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Romania Business Forecast Report Q4 2013

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Abstracts

Core Views

We forecast real GDP in Romania to expand by an above-consensus 2.4% in 2013 and 2.8% in 2014, driven by robust exports and a moderate recovery in private consumption through H213.

The rebalancing of Romania's current account will continue over the next few quarters, as strong export performance and weak domestic demand stifles import growth, narrowing the country's trade deficit. However, we stress that the pace of the current account correction will slow over the coming quarters, as imports are supported by a more significant economic recovery in 2014.

Although Romania's fiscal deficit will narrow to 2.5% of GDP in 2013 and 2.3% in 2014, the pace of fiscal consolidation in the country is slowing. Steady revenue growth will be offset by a modest recovery in government spending, as the country's exit from the European Union's Excessive Deficit Procedure (EDP) allows the government to modestly relax its fiscal consolidation programme.

The recent agreement of a new precautionary loan arrangement with the IMF will protect Romania against external shocks and increase the likelihood that the government will continue pursuing prudent macroeconomic policies over the next few years.

While we expect the threat of leu volatility to persist over the coming months, due to ongoing investor speculation over the direction of US quantitative easing (QE) tapering, we expect the currency to weaken towards the end of 2013 and into 2014.

Major Forecast Changes

We have revised our forecast for real GDP growth to 2.4% in 2013, from 1.7% previously, due to a robust net export story in the first six months of 2013, and our view that private consumption will show signs of a more significant recovery through H213.

In light of better-than-expected government revenues in the first few months of this year, we have revised our forecast for Romania's fiscal deficit to come in at 2.5% of GDP in 2013 and 2.3% in 2014, from 2.6% and 2.4% previously.

We have revised our forecasts for the current account deficit to come in at 1.3% of GDP in 2013 and -0.9% in 2014, from 3.6% and 3.7% previously, against the backdrop of recovering external demand in Romania's main trading partners and a slower-than-expected recovery in import demand in 2013.

We now forecast the interest rate to fall to 4.00% by the end of the year, from 4.50% previously, against the backdrop of increasingly dovish statements by National Bank of Romania (NBR) Governor Mugur Isarescu and easing inflation, which we have long expected to fall in H213.

Key Risk To Outlook

The main risk to our economic growth outlook is for a weaker-thanexpected recovery in the euro over the coming quarters, which would weigh on export growth and industrial production going forward. In such a scenario, we would be tempted to revise our economic growth forecasts for 2013 and 2014, with real GDP growth lower than 2.0% a possibility this year.

While we do not anticipate prices to edge higher over the next few quarters, another supply-side food price shock or a further significant leu sell-off would elevate prices over the short term. In such a scenario, the NBR could choose to delay its rate cutting cycle until early 2014, prompting a revision to our forecast for 50bps of cuts by end-2013. With the NBR having accepted above target range levels of inflation for a significant proportion of the past few years, however, we believe inflation would have to edge significantly higher for this scenario to play out.

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Long-Term Political Outlook: Waning EU Influence Threatens Reform Agenda. The strength and quality of Romania's political institutions fall short relative to much of Europe, implying significant challenges ahead despite the progress made since the fall of communism. With membership of the euro looking increasingly unlikely within the next decade, and EU influence on Romania's political trajectory set to wane, there is a growing risk of institutional deterioration, which could seriously jeopardise many of the improvements made over the last two decades.

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