

Romania | Macro Outlook

Romania likely to avoid technical recession

Accommodative monetary policy stance in 2020-21

ROMGBs shrugged-off political noise

NBR reaffirms its preference for stable leu

Economy (%)	2020e	2021e	2022e
GDP (real, y/y)	-4.7	3.9	3.7
Unempl. Rate	5.9	8.5	7.3
CPI (y/y)	2.8	3.4	2.7
Retail Sales (y/y)	2.0	5.3	2.8
Ind. Prod. (y/y)	-5.8	3.0	4.0
Public Debt/GDP	43.8	46.9	48.0

Source: Erste Group Research

Market	Spot	20Q4	21Q1	21Q2
EUR/RON	4.86	4.90	4.92	4.94
USD/RON	4.11	4.15	4.17	4.12
Target Rate (%)	1.50	1.50	1.50	1.50
3M Rate (%)	2.00	1.80	1.50	1.50
2Y Bond (%)*	2.91	2.75	2.60	2.70
5Y Bond (%)*	3.36	3.15	3.00	3.10
10Y Bond (%)*	3.84	3.65	3.50	3.60

Source: FactSet, Erste Group Research

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

Source: Erste Group Research

General	2020
Population mn	19.3
GDP/Capita EUR	11,098

Source: Erste Group Research

Spot Rates as of:

09th Sep. 2020

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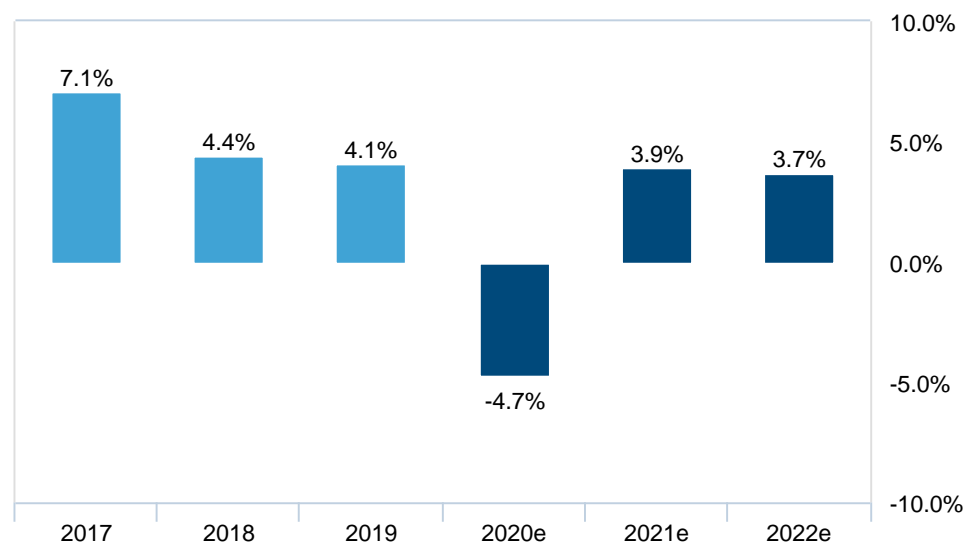
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Our ultra-high frequency index shows economic activity at 81% of an average pre-crisis month in March, at 28% in April, at 43% in May and at 75% in August. The Romanian economy is gradually moving towards pre-pandemic levels, helped by investments in the construction sector and growth of retail trade. On the other hand, the manufacturing sector is slower to recover. As the COVID-19 shock is left behind, legacies from the past related to weak public finances and a high current account deficit are back on the agenda. Political jitters intensified ahead of local elections, but their impact on bond and FX markets has been rather marginal so far.

We forecast economic growth at -4.7% in 2020, +3.9% in 2021 and +3.7% in 2022. Significant inflows of EU grants over the next decade, estimated at 2.4pp of GDP per year on average, should mitigate the contractionary effect of a fiscal consolidation process, which is needed to avoid rating downgrades. The average inflation rate is estimated at 2.8% in 2020 and 3.4% in 2021, inside the NBR's target band. The amplitude and timing of the further monetary policy easing is likely to be correlated with the size and pace of the upcoming fiscal consolidation.

GDP (real,y/y)



Source: Erste Group Research

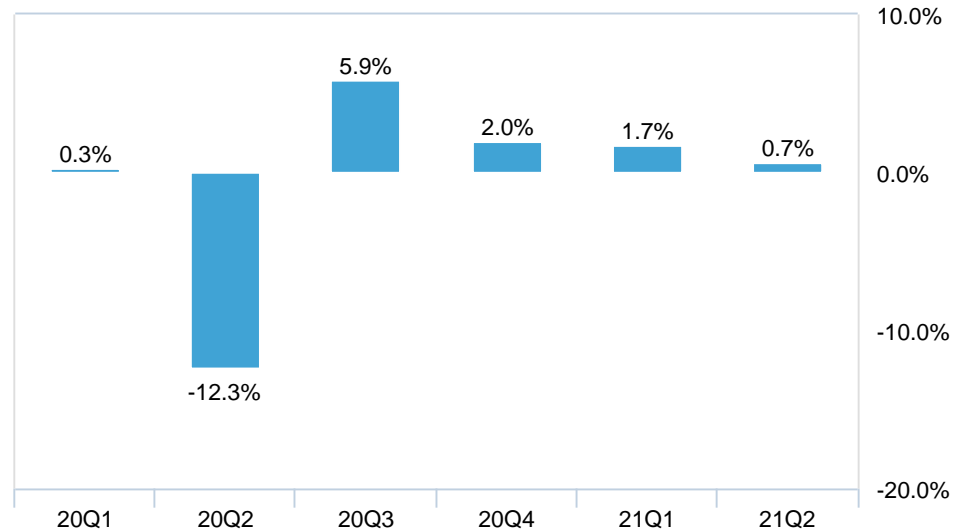
GDP

Romania likely to avoid technical recession

Real GDP fell by -12.3% q/q and -10.5% y/y in 2Q20. The demand side, government consumption and gross fixed capital formation were the only positive contributors to real GDP in y/y terms, adding +0.5pp and +0.4pp, respectively. Household consumption acted as a major drag on growth (-8.1pp) at the height of the corona crisis. Net exports (-2.4pp) and change in inventories (-0.9pp) also weighed on second quarter GDP. Supply side, IT services (+0.6pp), construction (+0.3pp) and public administration (+0.3pp) delivered positive contributions to real GDP in 2Q20. The industry contribution to growth was deeply negative (-4.6pp), affected by the COVID-19 containment measures.

We reaffirm our full-year GDP forecast of -4.7% in 2020, which is unchanged since the beginning of the COVID-19 crisis. The outlook for 2021 heavily depends on the fiscal policy stance after the general elections and subsequent measures to bring the budget deficit under control and avoid rating downgrades. We recently revised upwards our economic growth forecasts for 2022-24 by 1.2-1.4pp to +3.7%, +4.7% and +5.3%, respectively, to account for larger inflows of EU funds.

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



Source: Erste Group Research

Annual	2018	2019	2020e	2021e	2022e
GDP real	4.4%	4.1%	-4.7%	3.9%	3.7%
CPI (y/y)	4.6%	3.8%	2.8%	3.4%	2.7%
Private Consumption	7.2%	6.0%	-4.2%	3.7%	3.1%

Source: Erste Group Research

Inflation

Inflation inside NBR target over entire policy horizon

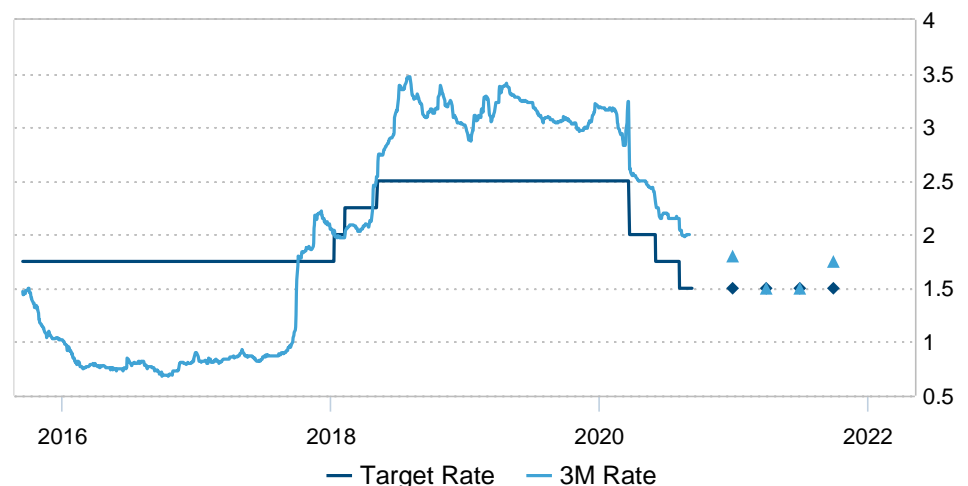
CPI inched 0.1pp lower in August to 2.7% y/y, after a -0.05% m/m drop vs. 0.00% m/m and 2.8% y/y Bloomberg/Reuters median, which was similar to our call. We forecast inflation within the NBR's target range of 2.5%±1pp for the next eight quarters policy horizon. Adjusted core 2 inflation inched 0.1pp lower to 3.7% y/y, in line with our expectations. The main components, both food and non-food prices, inched 0.1pp lower to 5.5% y/y and 0.8% y/y, respectively, while services inflation stood flat at 3.0% y/y, reflecting persistent wage-led domestic inflationary pressures.

Monetary Policy

Accommodative monetary policy stance in 2020-21

As the NBR has a preference for flexibility to react to potential currency weakness, liquidity management should remain the main operational instrument. Consequently, we expect the NBR to ease the policy stance by initially cutting reserve requirement ratios (RRR) for RON liabilities, followed by loosening liquidity management and perhaps asymmetric changes in the standing facilities corridor. The amplitude and timing of the monetary policy easing is likely to be correlated with the size and pace of fiscal consolidation. Political noise ahead of local and general elections, which are both due by year-end, should delay monetary policy accommodation.

Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	20Q4	21Q1	21Q2	21Q3
Target Rate	1.50	1.50	1.50	1.50	1.50
3M Rate	2.00	1.80	1.50	1.50	1.75

Source: FactSet, Erste Group Research

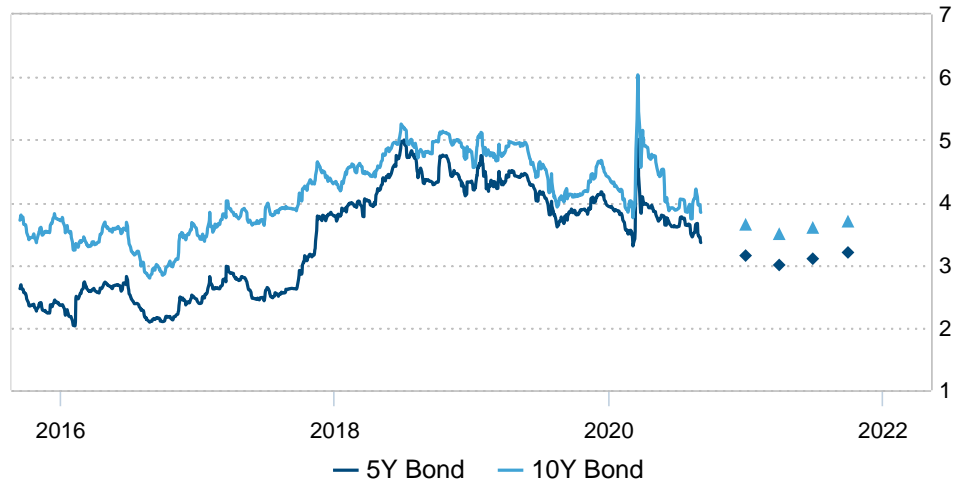
Bond Yields

ROMGBs shrugged-off political noise

The climax of the pressure on the back-end ROMGBs, a segment largely owned by offshore investors, is likely behind us. The NBR's bond buying program and bilateral repo operations, along with abundant liquidity worldwide, supported ROMGBs. The 10Y-3Y ROMGBs spread was little changed at 40-50bp during the summer, but the no-confidence vote and renewed talks about a 40% increase in pensions spurred some selling on the long end of the curve in the second half of August. As a result, the 10Y-3Y spread temporarily widened towards 70bp.

A gradual correction of the twin deficits over 2021-23 alongside abundant global liquidity are supportive for the RON sovereign debt. The EC's surveillance of Romania's public finances, after the COVID-19 crisis ends, is another anchor that should support foreign investor confidence in ROMGBs. The ROMGBs spread vs peers is still elevated at +235bp vs. Poland 2027 and +150bp vs. Hungary 2027, leaving plenty of room for convergence, provided fiscal consolidation opens the way for further monetary policy easing.

Generic Bond Yields (%)



Source: FactSet, Erste Group Research

Market	Spot	20Q4	21Q1	21Q2	21Q3
2Y Bond*	2.91	2.75	2.60	2.70	2.80
5Y Bond*	3.36	3.15	3.00	3.10	3.20
10Y Bond*	3.84	3.65	3.50	3.60	3.70

Source: FactSet, Erste Group Research

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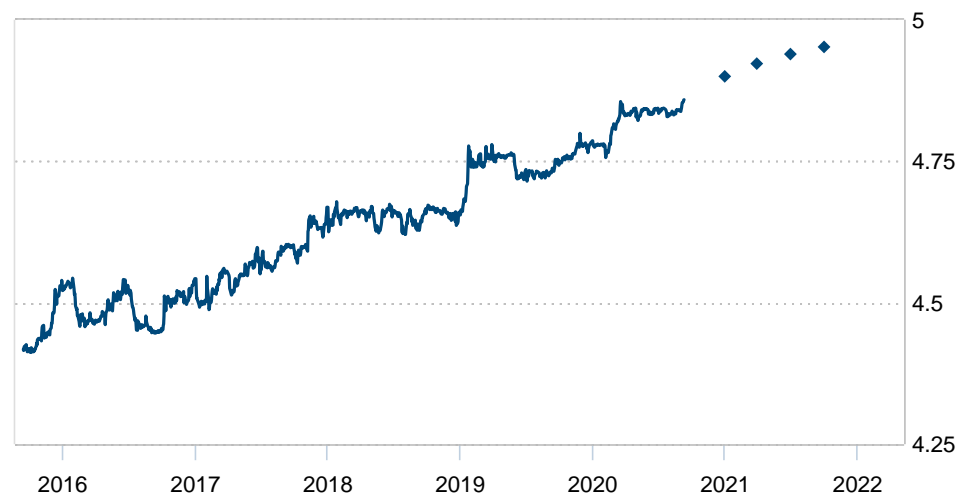
Romanian Leu

NBR reaffirms its preference for stable leu

The NBR governor declared that the 'NBR's option for bilateral operations relates to the concern for providing liquidity in strict connection with financing needs and for sustainably lowering interest rates, while preventing excessive volatility of the leu's exchange rate.' The NBR's FX reserves climbed to a record high of EUR 36.2bn in July after a series of dollar and euro Eurobond issues by the MinFin. The exchange rate importance in the NBR's reaction function links further policy easing to a stable RON.

We expect the leu to continue to depreciate as long as the twin deficits are relatively wide. Our forecast shows an average weakening of the leu of 2-3ppt vs. the euro per year in nominal terms. A larger correction higher in the EURRON vs. the historical norm should not be ruled out after the general elections. The NBR is likely to continue to intervene in the FX market to smooth volatility, without curbing the trend. Record-high FX reserves at EUR 36.2bn in July offer the central bank enough ammunition to curb leu weakness.

EUR/RON



Source: FactSet, Erste Group Research

	Spot	20Q4	21Q1	21Q2	21Q3
EUR/RON	4.86	4.90	4.92	4.94	4.95
vs. Spot		0.8%	1.2%	1.6%	1.9%
USD/RON	4.11	4.15	4.17	4.12	4.13
vs. Spot		1%	1.5%	0.2%	0.5%

Source: FactSet, Erste Group Research

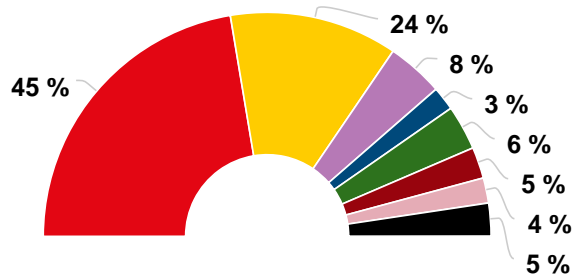
Politics

Heavy election calendar into year-end

In late August, the Social-Democrat Party did not manage to gather a quorum in the Parliament to topple the Liberal government in a no-confidence vote. The political calendar looks heavy into the year-end, with local elections on September 27, which should offer a good indication for parliamentary election results (likely to be scheduled for December 6). Depending on the result of the local elections and the development of the pandemic, there is a risk that general elections might be delayed to March 2021.

The bi-polar political scene - the PSD (center-left), which can gather a majority in the Parliament on certain topics vs. the minority PNL (center-right) government and PNL-backed president - leads to frequent episodes of political noise. The winner of the general elections would benefit from four years without scheduled ballots and huge inflows of EU grants. The latest opinion polls point to a center-right coalition led by PNL post-elections, with a rather fragile parliamentary majority and difficult fiscal decisions expected ahead.

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:
 Dec-20

Forecasts

Annual	2014	2015	2016	2017	2018	2019	2020e	2021e	2022e
Real GDP growth	3.4	3.9	4.8	7.1	4.4	4.1	-4.7	3.9	3.7
Inflation (CPI, avg)	1.1	-0.6	-1.5	1.3	4.6	3.8	2.8	3.4	2.7
Unemployment rate (avg)	6.8	6.8	5.9	4.9	4.2	3.9	5.9	8.5	7.3
Retail sales growth	6.5	9.4	12.4	10.8	5.4	7.2	2.0	5.3	2.8
Industrial output growth	6.0	2.8	3.1	7.8	3.5	-2.3	-5.8	3.0	4.0
Private consumption growth	4.2	5.9	8.3	10.1	7.2	6.0	-4.2	3.7	3.1
Fixed capital formation growth	3.3	7.5	-0.2	3.6	-1.2	18.2	-5.0	4.0	5.5
Percent of GDP									
Trade balance	-4.0	-5.2	-5.9	-6.9	-7.4	-7.7	-8.6	-7.8	-7.8
Current account balance	-0.2	-0.6	-1.4	-2.8	-4.4	-4.6	-4.1	-3.4	-3.5
Foreign direct investment	1.6	2.2	2.7	2.6	2.6	2.4	0.5	1.3	1.7
Budget balance	-1.2	-0.6	-2.6	-2.6	-2.9	-4.3	-8.6	-5.5	-4.1
Public debt	39.2	37.8	37.3	35.1	34.7	35.2	43.8	46.9	48.0
External debt, gross	64.6	59.1	55.3	51.9	48.8	47.4	51.1	49.3	48.7
FX, money market									
USDLCY average	3.35	4.01	4.06	4.05	3.94	4.24	4.28	4.16	4.19
EURLCY average	4.44	4.45	4.49	4.57	4.65	4.75	4.88	4.95	5.03
EURLCY eop	4.48	4.52	4.54	4.66	4.66	4.78	4.90	4.99	5.07
(percent)									
CB policy rate (avg.)	3.34	1.75	1.75	1.75	2.34	2.50	1.70	1.50	1.75
3m interbank offer rate (avg.)	2.55	1.34	0.77	1.15	2.79	3.12	2.40	1.70	2.30
2Y Yield (average)*	2.92	1.64	1.34	1.57	3.40	3.40	3.10	2.75	3.00
5Y Yield (average)*	3.70	2.50	2.40	2.80	4.30	4.05	3.50	3.15	3.40
10Y Yield (average)*	4.60	3.50	3.30	3.90	4.70	4.53	4.12	3.65	3.80

Source: Erste Group Research

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