, iv) fading out of the effect of past indirect tax cuts.*

With regards to its trajectory, we project annual inflation rate to cross into positive territory as early as Q1'17 and to test the lower bound of NBR's target interval (2.5%±1%) at some point in Q4'17.

We estimate annual inflation rate to reach -0.5% at end-2016 and to increase to 1.5% at end-2017 and further to 2.7% at end-2018.

II.3. Labour market – On the edge

Ioan Mincu
george.mincu-radulescu@brd.ro

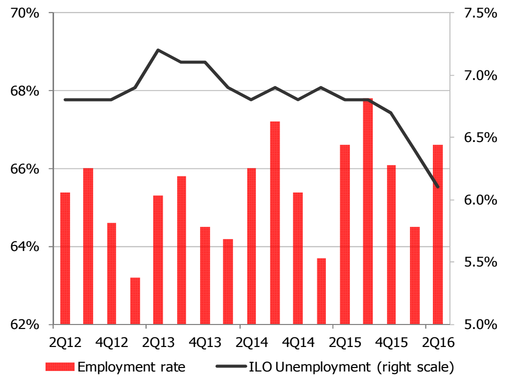
Labour market conditions continued to improve throughout the year, benefitting from the increased capacity of the economy to absorb available labour.

The number of employees economy-wide increased at a pace of 3.4% in the first eight months, with contributions from the labour demand of the public and private sectors. The rise in the number of employees in the latter sector is mainly attributable to construction sector (+5.1% y/y in 8M'16) and market services (+4.9% y/y in 8M'16), particularly Hotels&Restuarants (+11.8% y/y), IT&C (+9.6% y/y), Scientific and technical activities (+8.7% y/y) and Administrative and support service activities (+6.6% y/y).

According to the latest quarterly labour force survey released by NIS, the activity rate (sum of employed and unemployed persons/population in specific age category) for the 20-64 age group rose to 70.6% in Q2'16 (vs. 69.0% in Q1'16). **Employment rate for the age group 20-64 years stood at 66.6% in Q2'16** (up from 64.5% in Q1'16), 3.4 percentage points below the national target (70%) assumed in the context of "Europe 2020 Strategy". Meanwhile, employment rate for working age population (15-64 years) printed at 61.8% (vs. 59.8% in Q1'16), being equal for the two areas of residence. Employment rate remained particularly low among women (53.4% vs. 70% among men, 15-64 years), young people (22.2%, 15-24 years) and older workers (43.5%, 55-64 years).

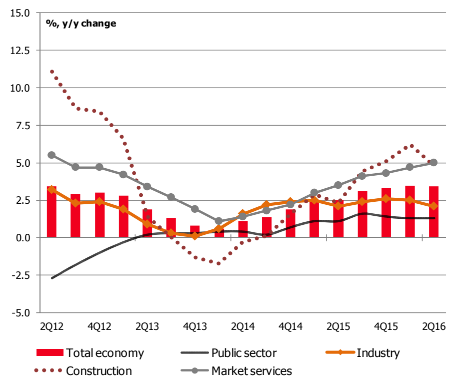
DG ECFIN survey reveals mixed employment expectations for the next three months across economic sectors. Employment expectations in services sector decreased slightly in Sep'16, but recruitment intentions remained distinctly positive. Hiring prospects were modestly more optimistic in construction, whereas they were relatively stable in industry. On the flip side, employment expectations in retail turned pessimistic in Sep'16.

Decline in unemployment gathered pace Employment – 3.4pp below EU2020 target



Source: NIS, BRD-GSG Research

Intensifying recruitment – particularly in market services and construction



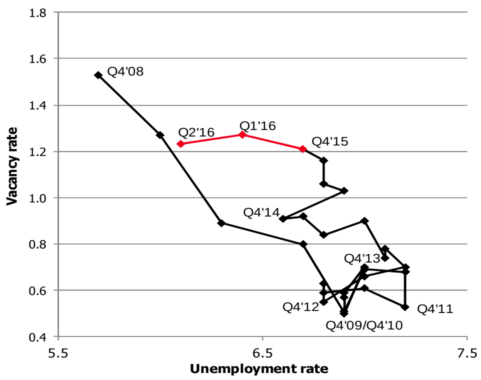
Source: NIS, BRD-GSG Research

The expanding number of employees in the economy fostered a steady decrease in unemployment rate, which reached a post crisis low of 6% in August 2016 (vs. 6.7% in Dec'15), thus staying well below eurozone (10.1%) and EU28 (8.6%) averages. However, the figure must be placed in the context of strong net outward migration and declining working-age population.

Total number of unemployed persons amounted to roughly 529th. persons in Aug'16, registering an annual decline of around 101th. persons. Male unemployment rate remained significanty above female one (6.8% vs. 4.9%).

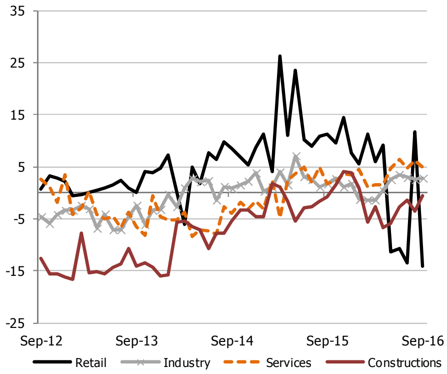
A challenging issue is represented by youth unemployment rate, which retreated only marginally, remaining at an elevated level by regional comparison (20.4% in Jun'16, down from 21% in Jan'16, but above EU28 avg. of 18.8%).

Beveridge curve – signalling the expansion phase of the economy



Source: NIS, BRD-GSG Research

Employment expectations – divergent evolutions across economic sectors

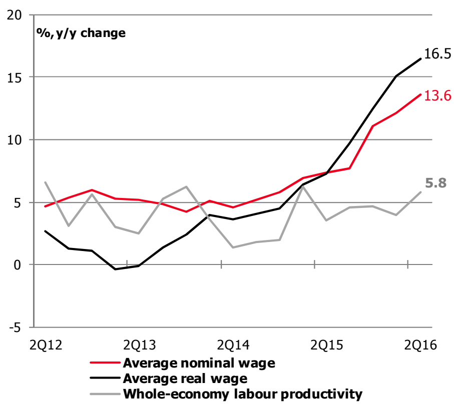


Source: DG ECFIN, BRD-GSG Research

Annual growth in the average nominal and real wage remained high, attributable to tighter labour market conditions, public sector pay rises and the minimum wage hike, which was larger than last year. Average nominal net wage amounted to RON 2,076 in Aug'16, recording a 14.5% y/y increase (+14.7% y/y in real terms). Across the business sector, highest growth rates were seen in sectors with a particularly high concentration of minimum wage earners (i.e. accommodation and food services, food industry, light industry, transport and storage, construction, administration and supporting services).

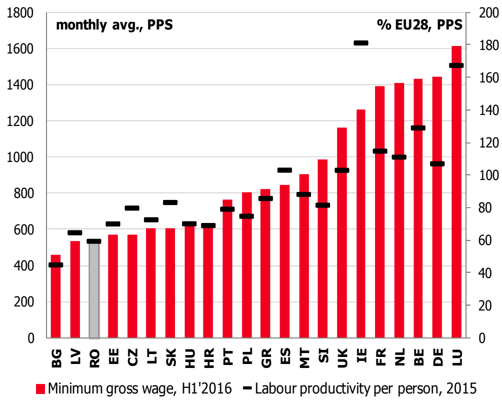
The increase in wages has been consistently exceeding productivity gains over past quarters, translating into higher unit labour costs. This evolution could: i) generate inflationary pressures, ii) hinder external competitiveness, iii) result in a reduction of production/postponement of investment, iv) contain firms' ability to create new jobs. Nonetheless, on a more positive note, it might motivate companies to invest in technology in order to enhance productivity, allowing them to accommodate for the higher wage costs.

Wage dynamics decoupled from productivity growth



Source: Eurostat, NIS, BRD-GSG Research

Minimum wage and productivity per person – among the lowest in EU



Source: Eurostat, BRD-GSG Research

Taking a closer look at minimum wage dynamics, we note that it followed a steep ascending trajectory beginning with 2013, recording an average annual growth rate of 15.6%, in contrast to consumer price inflation over the same period. Nonetheless, in spite of surging in recent years, minimum wage remains the third lowest among EU member states, after Bulgaria and Latvia.

In relative terms, the minimum wage rose from 34% of the average wage in 2012 to 43.5% in May'16. The squeezing of wage distribution around the minimum threshold could lead to slower employment growth in the long run, with the greatest impact felt by younger, low skilled/inexperienced workers and in industries with a higher proportion of low-wage workers. Moreover, labour market distortions could arise (i.e. constrain the room for future wage bargaining, diminish returns on skills/education for employees).

Labour market prospects:

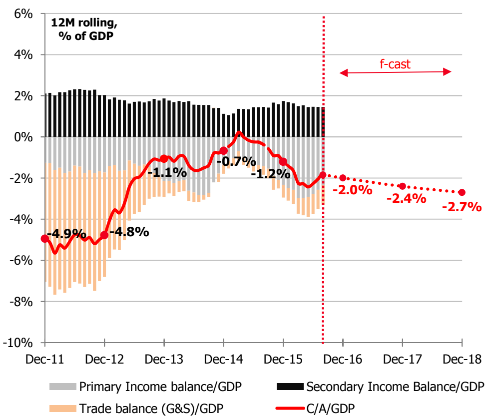
Employment growth is expected to continue, although at a more modest pace, taking into account persistent rigidities in the labour market. Accordingly, we envisage ILO unemployment rate to average 6.2% in 2016 and to settle at 6.1% in 2017/2018.
Average nominal net wage is likely to record steady growth in the following quarters, albeit at a slower pace, underpinned by the current tightening labour market and deepening skill mismatches, which are likely to induce stronger competition both between companies and sectors in order to attract and retain workforce.

II.4. External Sector – Tacking against the wind

Ioan Mincu
george.mincu-radulescu@brd.ro

Current account deficit underwent a strong expansion to EUR 2.1bln in 8M'16 (vs. EUR 904m in 8M'15). The main culprits for the widening external shortfall were the worsening of trade balance and the reduction of secondary income surplus. The 12 month rolling current account deficit stood at 1.9% of estimated GDP in Aug'16.

Evolution of net lending



Source: NBR, BRD-GSG Research

C/A gap – breakdown by components

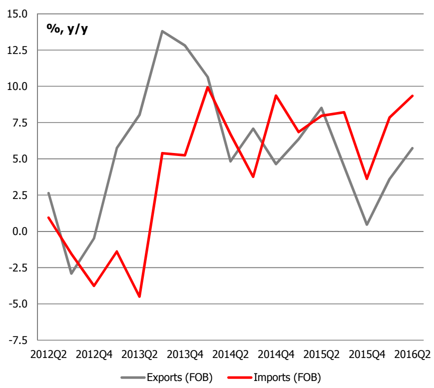
	8M'15	8M'16	y/y
Current Account Balance	**-904**	**-2,108**	**133.2%**
A.Trade Balance (Goods&Services)	**13**	**-676**	
Goods	**-4,383**	**-5,693**	**29.9%**
- Exports (FOB)	32,403	33,938	4.7%
- Imports (FOB)	36,786	39,631	7.7%
Services	**4,396**	**5,017**	**14.1%**
B. Primary Income	**-2,628**	**-2,840**	**8.1%**
C. Secondary Income	**1,711**	**1,408**	**-17.7%**
- Inward	3,680	3,322	-9.7%
- Outward	1,969	1,914	-2.8%

Source: NBR, BRD-GSG Research

Goods deficit rose sharply (+29.9% y/y) from EUR 4.38bln in 8M'15 to EUR 5.69bln in 8M'16, owed to the high imports growth rate (+7.7% y/y) accompanied by a more modest advance of exports (+4.7% y/y).

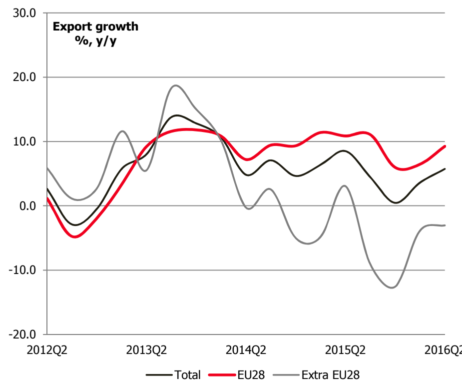
By geographical breakdown, intra-EU trade was the main source of the trade deficit. Exports growth was supported by demand coming from EU countries (+7.3% y/y in 8M'16, 73% of total exports), while non-EU28 exports suffered a contraction (-2.9% y/y). Meanwhile, intra-EU imports rose by 8.7% y/y in 8M'16 and accounted for 77% of total imports, while extra-EU imports increased by 4.3% y/y.

Romanian exports/imports growth



Source: Eurostat, BRD-GSG Research

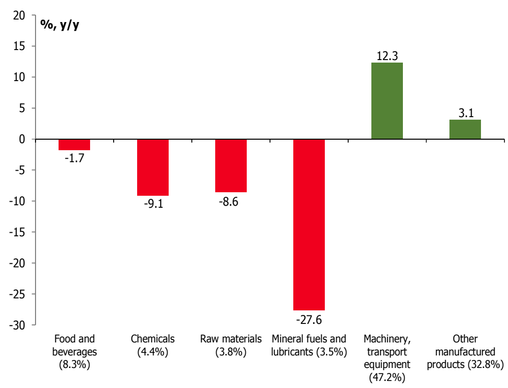
Exports growth fostered by intra-EU trade



Source: Eurostat, BRD-GSG Research

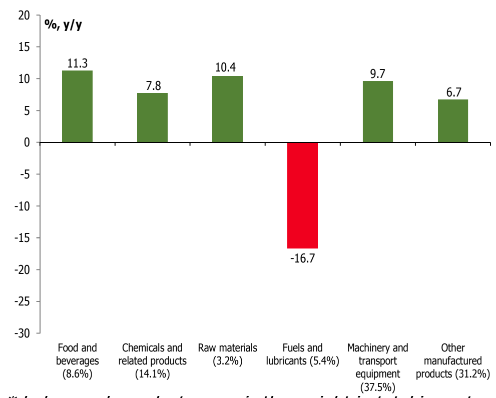
Looking at exports breakdown by product group, growth was mainly underpinned by Machinery and transport equipment (+12.3% y/y in 8M'16, 47.2% of total exports). Turning to imports, with the exception of Fuels and lubricants, all other main categories recorded an increase in volumes. Trade surpluses were posted only by Machinery and transport equipment (EUR 1.3bln in 8M'16) and Raw materials (EUR 39.8m).

8M'16 Export dynamics by product group



** below each product group is the weight in total exports*
Source: NIS, BRD-GSG Research

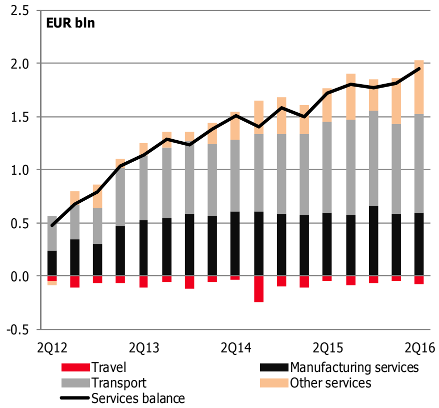
8M'16 Import dynamics by product group



** below each product group is the weight in total imports*
Source: NIS, BRD-GSG Research

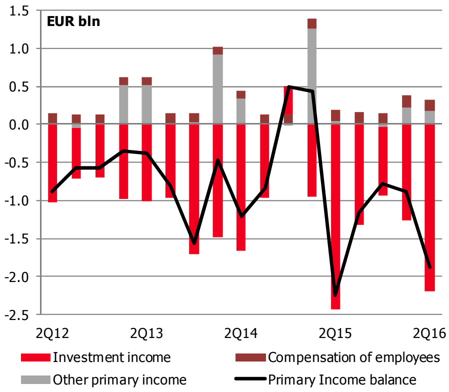
Services surplus increased by 14.1% y/y and amounted to EUR 5.01bln in 8M'16. Exports of services totaled EUR 11.55bln (+7.6% y/y), while imports stood at EUR 6.54bln (+3.1% y/y). This evolution is in line with the fact that the domestic foreign trade sector is increasingly integrating into global services trade. Most components of the balance of trade in services registered an improvement in comparison to the same period a year ago. Largest contributors to growth in the overall surplus were: Transportation services (EUR 2.37bln in 8M'16, +7.7% y/y), Telecommunications, computer, and information services (EUR 1.2bln, +26.3% y/y) and Business services (EUR 446m, +54.9% y/y).

Services surplus – steady expansion



Source: NBR, BRD-GSG Research

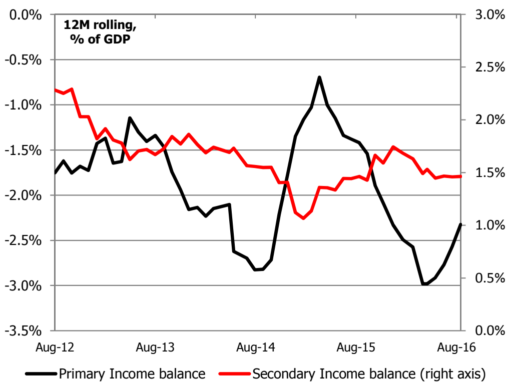
Investment income deficit – largest component of primary income



Source: NBR, BRD-GSG Research

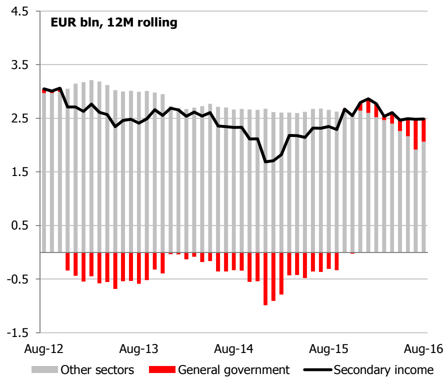
Primary income deficit widened by 8.1% y/y to EUR 2.84bln in 8M'16, mainly as a result of a significant decline in the surplus of the other primary income account (-22.1% y/y), which includes net income from the EU budget. Negative dynamics recorded by other primary income were just partially cushioned by an improvement in the other component balances. The surpluses on compensation of employees (+15.2% y/y) and income on reserve assets (+63.7% y/y) registered notable increases in 8M'16. Meanwhile, direct investment income in the form of dividends paid to non-residents (+4.7% y/y) and portfolio investment income (+9.1% y/y) ran higher deficits. As such, the largest component of the overall balance remained the investment income deficit (-EUR 4.3bln), chiefly determined by a direct investment income deficit of EUR 3.2bln.

Primary Income vs. Secondary Income



Source: NBR, BRD-GSG Research

Secondary income surplus decreasing due to lower workers' remittances



Source: NBR, BRD-GSG Research

Secondary income balance posted a surplus of EUR 1.41bln in 8M'16, down by 17.7% y/y. The balance on secondary income of the general government recorded a surplus of EUR 253m (vs. a deficit of EUR 28m in 8M'15). Meanwhile, the balance on private secondary income weakened in comparison with the corresponding period of last year, registering a surplus of EUR 1.15bln (vs. EUR 1.74bln in 8M'15) given a decline in workers' remittances from abroad.

Capital Account

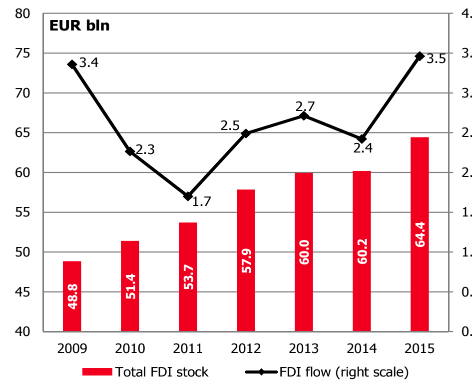
Capital Account surplus increased by 13.3% y/y in 8M'16 and amounted to EUR 3.27bln, being almost entirely related to drawdown of funds from the EU budget.

Financial Account

In 8M'16 financial account witnessed net outflows worth EUR 3.38bln (vs. EUR 2.28bln in 8M'15).

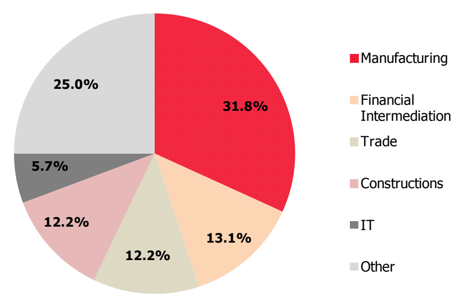
Foreign direct investments in Romania went up by 18.6% y/y and amounted to EUR 2.74bln in 8M'16, out of which Capital investments accounted for EUR 2.38bln, while intra-group loans recorded a net value of EUR 362m.

FDI stock and flow evolution



Source: NBR, BRD-GSG Research

2015 FDI stock distribution



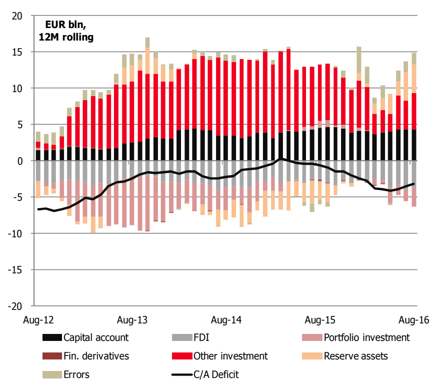
Source: NBR, BRD-GSG Research

According to the latest report on FDI released by NBR, FDI net flow in 2015 was mainly channeled towards trade sector, financial intermediation and insurance and some manufacturing sub-sectors (i.e. transport means, oil processing, chemicals, machinery and equipment). The flow of equity participation into FDI enterprises in 2015 was split between corporate development (EUR 1.74bln) and corporate restructuring (EUR 1.25m). Meanwhile, greenfield investment (EUR 96m) and mergers and acquisitions (-EUR 5m) continued to record a lackluster evolution.

Total FDI stock increased by 7% y/y and amounted to EUR 64.4bln or 40.2% of GDP in 2015, out of which the largest shares were held by manufacturing (31.8% of total FDI stock), financial intermediation and insurance (13.1%), trade and constructions (12.2% each).

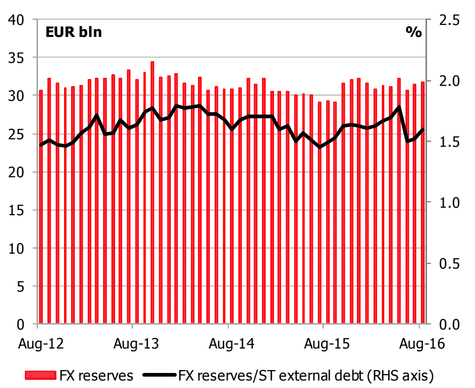
Portfolio investment recorded net inflows of EUR 367m in 8M'16 (vs. net outflows of EUR 2.20bln in 8M'15). Non-residents' portfolio investment showed a net inflow of EUR 550m, marking a significant reversal from the EUR 2.04bln net outflow in 8M'15. Foreign investors' holdings of domestic equity and investment fund shares diminished by EUR 395m, while those of debt securities rose by EUR 943m. On the other side, domestic investors increased their exposure on foreign bonds and shares by EUR 49m and by EUR 133m, respectively.

Financing of the current account



Source: NBR, BRD-GSG Research

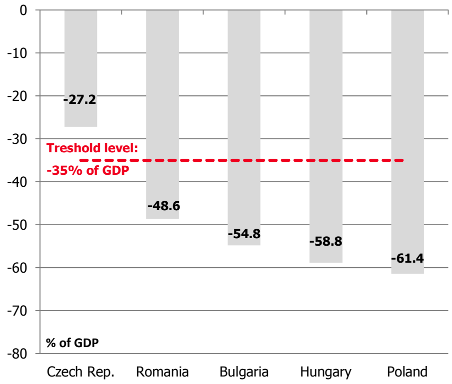
FX reserves/Short-term debt



Source: NBR, BRD-GSG Research

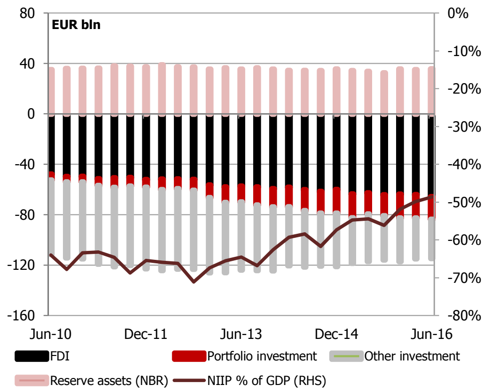
International reserves are broadly adequate, exceeding indicators of reserve adequacy and comparing favorably to countries in the region. As of Aug'16 goods and services import cover (foreign exchange including gold to average monthly imports of goods and services) stood at 6.4 months, same as at end-2015. Meanwhile, the coverage of short debt through FX reserves stood at a comfortable 1.59.

NIIP – regional comparison Q2'16



Source: NBR, BRD-GSG Research

NIIP – steadily improving since 2012



Source: NBR, BRD-GSG Research

Net international investment position (NIIP) improved considerably since the peak of -70% of GDP reached in 2012, primarily underpinned by the sustained economic activity and low current account deficits recorded in recent years. Despite this downward correction, Romania's NIIP remains elevated (-48.6% of GDP in Q2'16), higher than the indicative threshold level of -35% of GDP, thus representing a source of macroeconomic vulnerability. Still, Romania compares favorably with NIIP deficits of regional peers, only Czech Republic registering a smaller NIIP (-27.2% of GDP in Q2'16). Adding to the positive side is the composition of NIIP deficit. The bulk of Romania's NIIP liabilities consists of foreign direct investment (50.1%), which is considered to be a stable source of financing. Nonetheless, Romania's stock of portfolio liabilities expanded over last years, making up 14.8% of total liabilities in Q2'16, which implies a certain degree of exposure to potential capital flight. The stock of other investment liabilities witnessed a strong reduction in recent years because of external debt repayments and the diminishing roll-over rates in the case of credit institutions, but remains quite large at 35.1% of the total.

Gross external debt totaled EUR 90.1bln at end-Aug'16 (or 53% of projected GDP), down by 0.4% from end-2015, due to the reduction in the long-term component by 0.6% to EUR 70.2bln, which offset the 0.2% increase in short-term debt to EUR 19.9bln.

C/A balance (BMP6) prospects:

Overall, we project current account deficit to widen to 2.0% of GDP this year. Over the next two years, current account shortfall is expected to increase further, as growing domestic demand shall maintain import growth at strong levels, thus weighing on the trade balance. Moreover, income gap is projected to continue to widen, taking into account higher dividend and interest payments to foreign investors. That said, we currently envisage current account gap to rise to 2.4% of GDP in 2017 and 2.7% of GDP in 2018, levels deemed sustainable and consistent with the necessity of attracting external savings to ensure real convergence.

Upside risks are lurking as additional fiscal stimulus might lead to economy overheating, negatively impacting external sustainability. Moreover, cost competitiveness could be affected by rapid wage growth overtaking productivity gains, while strengthening non-cost competitiveness might prove challenging. External factors also raise concerns regarding export outlook, foremost Brexit uncertainty, followed by the modest economic activity in Eurozone, the slowdown in global trade and geopolitical tensions.

II.5. Fiscal Policy and Public Debt – A no slam dunk case

Fiscal policy

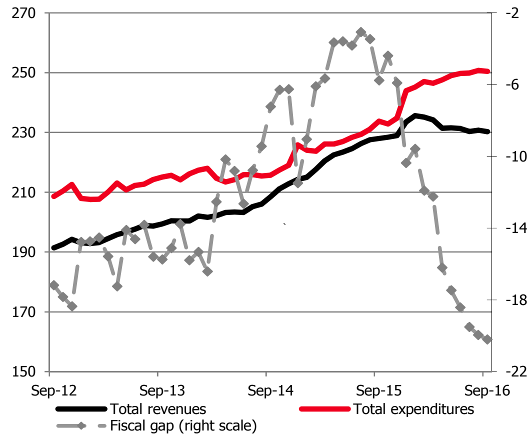
Ioan Mincu
george.mincu-radulescu@brd.ro

The nine month budget execution ended with a deficit of RON 3.7bln or 0.49% of GDP expected (RON 758.5bln). This marks a significant deterioration in comparison to the same period a year ago, when a budget surplus of RON 6.1bln or 0.86% of GDP was recorded. The explanation for this setback lies in the compression of budget revenues (-2.0% y/y in 9M'16), which was coupled with an expansion of budget expenditures (+4.0% y/y).

The 12M rolling deficit stands at RON 20.2bln or 2.66% of GDP, within this year target of 2.8% of GDP.

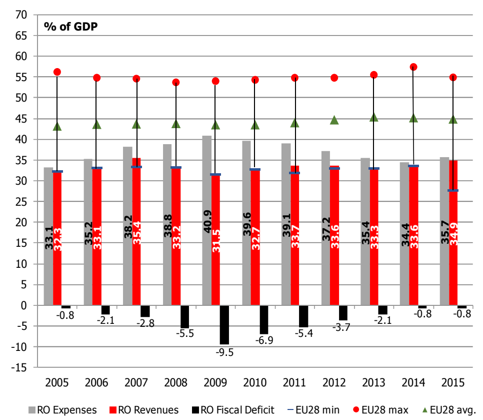
Looking at the breakdown of revenues by components, the decline in the collection of some indirect taxes, VAT in particular (-8.6% y/y, given successive VAT rate cuts) and of non-fiscal revenues (-3.9% y/y), offset the larger receipts of income (+3.8% y/y) and profit tax (+12.3% y/y), social security contributions (+6.9% y/y), excise taxes (+6.4% y/y) and customs duties (+18.6% y/y).

Budget stance (RON bln, 12m cumulated) - marked weakening



Source: MinFin, BRD-GSG Research

Budget revenues – stuck below 35% of GDP, very low by regional comparison



Source: Eurostat, BRD-GSG Research

On the expenditure side, Staff expenses picked up strongly by 9.6% y/y in 9M'16, fueled by higher wages of budgetary personnel and the minimum wage hike. Expenditures on goods and services were tightly managed, recording a 1.3% y/y decline. Meanwhile, public-debt related interest payments rose by 6% y/y. Social assistance expenditure spiked by 7.7% y/y, with amounts of certain rights being increased (i.e. the 5% raise in the value of pension point starting with Jan'16, doubling of child allowances beginning with Jun'15, higher social benefits to persons with disabilities). Capital expenditures increased by 26.8% y/y.

Last year's pattern of an uneven distribution of public spending throughout the fiscal year appears to repeat, with most of the fiscal deficit likely to be incurred during the last months of the year. This offers the government room to adjust expenditures to the extent of available resources, in order to avoid breaching the Maastricht threshold level.

Looking forward, the fiscal policy of Romania remains pro-cyclical. The beginning of 2017 will be marked by the entry into force of a new pack of easing measures: i) the reduction in standard VAT rate from 20% to 19%, ii) the elimination of supplementary excise tax on car fuels (applied since Apr'14) , iii) the elimination of special construction tax.

The forthcoming general elections paved the way for a myriad of legislative initiatives aimed at further easing of fiscal/income policies (currently at different stages of the legislative process), which are used as main weapons in the political warfare:

- the scrapping of 102 non-fiscal taxes (including radio-TV tax, the environmental tax on motor vehicles, consular and citizenship taxes, taxes for the commerce registry),
- 15% salary increase for employees in the education and welfare sectors starting January 1st, 2017, 25% salary increase for National Health Insurance House (CNAS) employees starting December 1st, 2016, unfreezing of bonus payments for employees in healthcare system (will be computed based on this year's wage level, not the one registered in 2009),
- exempt pensioners from income tax and the payment of social contribution to the healthcare system (the contribution going to be paid from the state budget),
- the reduction of social security contributions by 5 percentage points (2pp for employer and 3pp for employee),
- the gradual increase in the pension point to 45% of average gross wage, from the current 32.5%.

The aforementioned initiatives raise the probability of larger fiscal slippages and a longer lasting derailment from medium term targets, posing a significant threat to the sustainability of public finances in case they are passed without proper budgetary impact assessments and in the absence of clear compensatory measures as fiscal responsibility law stipulates. But judging by previous election cycles, many of these promises are likely to remain just that - promises. Also, the government expressed intent to challenge any populist measure passed by the Parliament in the Constitutional Court, if it does not clearly state the sources of funding.

Further on, we briefly underline the risks posed by a new round of fiscal stimulus. Higher pensions and public sector wages would translate into faster dynamics of household disposable income, leading to a build-up in inflationary pressures induced by aggregate demand, as long as they are not accompanied by a proportional advance in terms of productivity. Rising prices will then gradually offset real wage gains, thus slowing down real convergence.

Moreover, the risk of triggering excessive deficit procedure once again is likely to signal vulnerabilities in the domestic economy for foreign investors, with a negative impact on capital inflows, financing costs and exchange rate movements. The latter will put additional strain on an already weakening external position.

Under the above mentioned circumstances, **maintaining fiscal deficit at a safe level could prove a real challenge for the next administration**. As it stands, the only offsetting revenue source for the potential new easing measures consists of an expected improvement in collection (i.e expanding tax base linked with sustained economic activity/growing salaries). Headline tax hikes appear unlikely over the short run, but more projected spending in the future will likely lead to calls for higher taxes. In addition, failure to achieve the planned budget revenues could result in an underexecution of priority spending, including investment and social projects, which would adversely affect the production potential of domestic economy.

Fiscal deficit prospects: We see the risk of budget deficit exceeding the target as relatively low this year, but it increases considerably next year, given the expected reduction in budget revenues and the potential overshooting of the projected level of expenditures, taking into account policy loosening measures that are currently envisaged.
Hence, estimating fiscal gap for next year is a daunting task, with our expectations spanning from 2.5% to 4.5% of GDP. In a worst case scenario, assuming all promises are kept, fiscal deficit might head towards the upper bound of the aforementioned interval. Meanwhile, a prudent fiscal approach is the right way towards complying with Maastricht criteria. However, after the election tide settles and uncertainty around fiscal outlook diminishes, we can more properly assess 2017 budget deficit level.

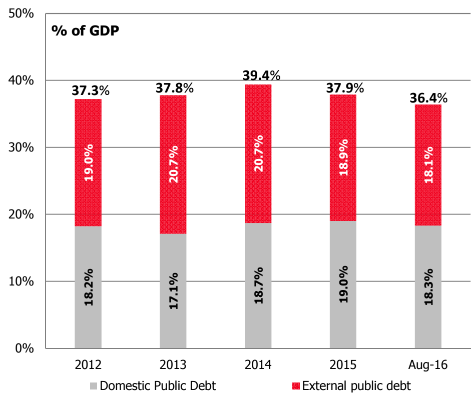
Public debt

There are several methodologies for calculating government debt, the most important being: i) the EU or Maastricht methodology, ii) the extended ESA 2010 methodology, and iii) the national methodology. In our analysis, we will refer to public debt measured using Maastricht methodology, as it allows for cross-country comparison.

Romania's general government gross debt remains at a moderate level, well below the Maastricht threshold level (60% of GDP) and the critical level of 45% of GDP estimated by NBR (above which the probability of recession reaches approximately 50 percent). By regional comparison, government debt stands below the levels reported by most member states.

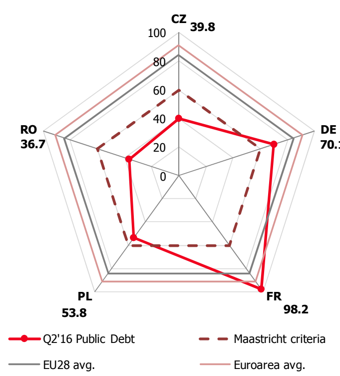
The public debt-to-GDP ratio declined to 36.4% in Aug'16 from 37.9% at end-2015. External debt component dropped from 18.86% of GDP to 18.1% of GDP in the aforementioned period, whereas domestic debt decreased from 19% of GDP to 18.3% of GDP.

Public debt evolution/structure



Source: MinFin, BRD-GSG Research

Public debt (% of GDP) in Q2'16 – low by regional comparison



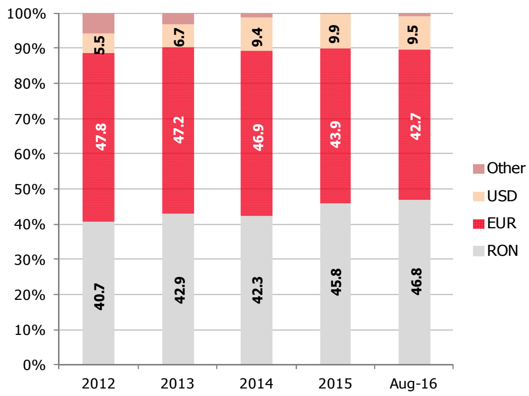
Source: Eurostat, BRD-GSG Research

The current maturity structure is compatible with ensuring the predictability of repayments and keeping refinancing risks at bay, with short-term debt accounting to only 6.4% of public debt in

Aug'16. Weighted average residual maturity for locally-issued government securities stood at 3.6 years in Aug'16, while for the securities issued on external markets at 8.4 years.

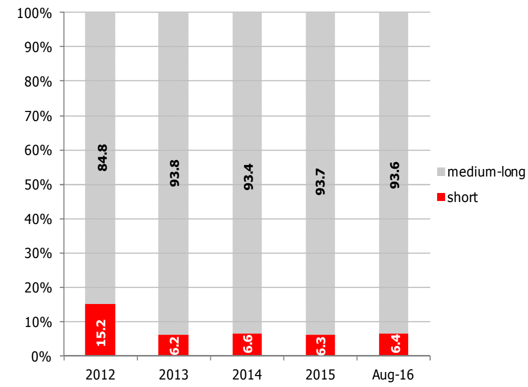
The proportion of foreign currency denominated government debt is elevated (53.2% in Aug'16), with the bulk of it being EUR-denominated (80.4% of total). However, taking into account the relative stability manifested by EUR/RON exchange rate and the fact that a great share of EUR-denominated debt is represented by long-term debt, we view the foreign exchange rate risk as being manageable.

Large share of foreign-denominated debt



Source: MinFin, BRD-GSG Research

Low share of short-term debt



Source: MinFin, BRD-GSG Research

Annual interest expenses were relatively stable during recent years, standing at 1.4% of GDP in 2015 (down from 1.5% of GDP in 2014).

Moving forward, according to MoF debt-management strategy, the main objectives are: i) to respect Maastricht threshold level (60% of GDP) and maintain the public debt even below 45% of GDP (level considered being sustainable), ii) to extend the weighted average maturity of government debt portfolio, iii) to continue to maintain a foreign currency buffer, iv) to diversify investor base.

Public debt prospects: We currently project public debt level to reach 38.5% of GDP in 2016. Under a conservative scenario (no-fiscal policy change), it is expected to rise to 40% of GDP in 2017 and 41% in 2018. Conversely, taking into account a potential enforcement of expansionary legislatives currently under debate, it could head towards 42.5% of GDP in 2018.

Bond Market

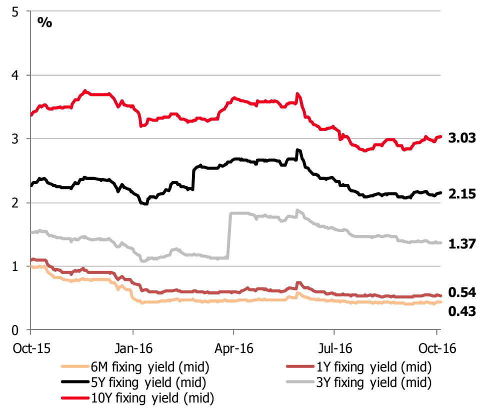
Since our Spring report, the evolution of sovereign bond yields was shaped by the successive shifts in investor sentiment towards markets in the region.

Yields (particularly longer maturities) felt the impact of worsening global financial market sentiment around Brexit referendum, whose surprise outcome triggered a strong reaction in the form of a sell-off in risky assets, a decline in yields on "safe" government bonds and a fall in stock indices. Fears that Brexit might lead to a slowdown in the global economic recovery added to the negative impact on commodity prices. However, yields quickly reversed trend as financial market concerns were alleviated by central bank's readiness to act with unconventional tools in order to avoid the risk of a systemic liquidity crunch. This allowed for an orderly repricing in financial markets and a cautious recovery in risk appetite.

The downward adjustment in yields continued throughout Q3'16, under the confluence of several factors: i) a more favorable sentiment in global financial markets, fostered by the partial recovery in commodity prices, easing fears about global growth outlook (China's near term prospects brightened slightly on the back of policy support for growth, while macro data coming out of emerging markets has slowly, yet, steadily improved) and a limited Brexit impact so far, ii) growing expectations that central banks in major advanced economies will maintain loose monetary conditions for longer, iii) ongoing favorable trend in domestic fundamentals and a relatively steep yield curve, which fueled investors' interest in domestic securities, iv) ample domestic liquidity.

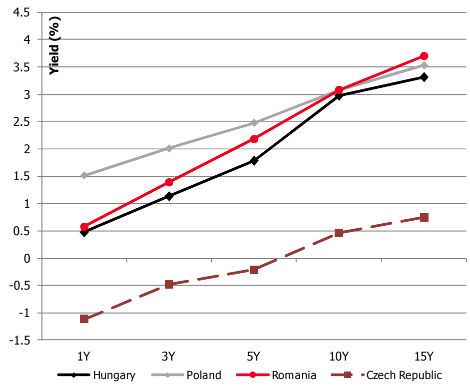
The decline in domestic bond yields came to a halt in the beginning of October, with yields embarking on an upward trend thereafter, due to domestic factors (concerns raised by the potential enforcement of Swiss franc-denominated loans conversion law, risk of greater fiscal slippages and the power struggle ahead of December parliamentary elections) coupled with a deterioration in risk sentiment in global financial markets (expectations/uncertainties related to the decisions of major central banks, a higher probability of a "hard Brexit" scenario, louder noise around US elections).

Post-Brexit downward adjustment



Source: NBR, BRD-GSG Research

Steep curve by regional comparison

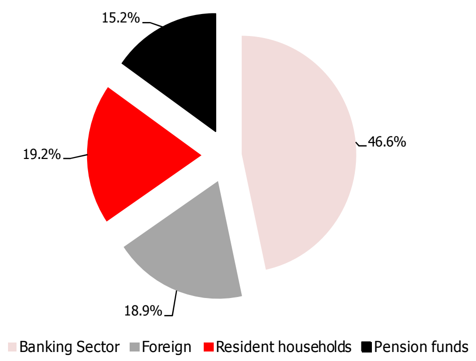


** as of October, 31 2016*

Source: BBG, BRD-GSG Research

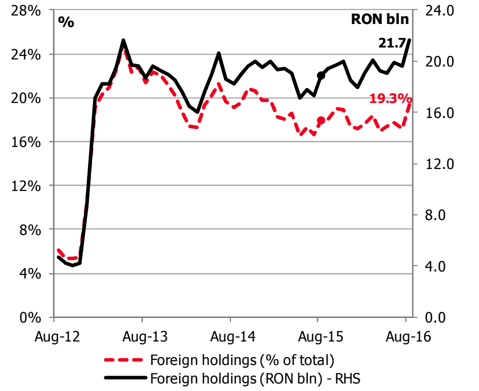
Non-residents' holdings of RON-denominated Treasury bonds increased notably in Aug'16 to RON 21.7bln (vs. RON 19.7bln in Jul'16). This volume represented 19.3% of total local currency denominated government bonds. Still, non-residents exposure remains well below levels recorded in Poland (34.2%), Czech Republic (26.6%) and Hungary (21.8%). Foreign residents' relatively light positioning lowers the risk of sudden and disruptive outflows if market conditions worsen. In the meantime, banking sector continues to hold the large majority of domestic securities (46.6%), its exposure equaling to around one fifth of its total assets. In the absence of a stronger credit rebound and with savings edging higher, banks exposure to government securities is likely to remain substantial. As institutional investors, local asset managers and private pension funds have a relatively small share in the government securities.

Holdings of government securities issued on domestic market (Aug'16)



Source: MinFin, BRD-GSG Research

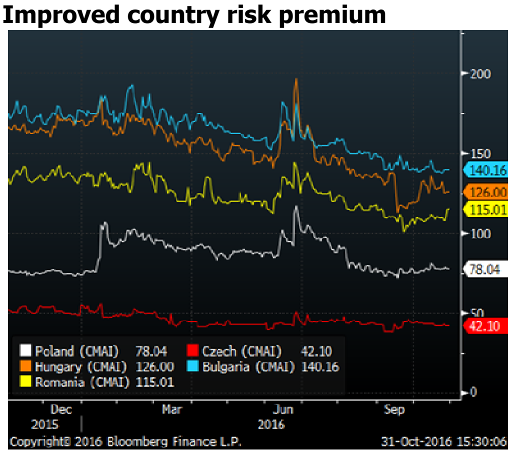
Foreign holdings of RON-denominated government securities peaked in Aug'16



Source: MinFin, BRD-GSG Research

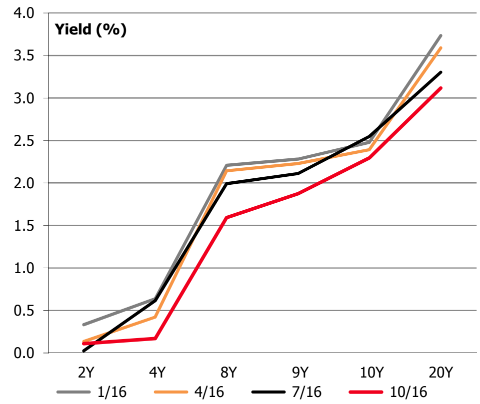
Romania's CDS spread, which reflects the country risk assessment, increased considerably towards the end of Q2'16, due to the unfavorable atmosphere related to Brexit. However, the afterward improvement in investor sentiment translated into a marked decline in CDS quotes for Central and Eastern European countries. Country risk premium as measured by Ro 5Y USD CDS stands at 115bps (as of Oct, 31st), below the levels recorded by Bulgaria (140) and Hungary (126), but above the ones of Poland (78) and Czech Republic (42).

Improved country risk premium



Source: BBG, BRD-GSG Research

Reflected in declining ROMANI yields



Source: BBG, BRD-GSG Research

Up until now (31st of Oct'16), debt managers covered around 84.6% of estimated financing needs for this year (RON 70.62bln) as follows: i) RON 41.6bln and EUR 775m on domestic market, ii) EUR 3.25bln on external markets. MinFin tried to ensure a predictable policy of issuances, in general the amounts announced being fully awarded, with the exception of some periods of heightened volatility when the allotted amount was lower than planned. Also, in the case of some long term issuances, debt managers sold more than initially intended, as to take advantage of high demand and advantageous costs, while at the same time aiming at extending the average remaining maturity.

Bond market prospects:

Looking forward, provided that Romania continues to stand firm on macroeconomic fundamentals, domestic bond curve shall further benefit from the abundant global liquidity trickling into risky assets in a "hunt for yields", amid prospects for a prolonged period of low interest rates in advanced economies. Also, more scarcity in MinFin primary market issuance and tight allotment will keep borrowing costs in check. Meanwhile, the large fiscal buffer *(roughly covering 4 months' worth of financing needs) may act as a safety net, in case of faltering primary market demand.*

However, risks are looming, as the re-emergence of internal/external imbalances on account of the failure to meet the fiscal policy objectives, along with legislative changes threatening the currently sound financial position of the banking sector may lead to a swift negative change in investors' perception vis-à-vis the domestic market, with dire consequences on capital flow dynamics and financing costs. That is why we abide by the view that a balanced macroeconomic policy mix and wide-ranging structural reforms are needed in order to continue to safeguard financial stability and sovereign creditworthiness, with the latter being prerequisites in achieving sustainable growth.

III. Financial Market

III.1. Money market and Monetary policy – Walking on quicksand

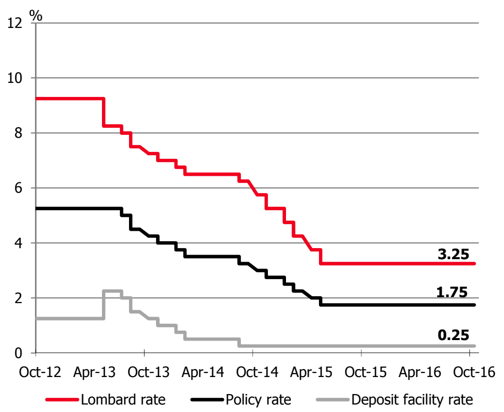
Monetary policy decisions

Ioan Mincu
george.mincu-radulescu@brd.ro

Taking account of the divergence between short-term inflation developments and the medium-term outlook and of the heightened uncertainties surrounding the short-term economic and financial developments both domestically and internationally, **NBR pursued a prudent monetary policy stance, maintaining policy rate unchanged at the historical low of 1.75%**. The symmetrical corridor between the interest rate on the permanent credit facility and the interest rate on the permanent deposit facility was also preserved at 150bps.

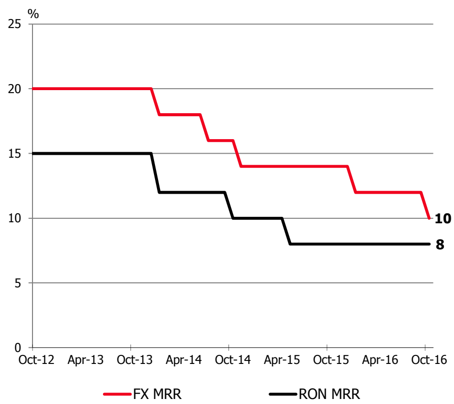
Moreover, NBR continued to ensure adequate liquidity management in the banking system, while maintaining unchanged the level of the minimum reserve requirements ratio (MRR) on RON denominated liabilities of credit institutions at 8%. In the meantime, in order to continue the harmonisation of the reserve requirements mechanism with the standards and practices of ECB and the major central banks across EU, NBR Board decided to cut the MRR ratio on FX-denominated liabilities of credit institutions to 10% from 12% starting with the 24 October – 23 November 2016 maintenance period. The decision came against the background of declining foreign currency lending and a strengthened level/improved composition of FX reserves.

NBR maintained the status quo



Source: NBR, BRD-GSG Research

FX MRR was reduced to 10%



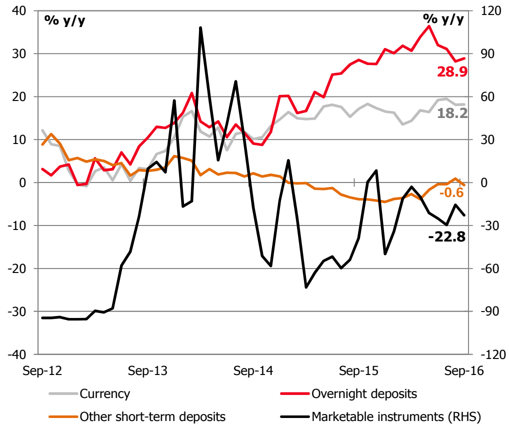
Source: NBR, BRD-GSG Research

Money supply

The strong pick-up in M3 growth halted at relatively high rates. The annual growth rate of M3 amounted to 12.2% in Sep'16. The prevailing role in M3 growth was played by its most liquid component, narrow money (M1), amid the fast-paced economic activity and the lower opportunity cost of holding liquid assets. M1 increased by 25.3% y/y in Sep'16, with its share in M3 touching a post-crisis peak of 55.5%. Both major components of M1 contributed to this development, as Overnight deposits expanded at a brisk pace of 28.9% y/y, while currency in circulation rose by 18.2% y/y. Meanwhile, the annual rate of change of time deposits with a maturity of up to two years stood in negative territory, at -0.6% in Sep'16.

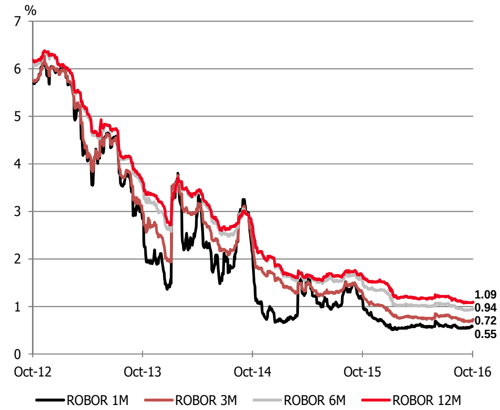
Turning to the creation of money, the M3 growth reflects high growth in net external assets (+36.4% y/y), while net domestic assets witnessed a contraction (-2.3% y/y).

Money aggregate growth remains high



Source: NBR, BRD-GSG Research

Interbank rates – around historical lows



Source: NBR, BRD-GSG Research

Interbank rates

ROBOR rates remained around historical lows across the maturity spectrum, recording marginal fluctuations while standing well below policy rate. Rates at the short-end of the curve continued to run close to NBR's deposit facility rate, reflecting the relatively high level of banks' net liquidity surplus. In October, ROBOR 3M averaged at 0.70% while the 6M and 12M rates at 0.93% and 1.08% respectively.

Monetary policy prospects:

Taking into account the lower than previously forecasted inflation trajectory, the frail lending growth, the accommodative stance of ECB and other regional banks, as well as ongoing uncertainties surrounding future macroeconomic/financial developments, we assess a low probability of a policy rate hike next year, with a higher likelihood of a rate increase associated with 2018. However, in case the risk of consistently exceeding the inflation target in the medium term builds up, it could be appropriate to raise the interest rates sooner, during the second half of 2017.

In the meantime, in view of the pro-cyclical fiscal stance and the high wage growth, NBR could signal a tightening bias through a narrowing of interest rate corridor. Such a move would reduce the gap between policy rate and interbank rates, strengthening the latter ones role within the monetary policy transmission mechanism.

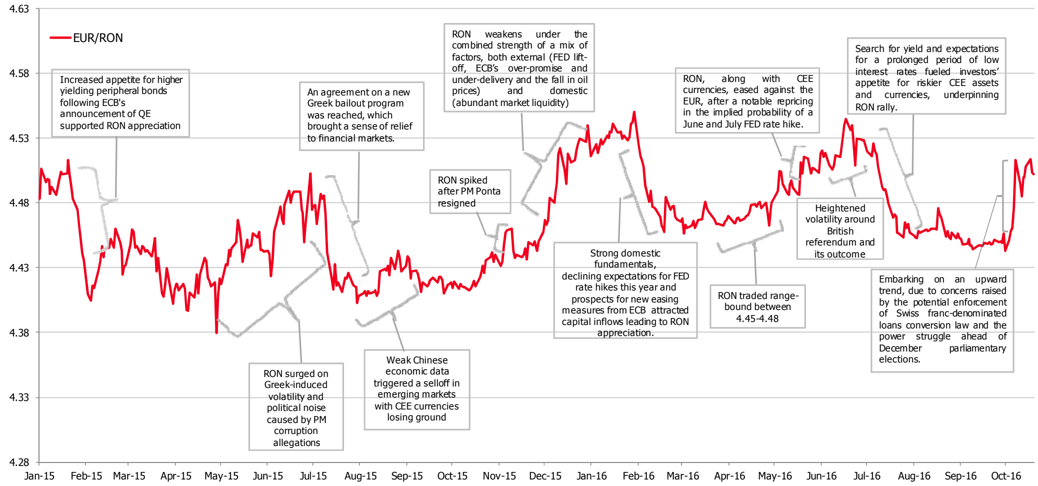
As concerns minimum reserve requirement ratios (MRR), NBR will most likely lower them gradually, as it seeks to bring their level closer to ECB standards. Nevertheless, the timing of new MRR reductions will depend on market liquidity conditions.

The evolution of interbank rates will continue to be determined by the following factors: NBR's liquidity management policy, MinFin issuance strategy and external developments. We currently do not assess a significant deviation from present levels in the coming quarters.

III.2. Forex market – Beyond the noise

Ioan Mincu
george.mincu-radulescu@brd.ro

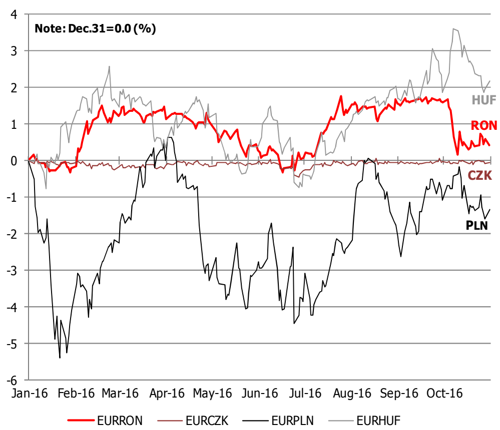
The wave of renewed risk appetite in the post Brexit period triggered a shift in investors' sentiment towards markets in the region, translating into a significant downward correction in EUR/RON exchange rate throughout Q3'16, similar to that of its regional peers. RON appreciation was also supported by the relatively strong macroeconomic performance of domestic economy.



Source: Bloomberg, BRD-GSG Research

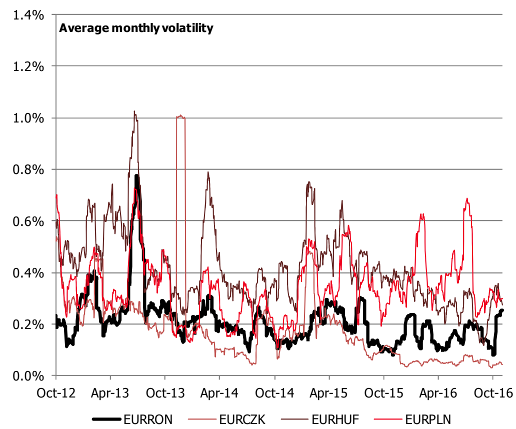
However, EUR/RON exchange rate saw its downtrend come to a halt in the early days of October, embarking on a swift upward path within a domestic environment fraught with uncertainties associated with the potential enforcement of Swiss franc mortgage conversion law (likely to affect foreign investor perception of local economy and financial market) and the noise surrounding forthcoming general elections.

RON – marked weakening in Oct'16



Source: NBR, BRD-GSG Research

EUR/RON – heightened volatility recently



Source: Bloomberg, BRD-GSG Research

Additional pressure came from the relative worsening of investor sentiment, owed to increased odds of a December rate hike, the fractious U.S. election campaign, concerns raised by Deutsche bank regarding the health of Euroarea banking system and a higher risk of a hard Brexit. Consequently, in Oct'16 the average exchange rate against the EUR stood at 4.4942, 2.0% weaker than its average level in Sep'16.

EUR/RON exchange rate volatility did not show significant rises, except for the recent episode of moderate depreciation. RON volatility is limited by the managed float exchange rate regime, relatively small size of the market and low involvement of foreign investors.

FX prospects:

RON is likely to remain under pressure (trading around 4.50 against the EUR) until year-end and witness some episodes of higher volatility than usual.

We consider that EURRON evolution will be mainly driven by risk sentiment on external markets and domestic political developments, with risks ahead of Parliamentary elections in December skewed to the upside. Considerable liquidity injections brought about by Treasury operations at the turn of the year will likely put further strain on RON.

The central bank will however continue to closely monitor the exchange rate and prevent significant deviations, in our view. Yet, NBR may allow some more flexibility and slightly widen its comfort range for EUR/RON during this period.

Throughout 2017, we see EURRON evolution as being influenced by several factors:

- further real convergence of the economy, subdued domestic and imported inflation, capital inflows, which should support RON strengthening,

- ongoing risks of fiscal slippages, further deterioration of external position, uncertainties related to external environment which could trigger renewed bouts of risk aversion, generating depreciation pressures.

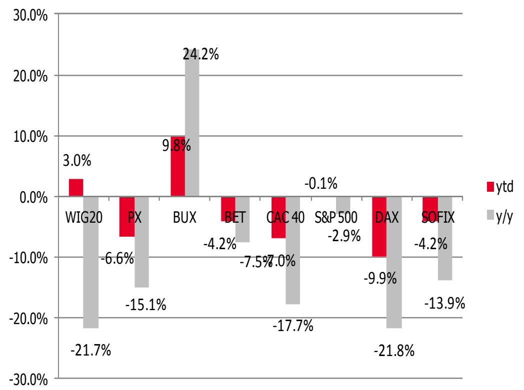
We thus expect EURRON to trade closer to the top of the 4.40-4.50 range for most of 2017, recording an average level of 4.48. For 2018, we expect EURRON to post an average level of 4.46.

III.3. The Capital Market – Ending a dissapointing year, lacking new comers to stock exchange

Laura Simion, CFA
laura.simion@brd.ro

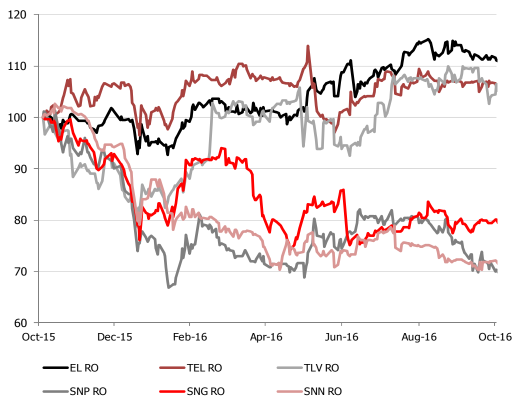
In the past six months the performance of the local stock exchange was affected by several events, both domestic (local elections, oncoming parliament elections, approval of some populist laws such as "walk away" mortgage law and Swiss franc denominated loans conversion law) and international (Brexit, US elections, EU immigrants' problems) which increased the volatility of the equity markets and diverted funds toward safer assets. BET lost 5.4% on an annual basis and 2.7% ytd. Analyzing indices constituents, most of utilities shares and Banca Transilvania had positive contributions, while oil&gas sector and part of financial sector (BVB, BRD, FP) had a negative influence. In CEE region, Hungary continued to differentiate from the rest, having a stellar performance with BUX posting +26.4% ytd and +38.2% y/y, driven by energy, financial and pharma sectors. Bulgarian SOFIX also reversed the trend starting with the beginning of September on the back of industrial stocks (metals, chemicals and auto parts) and currently is up +14.4% ytd and +18.8% y/y, while Polish and Czech PX are still on the negative side both yearly and ytd.

BET and other CEE indices performance



Source: Bloomberg, BRD-GSG Research

BET- drivers and laggards

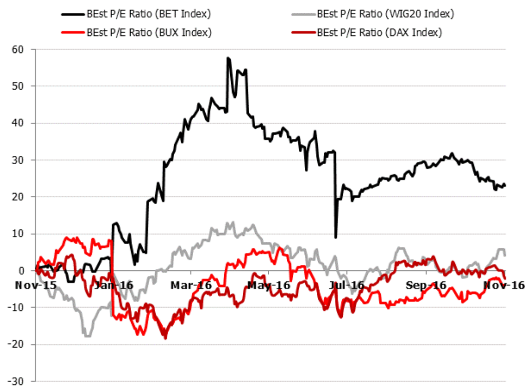


Source: Bloomberg, BRD-GSG Research

When compared to regional peers, valuations of the Romanian stocks included in BET index started to increase with March 2016, driven by generous dividend announcements. Although, the value of P/E declined in summer, Romanian blue chips are still expensive vs. neighborhood countries, but also vs. stocks in DAX index.

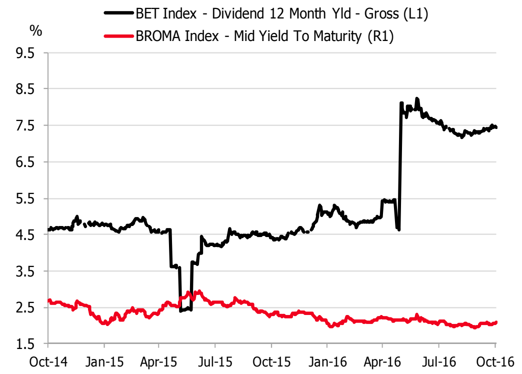
At the same time, the return of Romanian stocks measured as 12M gross dividends of BET constituents continued to outperform the T-bonds sector. Starting with April, when 2015 dividends were announced, BET 12M gross dividend yield climbed from 4.5% to 7.5%, while the yield to maturity of government bonds continued sliding down from 2.5% to 2%, amid a low interest rates environment.

P/E for regional indices:



Source: Bloomberg, BRD-GSG Research

Capital vs. bonds market performance



Source: Bloomberg, BRD-GSG Research

Most important events on local capital market in 2016

No new significant listing on stock market

2016 is the second year with no new shares listing on BSE main market. On the bonds segment, the Ministry of Finance successfully developed a 2Y T-bonds public offer for individual investors of RON 735m in July, while the International Investment Bank launched a second 3Y bonds issue of RON 300m in September. Moreover, on the alternative market (AERO) there were two bonds issues of smaller value (Bittnet Systems – RON 4.2m in July and Good People – RON 4.6m in March), while software company Ascendia listed its shares on AERO market in July, but without raising money. The remaining listings of state companies (Hidroelectrica, Bucharest Airports and Constanta Port) are again postponed toward 2017, while companies from private sector continued to prefer other financing sources.

In October, Fondul Proprietatea sold through a SPO 6.4% of OMV Petrom and the company was listed to London Stock Exchange (LSE) as secondary market via GDR-s. OMV Petrom is the fourth Romanian company listed to LSE via GDR-s after Romgaz, Electrica and Fondul Proprietatea.

2017 – the year of promoting to emerging markets category?

At the end of September, Bucharest Stock Exchange announced the inclusion of the stock exchange on the watch list for promoting to Secondary Emerging Category by FTSE Russell. The promotion in the superior market status will be accomplished following the fulfilment of the broad market liquidity criterion, and of the existence in the market of large companies with significant individual trading value. This is the first global institution which put Romanian stock exchange on a watch list for promoting to an emerging markets category, while other indices providers such as MCSI (USA), S&P Dow Jones (USA) and STOXX (Switzerland) currently place Romanian market among frontier markets category.

The promotion of Bucharest Stock Exchange to a superior league would put the local stock exchange on the radar of new investors following emerging markets and could translate in a significant increase of funds flows towards local equities, thus enhancing both liquidity and capitalization of the market.

III.4. Banking sector – Dynamic environment raises challenges

Marginal change of lending activity features since our previous report

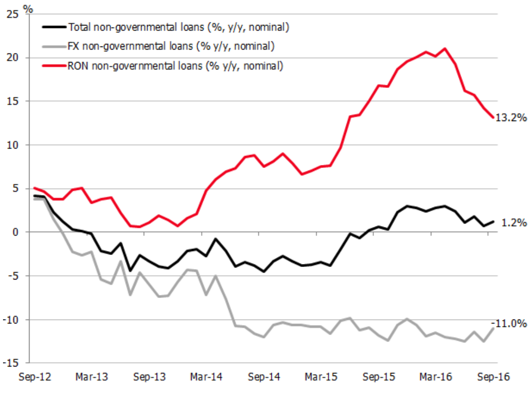
Carmen Lipară
carmen.lipara@brd.ro

The local banking sector faced another interference of political factor into the free market mechanism, after the enforcement of the mortgage "walk-away" law starting with 13 May'16. On 18 Oct'16, the Chamber of Deputies approved the draft law for CHF denominated loans conversion at the FX rate valid at the initiation date of the contract, creating confusion among market participants, as some debtors in CHF have already benefited from conversion of CHF loans at FX rate from 15 Jan'15 or from loans restructuring offers provided by banks.

Otherwise, lending activity doesn't follow the trend of an high economic growth rate, due to several possible explanations: 1/ Romania has one of the lowest financial intermediation rate in the region (loans/GDP is 29.9% in 2015 vs. 39.6% average of neighboring region); 2/ large corporations (mostly state-owned companies) hold enough cash&cash equivalents; 3/ export-oriented companies might access easily international financial resources at lower costs, etc.

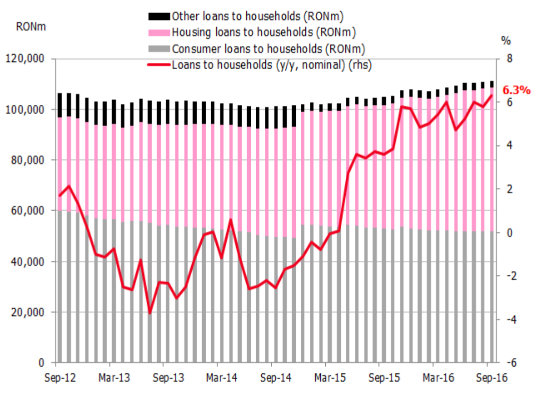
Loans growth is slightly above 1% (+1.2% y/y end-Sep'16), with households being the major driver of lending increases, while corporations are still in a wait-and-see mood, at the best case. More precisely, the annual pace of increase in household loans improved as of end-Sep'16 (+6.3% y/y vs. +5.2% y/y as of end-Jun'16, nominal terms), underpinned by the ongoing fast advance of housing loans (+16.2% y/y vs. +16.3% y/y as of end-Jun'16) and a milder decline of consumer loans (-1.8% y/y vs. -3.9% y/y as of end-Jun'16). On the flip side, the annual dynamics of loans to non-financial corporations deepened into negative territory, from -4.1% y/y as of end-Jun'16 to -5.3% as of end-Sep'16.

Non-governmental loans growth driven by RON lending



Source: Thomson Reuters Datastream, BRD-GSG Research

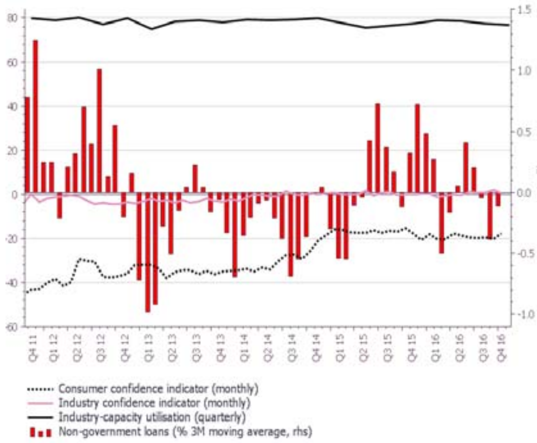
Housing loans gained weight in total households loans in the past two years



Source: Thomson Reuters Datastream, BRD-GSG Research

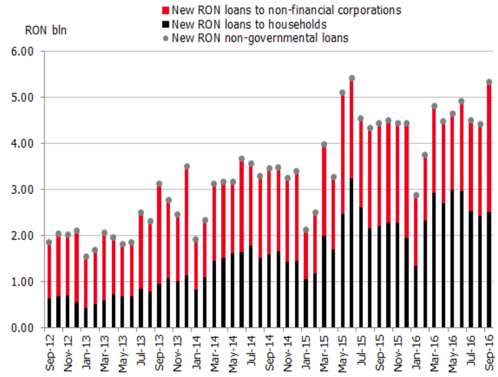
Historical lows of financing costs for corporations seem not to be a sufficient incentive for them to borrow, most probably due to low number of targeted investment projects reflected also by lower industry capacity utilization rate and slightly positive industry confidence indicators for the coming quarter.

Non-governmental loans growth might be supported by corporations lending



Source: Thomson Reuters Datastream, BRD-GSG Research

New RON denominated loans for corporations – historical high of the past four years in Sep'16



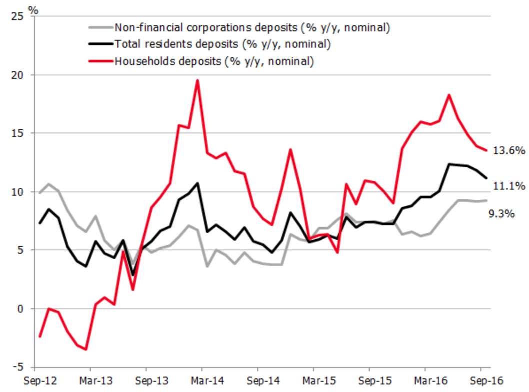
Source: NBR, BRD-GSG Research

The new loans statistic database showed that loans generation process slowed down in the first nine months of 2016 vs. 2015 (total non-governmental loans went up 10.0% y/y in Jan-Sep'16 vs. 27.2% y/y in Jan-Sep'15), as borrowing appetite of households eased, while loan demand from non-financial corporations increased significantly in Sep'16, when the maximum monthly level (RON 3.15bln) of the last four years was reached. The largest weight of new loans for households is held by consumer loans (58.5% for Jan-Sep'16) which increased by 20.4% y/y for 9 months in 2016 vs. +37.8% y/y for 9 months 2015. New mortgage loans went up 23.1% y/y for Jan-Sep'16 vs. +61.1% y/y for Jan-Sep'15. Otherwise, new loans to non-financial corporations is down by 1% y/y for Jan-Sep'16.

Consequently, we revised downwards **loans growth estimations** for 2016 and 2017, such as: +1.9% y/y (nominal terms) end-Dec'16 (vs. +3% y/y, previously), +3.0% y/y (nominal terms) end-Dec'17 (vs. +3.5% y/y, nominal terms, previously) and +3.7% y/y end-Dec'18. The major driver will remain households (+6.4% y/y in 2016, +6.0% y/y in 2017, +5.6% y/y in 2018, while corporations might continue to reduce their borrowed resources (-4.6% y/y in 2016, -1.4% y/y in 2017, +0.9% y/y in 2018).

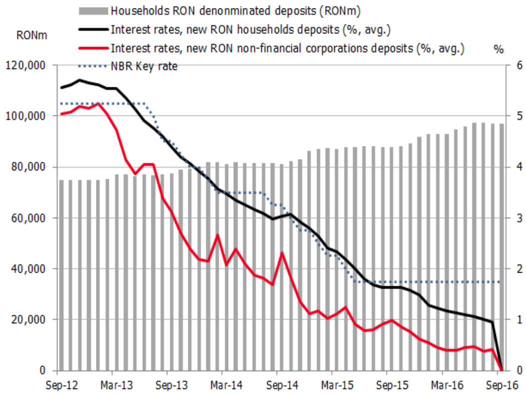
Contrary to the feeble growth of lending, non-government residents deposits' (deposits) record strong increases, exceeding all our expectations. Still, we believe that at some point households propensity towards savings might decrease, directing investments into more risky assets. Also, the fiscal stimulus effects should dissipate. Moreover, loans to deposits ratio went well below 0.9 (0.83 as of end-Aug'16), as inefficiency in utilization of financial resources increased for banks.

Households deposits – double digit annual growth rates in the past 12 months



Source: Thomson Reuters Datastream, BRD-GSG Research

RON households deposits returns at historical lows

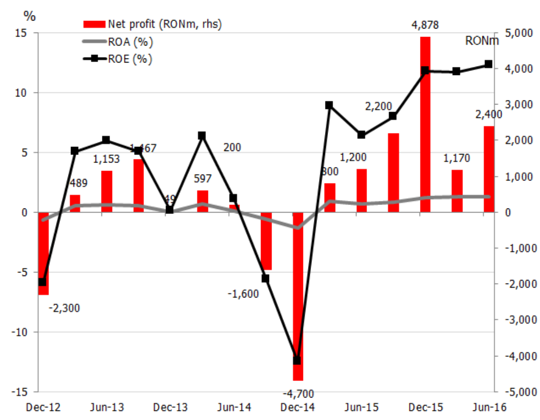


Source: Thomson Reuters Datastream, BRD-GSG Research

Hence, we reviewed upwards our **deposits growth** from our previous report to approx. +5.1% y/y (nominal terms) as of end-Dec'16 from +3.3% y/y (nominal terms) and we modified downwards to +0.6% y/y (nominal terms) end-Dec'17 from +3.6% y/y (nominal terms). For 2018, we estimate a decrease of deposits (-2.1% y/y, nominal terms) as we expect loans to deposits ratio to improve up to 0.9.

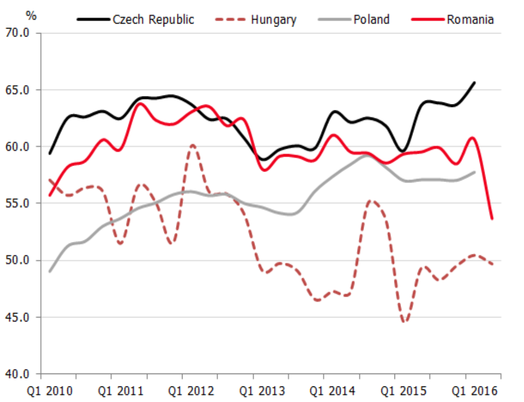
A lending activity which isn't too strong in a low interest rates environment will put under pressure interest rate margins which is the driver of banks' profitability. Still, 2016 is seen to be another profitable year, despite of decreasing margins vs. 2015, but supported by a slowdown of balance sheet cleaning process.

Local banking sector net result in the black…



Source: NBR, BRD-GSG Research

…while interest margin weight into total income is declining for local banking sector



Source: Financial Soundness Indicators (FSI), BRD-GSG Research

The slowdown of balance sheet cleaning process in H1'16 vs. 2014 has mainly been reflected in a smaller decline of NPLs ratio (using EBA definition for NPLs), which reached 10.56% as of end-Aug'16 vs. 13.51% as of end-Dec'15 (20.71% as of end-Dec'14). The NPL ratio is still higher than the EBA threshold (higher than 8%) used to assess a worse situation for local banking sector, but coverage ratio is above the requested level to position banking sector at the best performers group. However, the balance sheet cleaning process might gain speed in the second part of 2016 as compared with the first six months of this year, considering the need to align to EBA threshold. We revised downwards NPLs ratio to 9.8% as of end-Dec'16 (vs. 11.5%, previously) and to 9.0% (vs. 10.4%, previously) as of end-Dec'17 and to 8.0% as of end-Dec'18.

Moreover, the solvency ratios show a sound and solid banking sector in comparison with regional peers.

Country/Indicator	Regulatory Capital (Tier 1 Capital) to RWA	NPLs to Total Gross Loans	NPLs Net of Provisions to Capital	Reporting date
Czech Republic	16.10%	5.20%	21.70%	Q1 2016
Hungary	14.32%	10.90%	16.70%	Q1 2016
Poland	15.23%	4.40%	10.00%	Q1 2016
Romania	**17.20%**	**13.50%**	**38.20%**	Q1 2016

Source: Financial Soundness Indicators (FSI), BRD-GSG Research

We mention two of the main challenges ahead: 1/ legislative initiatives (i.e.: "walk away" mortgage law, CHF denominated loans conversion at the FX rate valid at the initiation date of the contract) that might hamper banks' solid capital position and 2/ digitalization process.

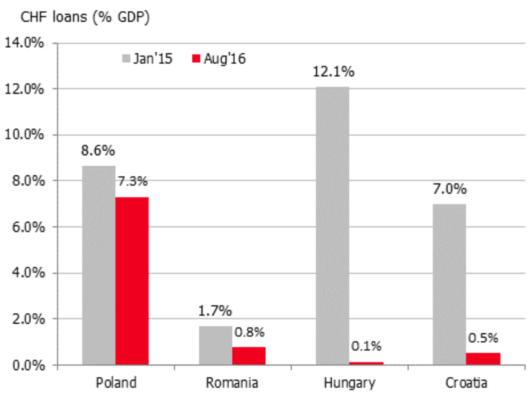
1/ As we have above stated, the provisions of **mortgage "walk-away" law** entered into force starting with 13 May'16 and the first assessment of the effects of the law together with features of those debtors who claimed the application of the mortgage "walk-away" law have been released with NBR's presentation of quarterly inflation report in a press conference held in Aug'16. 3,398 debtors submitted 3,907 notifications regarding the mortgage "walk-away" law to 24 banks between 13 May'16 and 20 Jul'16. The total amount of the loans notified accounted for RON 1.13bn (1% of the total household loans). The 24 banks contested 67.4% of the total number of notifications submitted. For the majority of the notified exposure (namely ~RON 0.84bln), loan-to-value (LTV) is higher than 1, while the indebtedness ratio is higher than 65% for 49% of the debtors who hold 51% of the notified exposures. For 56% of the notified exposures (~RON 0.63bln) were recorded delays higher 90 days. The average notified loan is approx. RON 300,000.

Analyzing the features of the debtor who notified the bank in case of the mortgage "walk-away" law, we may draw the conclusion that the law wasn't designed for a large number of people in social need, given the total amount notified during this period, but for few people whose cases might have been solved by negotiations with creditors on case by case basis, without the involvement of the political factor. Moreover, in most of the cases the value of the loan can't be recovered (~ RON 0.84bln), so the banks might incur a loss from these loans.

After the mortgage "walk-away" law enforcement, local banks decided to increase down payment for mortgage loans to assure them against a rising risk. After a couple months, the necessity for banks to increase lending forced them to reassess this decision and reduced, to some extent, the down payment for a mortgage loan.

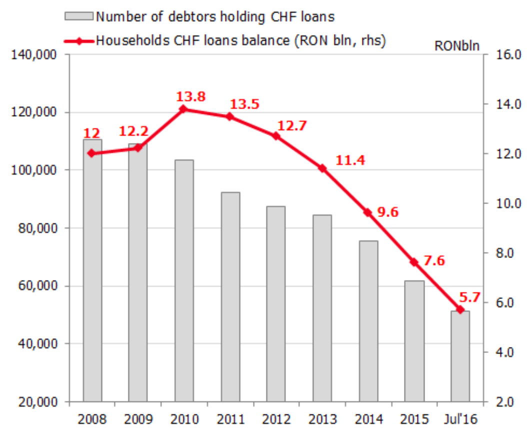
In our spring report, we mentioned that there was another initiative legislative regarding the possibility of **CHF denominated loans conversion at the FX rate valid at the initiation date of the contract.** The law was approved on 18 Oct'16 by the Chamber of Deputies and was submitted to the President for endorsement. Once again, the law doesn't include any criteria in order to define social cases, so no threshold for debt ratio, value of the loan, date of signing the contract, type of the loan. Thus, we may see that debtors, who contracted a CHF denominated loan for speculative investments, to be considered a social case, which is unusual in international banking environment. NBR responded to questions of Chamber of Deputies and made some estimations for the anticipated effects of the law: 1/ the estimated loss is RON 2.38bln, while the adjusted loss with provisions is RON 1.66bln; 2/ the decline of Tier 1 Capital ratio by 1.8% to 16.8% as of end-Jun'16; 3/ short position of RON 5.53bln (~EUR 1.22bln), namely banks should use local currency resources to buy EUR 1.2bln to match their FX position.

Romania had one of the lowest weight of CHF loans in GDP at the moment of Swiss National Bank decision to cancel the cap of EURCHF



GDP is computed based on last 4 quarters (moving average)
Source: Central Banks

Declining balance of CHF loans as compared with end-Dec'14



Source: NBR, NBR Answers given by NBR to Chamber of Deputies, as of 10 Oct'16

A brief statistic for CHF denominated loans: 1/ CHF denominated loans balance is approx. RON 5.7bln as of end-Jul'16, accounting for 3% of the non-governmental loans (approx. 5% of the loans granted to population); 2/ 90% of CHF loans were granted between 2005 and 2008; 3/ approx. 50% of the borrowers in CHF contracted consumer loans, without mortgage guarantee; 4/ NPL ratio for CHF loans granted to households is 33%, coverage ratio is 46%; 5/ approx. 20% of the CHF loans recorded delays higher than 60 days.

The law for conversion of CHF denominated loans came after some debtors have already benefited from conversion and restructuring operations in the past 20 months, as 57,298 requests were submitted between 16 Jan'15 and 26 Aug'16. 54.5% of the requests were for conversion operations, while 45.4% of requests were for restructuring operations. Approx. 58.5% of the requests were solved, a rather low percentage solved, most probably, because rumors regarding CHF denominated loans conversion at historical FX rate were present on the market since beginning/mid-2015, so potential debtors might have refrained from submitting a request for conversion or restructuring the loan, waiting for better conditions under a potential CHF denominated law.

The law for conversion the CHF denominated loans as well the mortgage "walk-away" law created a precedent and might signal that any time the political factor might interfere in the free market mechanism by giving advantages not only to the distressed borrowers but to anyone who have borrowed money and isn't willing to give it back to the bank, as long as no criteria to define the potential beneficiaries are mentioned.

If the mortgage "walk-away" law has medium to long term effects regarding the banks' activity (such as: tightening lending conditions; rising moral hazard; increasing provisions expenses or capital requirements), the conversion of CHF denominated loans at historical rate for all the debtors (including those who applied for reconversion/restructuring) might create confusion at banks' operational level given that are a lot of unknowns. Moreover, the Government contested the law for conversion of the CHF denominated loans at the Constitutional Court delaying the entire process for law enforcement.

An unstable regulatory framework might refrain prospective clients to access banks' products and services reducing the appetite for banks' investments and causing some reduction in their performance and activity. However, we believe that given the current questions marks regarding the constitutionality of these two laws' provisions, banks will continue to contest the mortgage "walk-away" mortgage law to the Constitutional Court, and a long and costly process might start in order to align the provisions of the laws with Constitution and EU regulations.

2/ The international banking sector is confronting with another challenge coming from the **digitalization** of the products and services offered. Although, this is also a threat for local banks, we believe that local clients, mostly households, need to be assisted by a bank's employee when deciding to acquire a financial service/product. The lack of trust of clients in local banks is even more amplified by the "walk-away" mortgage law and the CHF denominated loans conversion law, potentially triggering tensions and dissensions between banks and clients.

IV. Forecast: Main Macroeconomic and Financial Market Indicators

BRD-GSG Research Forecasts

	2011	2012	2013	2014	2015	2016(f)	2017(f)	2018(f)
Real sector								
GDP (real, %)	1.1%	0.6%	3.5%	3.1%	3.8%	4.7%	3.8%	3.9%
Final consumption expenditure (real, %)	0.8%	1.1%	-0.3%	4.0%	5.2%	8.0%	5.5%	4.3%
Gross fixed capital investment (real, %)	2.9%	0.1%	-5.4%	3.2%	8.8%	5.0%	6.0%	6.5%
Exports (real, %)	11.9%	1.0%	19.7%	8.0%	5.5%	5.0%	5.5%	6.4%
Imports (real, %)	10.2%	-1.8%	8.8%	8.7%	9.1%	10.5%	9.0%	8.5%
CPI (eop, y/y)	3.1%	5.0%	1.6%	0.8%	-0.9%	-0.5%	1.5%	2.7%
ILO unemployment	7.2%	6.8%	7.1%	6.8%	6.8%	6.2%	6.1%	6.1%
Public finance (ESA 2010)								
Fiscal balance (% of GDP)	-5.4%	-3.7%	-2.1%	-0.8%	-0.8%	-2.5%	-3.5%	-2.9%
Government revenue (% of GDP)	33.7%	33.6%	33.3%	33.6%	34.9%	33.2%	33.0%	34.0%
Government expenditure (% of GDP)	39.1%	37.2%	35.4%	34.4%	35.7%	35.7%	36.5%	36.9%
Public debt (% of GDP)	34.2%	37.3%	37.8%	39.4%	37.9%	38.5%	40.0%	41.0%
External sector								
Current account balance (% of GDP)	-4.9%	-4.8%	-1.1%	-0.7%	-1.2%	-2.0%	-2.4%	-2.7%
Trade balance (% of GDP)	-5.8%	-5.1%	-0.8%	-0.4%	-0.6%	-1.3%	-1.8%	-2.0%
FDI (EUR bln)	1.8	2.1	2.7	2.4	3.4	3.7	3.8	4.0
Secondary income (% of GDP)	2.1%	2.0%	1.9%	1.1%	1.7%	1.5%	1.7%	1.9%
Monetary and financial sector								
Key interest rate (%, eop)	6.0%	5.25%	4.00%	2.75%	1.75%	1.75%	1.75%	2.00%
Private sector credit (eop, nominal y/y)	6.6%	1.3%	-3.3%	-3.4%	3.0%	1.9%	3.0%	3.7%
NPLs (% of total loans)*	14.3%	18.3%	21.9%	20.7%	13.6%	9.8%	9.0%	8.0%
Loan-to-deposits	1.2	1.2	1.0	0.9	0.85	0.83	0.85	0.90
Financial markets								
EURRON (eop)	4.32	4.43	4.48	4.48	4.52	4.53	4.50	4.47
EURRON (avg)	4.24	4.46	4.42	4.44	4.445	4.49	4.48	4.46
EURUSD (avg)	1.39	1.29	1.33	1.33	1.11	1.12	1.14	1.17
USDRON (avg)	3.05	3.47	3.33	3.35	4.01	4.01	3.93	3.81
ROBOR 3M (eop)	6.05%	6.05%	2.44%	1.70%	1.02%	0.80%	1.00%	1.30%
EURIBOR 3M (eop)	1.36%	0.19%	0.29%	0.08%	-0.13%	-0.30%	-0.30%	-0.20%
Memo items								
GDP (nominal, bln RON)	565.1	595.4	637.5	667.6	712.8	760.6	806.3	858.3
GDP (nominal, bln EUR)	133.3	133.8	144.3	150.2	160.4	169.4	180.0	192.4

Source: Eurostat, NIS, NBR, forecast: BRD-GSG Reasearch, *based on NBR methodology for NPLs between 2011 and 2013, based on EBA definition for NPLs for the period 2014-2018e

BRD-GSG - Research

Florian LIBOCOR
Chief Economist
Head of Research
+40 21 301 6869
florian.libocor@brd.ro

Carmen LIPARĂ, PhD
Head of Financial Markets Research
+40 21 301 4370
carmen.lipara@brd.ro

Laura SIMION, CFA
Equity Analyst
+40 21 301 4461
laura.simion@brd.ro

Ioan MINCU
Economist
+40 21 301 4472
george.mincu-radulescu@brd.ro

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