Romania | Macro Outlook

External headwinds to hit 2020 growth
Monetary easing dependent on future fiscal steps
Strong reaction of ROMGBs to adverse events
Weakening bias of leu

Economy (%)	2019	2020e	2021e
GDP (real, y/y)	4.1	1.8	2.2
Unempl. Rate	3.9	5.8	6.2
CPI (y/y)	3.8	3.4	3.4
Retail Sales (y/y)	7.2	3.2	2.0
Ind. Prod. (y/y)	-2.3	-2.0	3.5
Public Debt/GDP	35.4	39.5	40.4

Source: Erste Group Research

Market	Spot	20Q2	20Q3	20Q4
EUR/RON	4.85	4.88	4.88	4.90
USD/RON	4.42	4.32	4.24	4.26
Target Rate (%)	2.50	2.50	2.50	2.50
3M Rate (%)	2.83	2.90	3.10	3.00
2Y Bond (%)*	3.23	3.90	4.00	3.90
5Y Bond (%)*	3.59	5.25	5.30	5.10
10Y Bond (%)*	4.19	5.70	5.80	5.50

Source: FactSet, Erste Group Research

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

Source: Erste Group Research

General	2019
Population mn	19.3
GDP/Capita EUR	11,847

Source: Erste Group Research

Spot Rates as of:
17th Mar. 2020

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Note:
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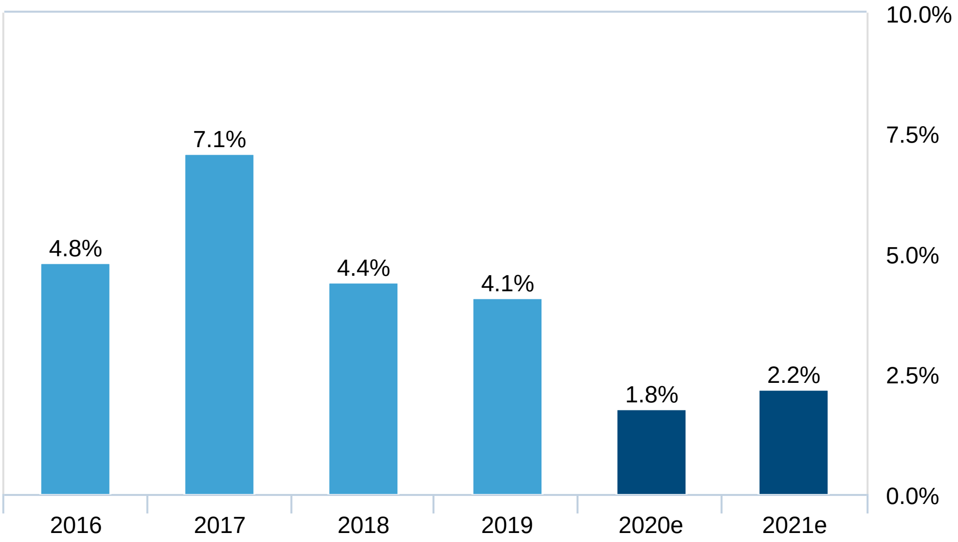
After years of exuberant fiscal and income policies, Romania is facing a difficult but unavoidable transition to a more prudent budgetary framework. Economic growth is likely to decelerate to +1.8% in 2020, from +4.1% in 2019. The local economy is being hit by a twin supply-demand shock related to the rapid spread of the coronavirus in Europe in March. Unlike most EU countries, Romania has very limited fiscal headroom to accommodate the external shock. The elephant in the room is the 40% public pension rise in September 2020, with large medium-term impact in a ‘no policy change scenario’.

Slower economic growth leads to an adjustment in the current account deficit to around -4.2% of GDP in 2020, from -4.7% in 2019. The NBR could ease liquidity conditions and adjust regulatory requirements for lending to allow banks to support troubled customers. NBR rate cuts are not a primary option because the central bank likes to have flexibility if the currency comes under weakening pressure. The leu should continue to weaken gradually and the NBR is likely retain a discreet presence in the market.

GDP (real,y/y)



Source: Erste Group Research

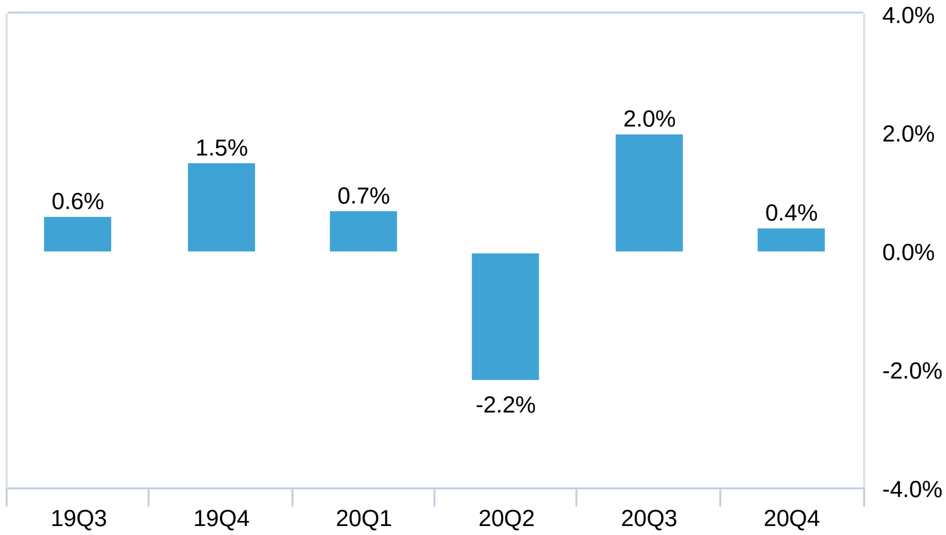
GDP

External headwinds to hit 2020 growth

Real GDP growth accelerated to +1.5% q/q and +4.3% y/y in 4Q19, due to one-off items related to the steep rise of the budget deficit. Household consumption went up by +4% q/q in 4Q19 (3Q19: +1.7% q/q), boosted by loose fiscal and income policies. Government consumption jumped +25.8% q/q in 4Q19 (3Q19: +5.6% q/q), in the context of a large increase in public spending in November and December. Gross fixed capital formation entered negative territory at the end of 2019 (-3.8% q/q), after five consecutive quarters of expansion. Foreign trade made a negative contribution to economic growth.

We cut our economic growth forecast to +1.8% in 2020 (-1.7pp), due to the spread of COVID-19 in Europe. Unlike most EU countries, Romania has very limited fiscal space to accommodate the twin supply-demand shock, and is hence experiencing stronger negative impact. In 2021, risks to our baseline economic growth forecast of +2.2% are related to fiscal adjustment measures to avoid a major fiscal slippage. Higher inflows of EU structural and cohesion funds could mitigate these risks. The absorption rate was 38% in March 2020.

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



Source: Erste Group Research

Annual	2017	2018	2019	2020e	2021e
GDP real	7.1%	4.4%	4.1%	1.8%	2.2%
CPI (y/y)	1.3%	4.6%	3.8%	3.4%	3.4%
Private Consumption	10.1%	7.2%	5.9%	2.5%	2.1%

Source: Erste Group Research

Inflation

Downside risks to our inflation forecast for 2020

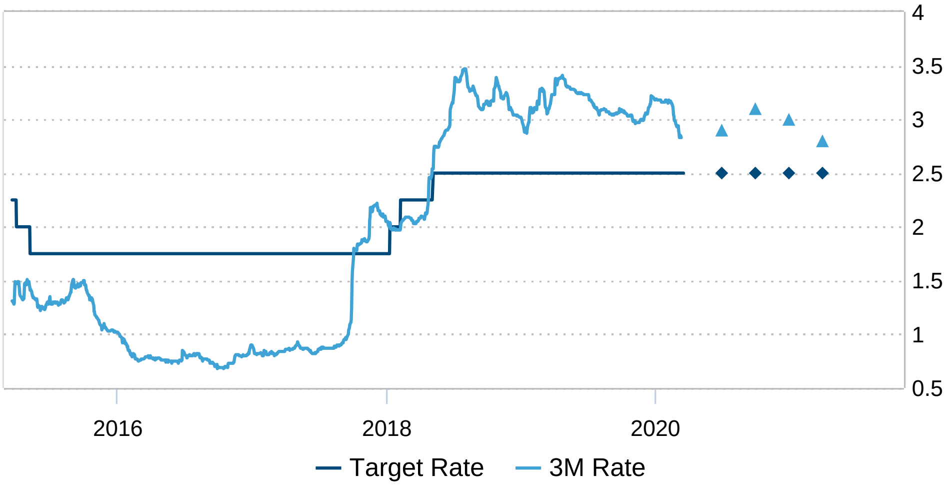
The inflation rate fell to 3.1% y/y in February 2020, from 4% y/y in December. Core inflation was on an upward trend in recent quarters and exceeded headline inflation in early-2020. We see inflation easing further to below 3% by the end of 2Q20, before rising gradually towards 3.5% in 2H20. Risks to our forecast are skewed to the downside due to lower oil prices on global markets and soft household consumption. We estimate that, in the absence of a monetary policy reaction, a 10% drop in oil prices could lead to a 0.4pp decline in the inflation rate over a one-year period.

Monetary Policy

Monetary easing dependent on future fiscal steps

In February 2020, the NBR cut the FX reserve requirement ratio (RRR) to 6% (-2pp) and kept the policy rate unchanged at 2.50%. The reduction of FX RRR released around EUR 600mn into the market and created better conditions for the MinFin to issue EUR-denominated bonds on the local market. The NBR could ease liquidity conditions and adjust regulatory requirements for lending to allow banks to support troubled customers. NBR rate cuts are not a primary option in 2020 because the central bank likes to have flexibility if the currency comes under weakening pressure.

Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	20Q2	20Q3	20Q4	21Q1
Target Rate	2.50	2.50	2.50	2.50	2.50
3M Rate	2.83	2.90	3.10	3.00	2.80

Source: FactSet, Erste Group Research

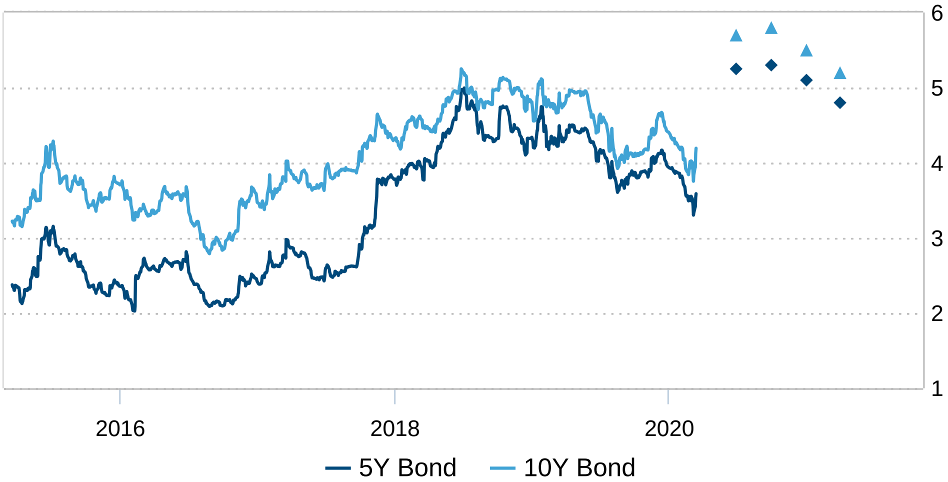
Bond Yields

Strong reaction of ROMGBs to adverse events

The early elections scenario has been on a roller coaster since the beginning of 2020. In January and February, investors gradually priced in rising chances for early elections and demand for ROMGBs increased. Supportive liquidity conditions on global markets also helped. In March, the Constitutional Court ruled that a government ordinance for organizing snap elections was unconstitutional. This event coincided with the severe stress on global markets due to COVID-19 and long-term RON yields rose sharply.

A shift towards fiscal prudence in 2021 could lead to lower yields for ROMGBs. Calmer global markets and a rebound in economic growth rates should reinforce this trend. The EC's surveillance of Romania's public finances, once the EDP was started in spring 2020, is yet other element that should support foreign investor confidence in ROMGBs on a longer-term horizon. Local bonds will be added to the Bloomberg Barclays Global Aggregate Index from September, which could bring in USD 1.4bn in passive inflows.

Generic Bond Yields (%)



Source: FactSet, Erste Group Research

Market	Spot	20Q2	20Q3	20Q4	21Q1
2Y Bond*	3.23	3.90	4.00	3.90	3.60
5Y Bond*	3.59	5.25	5.30	5.10	4.80
10Y Bond*	4.19	5.70	5.80	5.50	5.20

Source: FactSet, Erste Group Research

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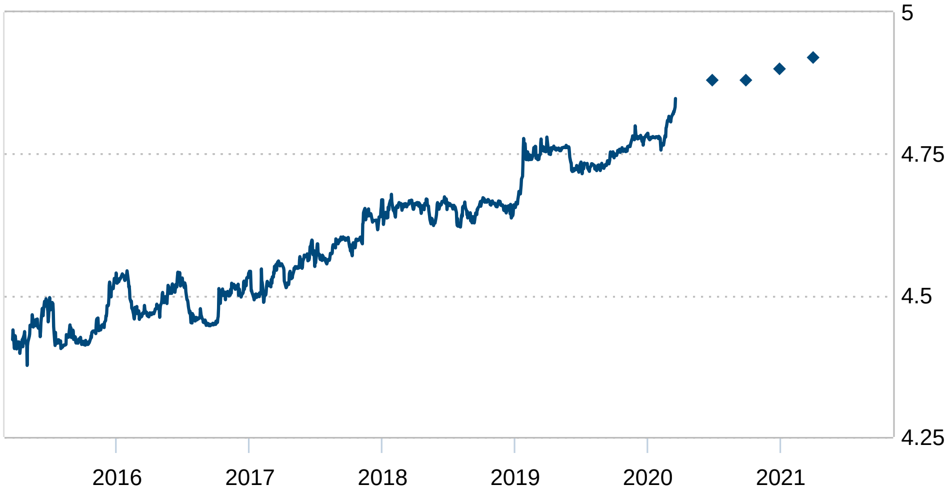
Romanian Leu

Weakening bias of leu

The Romanian leu depreciated to above 4.8/EUR in February, due to investors' worries about the twin deficits and rising political uncertainties. After being constantly present in the FX market to stem leu depreciation in the past months, the NBR probably took a few steps back and the leu weakened above the psychological level of 4.8/EUR. The central bank likely smoothed the general trend of weaker emerging currencies that was visible in other CEE countries.

We expect the leu to continue to depreciate as long as the current account deficit remains high. Our forecast shows an average weakening of the leu of close to 2% per year in nominal terms. The NBR is likely to continue to intervene in the FX market to smooth out volatility in the EURRON rate, without curbing the market trend. FX reserves were at the comfortable level of almost EUR 36bn in February.

EUR/RON



Source: FactSet, Erste Group Research

	Spot	20Q2	20Q3	20Q4	21Q1
EUR/RON	4.85	4.88	4.88	4.90	4.92
vs. Spot		*0.6%*	*0.6%*	*1%*	*1.4%*
USD/RON	4.42	4.32	4.24	4.26	4.28
vs. Spot		*-2.3%*	*-4.1%*	*-3.6%*	*-3.2%*

Source: FactSet, Erste Group Research

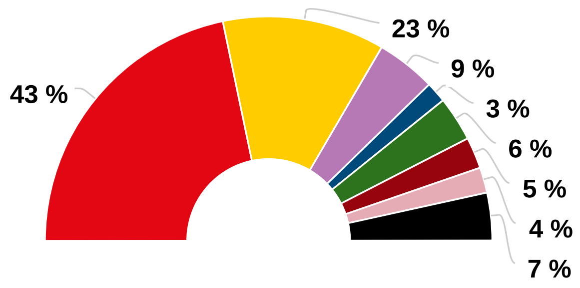
Politics

Imperative need for reforms

In October, the Social-Democrat government saw its political support withdrawn by the parliament. A Liberal government with a difficult reform agenda and shaky support in the parliament took office. Shortly after winning presidential elections in November, incumbent President Iohannis said he would be involved in seeking a new majority in the parliament. In March, the chances for early elections fell significantly after the Constitutional Court rejected a government ordinance for organizing them.

Local elections are scheduled for June and regular parliamentary elections for November 2020. The lack of structural reforms is a clear negative for long-term potential growth. Digitalization of the fiscal authority, streamlining of the education system to bring it closer to labor market needs, better capacity of the public administration to absorb EU funds and constitutional reform require solid political support. Results are only seen in a medium-term horizon, so it is imperative to start reforms as soon as possible.

Parliament Seats



PSD | left
PNL | centre right
USR | centre
PMP | right
UDMR | centre right
Pro Romania | left
Ethnic minorities | centre
Independent MPs | centre

Source: Erste Group Research

Last Election:
Nov-19

Next Election:
Jun-20

Forecasts

Annual	2014	2015	2016	2017	2018	2019	2020e	2021e
Real GDP growth	3.4	3.9	4.8	7.1	4.4	4.1	1.8	2.2
Inflation (CPI, avg)	1.1	-0.6	-1.5	1.3	4.6	3.8	3.4	3.4
Unemployment rate (avg)	6.8	6.8	5.9	4.9	4.2	3.9	5.8	6.2
Retail sales growth	6.5	9.4	12.4	10.8	5.4	7.2	3.2	2.0
Industrial output growth	6.0	2.8	3.1	7.8	3.5	-2.3	-2.0	3.5
Private consumption growth	4.2	5.9	8.3	10.1	7.2	5.9	2.5	2.1
Fixed capital formation growth	3.3	7.5	-0.2	3.6	-1.2	17.8	3.2	2.0
Percent of GDP								
Trade balance	-4.0	-5.2	-5.9	-6.9	-7.4	-7.8	-8.1	-7.5
Current account balance	-0.2	-0.6	-1.4	-2.8	-4.4	-4.7	-4.2	-3.8
Foreign direct investment	1.6	2.2	2.7	2.6	2.6	2.4	1.3	2.1
Budget balance	-1.2	-0.6	-2.6	-2.6	-2.9	-4.6	-6.0	-3.5
Public debt	39.2	37.8	37.3	35.1	34.7	35.4	39.5	40.4
External debt, gross	64.6	59.1	55.3	51.9	48.8	47.3	47.7	46.3
FX, money market								
USDLCY average	3.35	4.01	4.06	4.05	3.94	4.24	4.24	4.30
EURLCY average	4.44	4.45	4.49	4.57	4.65	4.75	4.88	4.94
EURLCY eop	4.48	4.52	4.54	4.66	4.66	4.78	4.90	4.97
(percent)								
CB policy rate (avg.)	3.34	1.75	1.75	1.75	2.34	2.50	2.50	2.25
3m interbank offer rate (avg.)	2.55	1.34	0.77	1.15	2.80	3.12	3.00	2.30
2Y Yield (average)*	2.92	1.64	1.34	1.57	3.40	3.40	3.90	3.20
5Y Yield (average)*	3.70	2.50	2.40	2.80	4.30	4.05	5.20	4.50
10Y Yield (average)*	4.60	3.50	3.30	3.90	4.70	4.53	5.60	4.90

Source: Erste Group Research

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