

Romania | Macro Outlook

Private consumption to remain key growth driver in 2017

CB likely to keep key rate unchanged at 1.75% throughout 2017

RON yields could be subject to upward pressure in 2017

Leu to fluctuate within 4.40-4.60 band in 2017

Economy (%)	2016e	2017e	2018e
GDP (real, y/y)	4.5	3.2	3.3
Unempl. Rate	6.7	6.8	6.7
CPI (y/y)	-1.6	1.2	2.0
Retail Sales (y/y)	11.0	5.0	5.0
Ind. Prod. (y/y)	2.0	2.8	3.1
Public Debt/GDP	40.4	41.8	42.3

Source: Erste Group Research

Market	Spot	17Q1	17Q2	17Q3
EUR/RON	4.51	4.50	4.51	4.51
USD/RON	4.23	4.25	4.18	4.10
Target Rate (%)	1.75	1.75	1.75	1.75
3M Rate (%)	0.40	0.85	1.00	1.05
2Y Bond (%)*	1.42	1.35	1.40	1.45
5Y Bond (%)*	2.31	2.45	2.50	2.55
10Y Bond (%)*	3.41	3.60	3.65	3.70

Source: FactSet, Erste Group Research

Rating	Current	Outlook
Moodys	Baa3	pos
S&P	BBB-	stable
Fitch	BBB-	stable

Source: Erste Group Research

General	2016
Population mn	19.8
GDP/Capita EUR	8,615

Source: Erste Group Research

Spot Rates as of:

13th Dec. 2016

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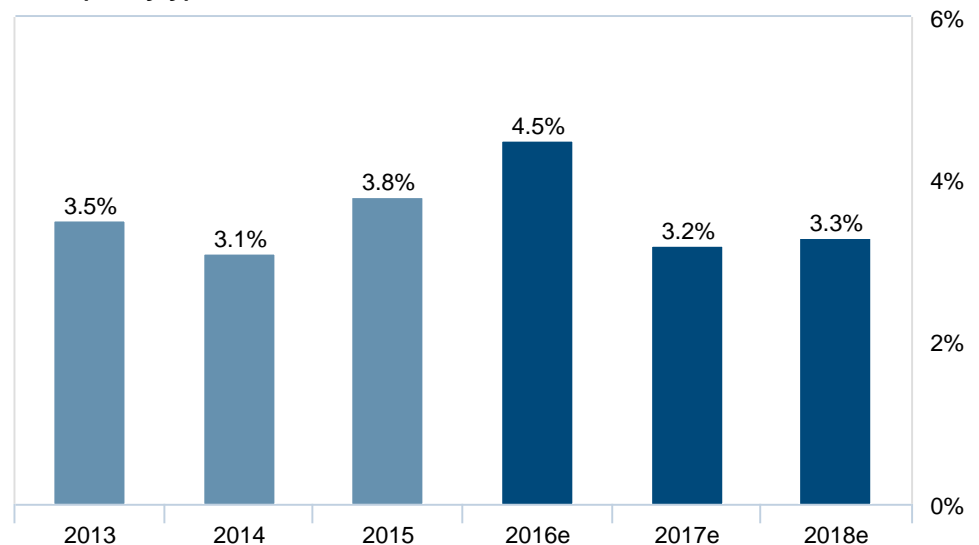
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Forecasts are not a reliable indicator for future performance.

The Romanian economy is seen rebalancing to sustainable growth in 2017, after being one of the fastest-growing economies in the European Union in recent years, mostly thanks to consumption-focused fiscal stimulus and higher wages in the public sector. Household consumption will probably remain a key driver behind the growth, while investments may provide less support for economic growth.

We believe that the new government, which will take office after the December elections, will become more restrictive in 2017 in order to keep the budget deficit in line with the Maastricht criteria.

GDP (real,y/y)



Source: Erste Group Research

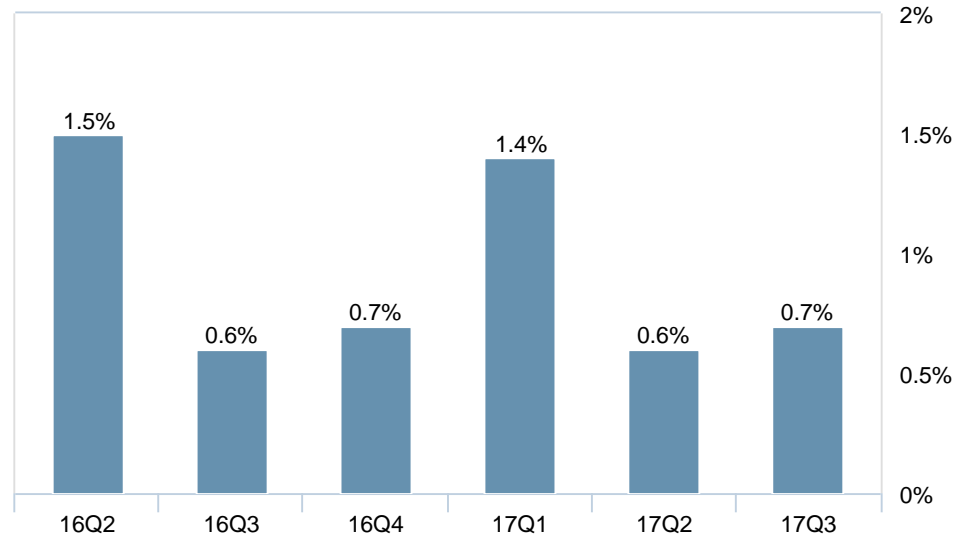
GDP

Private consumption to remain key growth driver in 2017

The Romanian economy lost speed in the third quarter (4.4% y/y), after GDP grew at the fastest rate in eight years in the previous quarter (6% y/y). The GDP structure revealed that the slowdown was predominantly driven by the sharp deceleration of investments, while private consumption grew at a sluggish pace. The drag from net exports was softer vs. previous quarters, as growth in imports was only slightly faster than that of exports. The local economy also received support from IT&C, retail and wholesale trade, while agriculture posted only a modest increase.

We see the Romanian economy expanding 4.5% this year before rebalancing towards its L/T potential of 3% next year. Our full-year GDP forecast for 2017 is 3.2%. Private consumption is expected to remain the key driver of 2017 growth, supported by the solid increases in net wages and improving labor market conditions. Fiscal policy, on the other hand, might be less supportive for growth next year, while external risks emanating from a number of uncertainties (Brexit, political developments in Turkey, etc.) could also weigh on economic growth.

GDP (real, s.a., q/q)



Source: Erste Group Research

Annual	2014	2015	2016e	2017e	2018e
GDP real	3.1%	3.8%	4.5%	3.2%	3.3%
CPI (y/y)	1.1%	-0.6%	-1.6%	1.2%	2.0%
Private Consumption	4.4%	5.9%	8.0%	5.0%	3.9%

Source: Erste Group Research

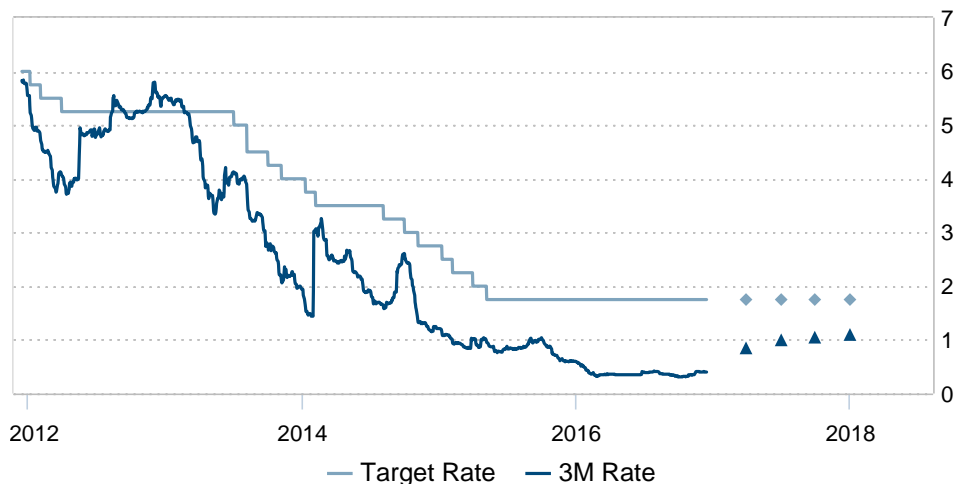
Monetary Policy

CB likely to keep key rate unchanged at 1.75% throughout 2017

Monthly inflation surprised to the downside in November, pushing the annual inflation down further to -0.7%, from -0.4% in the previous month. Our baseline scenario remains consistent with annual inflation of -0.6% in December 2016, followed by a moderate rebound in 1Q17, due to a base effect, ending the year at 1.7%.

We maintain our view of no key rate changes throughout 2017, since inflation is likely to hover just above the lower end of the target band (1.5-3.5%). The central bank may decide to narrow the symmetrical corridor of interest rates for the deposit facility and lending facility to 100bp (from the current 125bp), while keeping minimum reserve requirements for both RON and FX liabilities flat at 8% and 10%.

Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	17Q1	17Q2	17Q3	17Q4
Target Rate	1.75	1.75	1.75	1.75	1.75
3M Rate	0.40	0.85	1.00	1.05	1.10

Source: FactSet, Erste Group Research

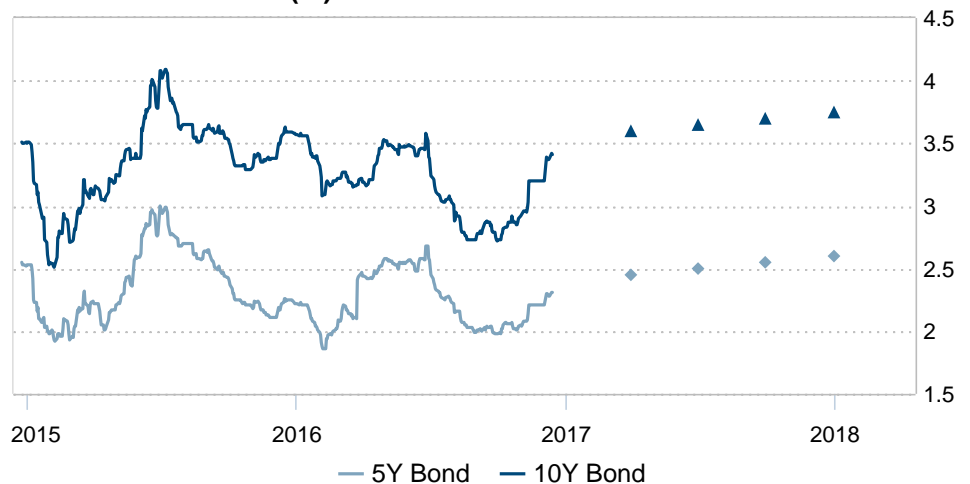
Bond Yields

RON yields could be subject to upward pressure in 2017

Local currency bond yields have increased significantly during the last few weeks, with the yield curve edging up almost 25bp on average since early November. Government bond yields are likely to be driven by a combination of internal and external factors. A much higher budget deficit and an external backdrop riven with uncertainties (upcoming Fed rate hikes, possible early elections in Italy, France and German elections in 2017, etc.) could dent investors' confidence often throughout 2017, whereas the extension of the QE program by the ECB should act as a suppressor of prospective increases in bond yields.

In light of the latest external developments, we have revised upwards our end-year 10-year yield forecast to 3.50% in 2016 (from 3.35%) and 3.75% in 2017 (from 3.40%).

Generic Bond Yields (%)



Source: FactSet, Erste Group Research

Market	Spot	17Q1	17Q2	17Q3	17Q4
2Y Bond*	1.42	1.35	1.40	1.45	1.50
5Y Bond*	2.31	2.45	2.50	2.55	2.60
10Y Bond*	3.41	3.60	3.65	3.70	3.75

Source: FactSet, Erste Group Research

Note:

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Romanian Leu

Leu to fluctuate within 4.40-4.60 band in 2017

The EURRON pair was traded above the 4.50 mark for most of the time in the last two months, as the national currency showed some signs of weakness against the European single currency. A notable event was the RON depreciation to its lowest level vs. the euro in almost five months (4.525), after Trump's surprise victory in the US presidential election triggered a risk-on sentiment on global markets. There was a similar depreciation of the national currency on November 16, when expectations of a faster rise in the Fed's interest rates got a boost from the prospects of a generous fiscal stimulus in the US.

The Romanian leu is seen hovering within a narrow range of 4.40-4.60 next year, but we do not completely rule out further bouts of volatility, largely driven by external headwinds ranging from Brexit to political developments in France and Germany. Uncertainty linked to geopolitical tensions remains another key source of risk to our outlook. We see the average EURRON at 4.51 in 2017.

EUR/RON



Source: FactSet, Erste Group Research

	Spot	17Q1	17Q2	17Q3	17Q4
EUR/RON	4.51	4.50	4.51	4.51	4.51
<i>vs. Spot</i>		-0.2%	0%	0%	0%
USD/RON	4.23	4.25	4.18	4.10	4.10
<i>vs. Spot</i>		0.5%	-1.2%	-3.1%	-3.1%

Source: FactSet, Erste Group Research

Politics

Budget deficit to approach 3% of GDP in 2017

Social-Democrats (PSD) claimed a landslide victory in the parliamentary elections, garnering almost 46% of total votes. Liberals struggled far behind, receiving around 20%. Other parties that have gained mandates in the Parliament are the Union to Save Romania (~9%), the ethnic Hungarians (~7%) and People's Movement Party (~5%) led by former President Traian Basescu. Under these circumstances, the PSD, along with their stalwart ally ALDE, which received only 5.6%, and backed by the ethnic minorities other than Hungarians who are a mainstay in the Romanian Parliament (3.8%) can easily build up a majority.

The budget deficit for 2017 is estimated at 3% of GDP, but the next government should take measures to keep the deficit under control. With Romania one of the poorest tax collectors in the European Union, we have to acknowledge that the balance of risks is mostly tilted to the upside in the absence of proper remedies. Public debt might continue to grow and is projected at 41.8% of GDP at the end of 2017, from 38.4% in 2015.

Last Election:
2016

Next Election:
2020

Forecasts

Annual	2010	2011	2012	2013	2014	2015	2016e	2017e	2018e
Real GDP growth	-1.1	1.1	0.6	3.5	3.1	3.8	4.5	3.2	3.3
Inflation (CPI, avg)	6.1	5.8	3.3	4.0	1.1	-0.6	-1.6	1.2	2.0
Unemployment rate (avg)	7.0	7.2	6.8	7.1	6.8	6.8	6.7	6.8	6.7
Retail sales growth	-7.0	-1.2	4.1	0.5	7.0	8.9	11.0	5.0	5.0
Industrial output growth	5.6	5.6	0.0	7.8	6.1	2.7	2.0	2.8	3.1
Private consumption growth	0.2	1.4	1.5	-2.4	4.4	5.9	8.0	5.0	3.9
Fixed capital formation growth	-1.8	7.7	3.8	-5.4	3.2	8.8	5.0	4.0	4.5
Percent of GDP									
Trade balance	-7.5	-7.3	-7.2	-4.0	-4.0	-5.2	-6.5	-7.2	-7.7
Current account balance	-4.6	-4.6	-4.5	-0.8	-0.5	-1.1	-2.2	-2.5	-2.7
Foreign direct investment	1.8	1.4	1.6	1.9	1.6	1.9	2.0	2.0	2.0
Budget balance	-6.7	-5.4	-3.7	-2.1	-0.9	-0.7	-2.9	-3.0	-3.0
Public debt	29.9	34.2	37.3	38.0	39.8	38.4	40.4	41.8	42.3
External debt, gross	72.9	74.0	74.4	68.0	63.1	56.7	53.1	50.1	46.6
FX, money market									
USDLCY average	3.18	3.05	3.47	3.33	3.35	4.00	4.07	4.16	n.a.
EURLCY average	4.21	4.24	4.46	4.42	4.44	4.45	4.49	4.51	n.a.
EURLCY eop	4.26	4.32	4.43	4.48	4.48	4.52	4.52	4.51	n.a.
(percent)									
CB policy rate (avg.)	6.67	6.22	5.34	4.84	3.34	1.75	1.75	1.75	2.00
3m interbank offer rate (avg.)	6.75	5.82	5.34	4.22	2.55	1.34	0.77	1.00	n.a.
2Y Yield (average)*	n.a.	n.a.	n.a.	n.a.	2.92	1.64	1.34	1.43	n.a.
5Y Yield (average)*	7.30	7.20	6.10	4.98	3.54	2.58	2.41	2.53	n.a.
10Y Yield (average)*	n.a.	n.a.	n.a.	5.41	4.40	3.69	3.26	3.68	n.a.

Source: Erste Group Research

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