ROMANIA | MACRO OUTLOOK

# Pre-election public spending bonanza

## Consumption boom supports growth, but abroad
## More room to remove policy restrictiveness
## Additional supply weighs on sovereign debt performance
## EUR/RON should remain broadly stable in 2024, asymmetric risks

| Economy (%) | 2024e | 2025e | 2026e |
|---|---|---|---|
| GDP (real, y/y) | 1.9 | 2.8 | 3.7 |
| Unempl. Rate | 5.3 | 5.2 | 5.1 |
| CPI (y/y) | 5.2 | 3.7 | 3.2 |
| Retail Sales (y/y) | 6.5 | 4.5 | 4.2 |
| Ind. Prod. (y/y) | 0.3 | 3.3 | 3.0 |
| Public Debt/GDP | 51.4 | 52.8 | 51.5 |

*Source: Erste Group Research*

| Market | Spot | 24Q4 | 25Q1 | 25Q2 |
|---|---|---|---|---|
| EUR/RON | 4.97 | 5.00 | 5.02 | 5.05 |
| USD/RON | 4.51 | 4.42 | 4.40 | 4.43 |
| Target Rate (%) | 6.50 | 6.00 | 6.00 | 5.75 |
| 3M Rate (%) | 5.55 | 5.32 | 5.62 | 5.37 |
| 2Y Bond (%)* | 5.79 | 5.70 | 5.80 | 5.50 |
| 5Y Bond (%)* | 6.17 | 6.50 | 6.20 | 6.00 |
| 10Y Bond (%)* | 6.74 | 6.80 | 6.70 | 6.50 |

*Source: FactSet, Erste Group Research*

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

*Source: Erste Group Research*

| General | 2024 |
|---|---|
| Population mn | 18.9 |
| GDP/Capita EUR | 18,760 |

*Source: Erste Group Research*

Spot Rates as of:
11th Sep. 2024

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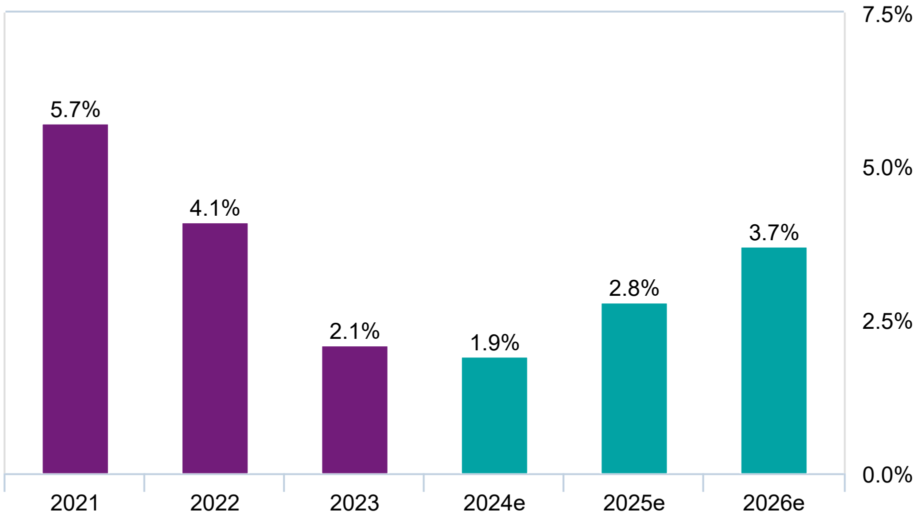
**Note:**
**Information on past performance is not a reliable indicator for future performance. Forecasts are not a reliable indicator for future performance.*

The government pursued an agenda of raising public sector incomes in a heavy election year. Public sector wages increased by nearly 20%, while public pensions were hiked at almost double that pace. Consequently, the budget deficit topped 4.0% of GDP after seven months and the government updated its financing plans, corresponding to a budget deficit of 6.9% of GDP vs. 5.0% in the initial plans. With structural issues unaddressed, the boom in domestic consumption was almost entirely offset by a negative contribution from net exports to economic growth. State infrastructure investments are well underway and should start to pay dividends in the future.

European and local elections were held mid-year and opinion polls suggest a continuity of the grand coalition after the general elections due on December 1. The new government is expected to adopt measures to rein in fiscal slippage. The size of the fiscal adjustment depends on the starting point for the budget deficit for 2024. The speed of the fiscal consolidation is subject to negotiations with the European Commission. The structure of the fiscal corrective measures is likely to be mainly from the revenues side, given the rigid structure of the government spending. Fiscal adjustment on the revenues is less growth-negative than on the expenditures.

**GDP (real,y/y)**




*Source: Erste Group Research*

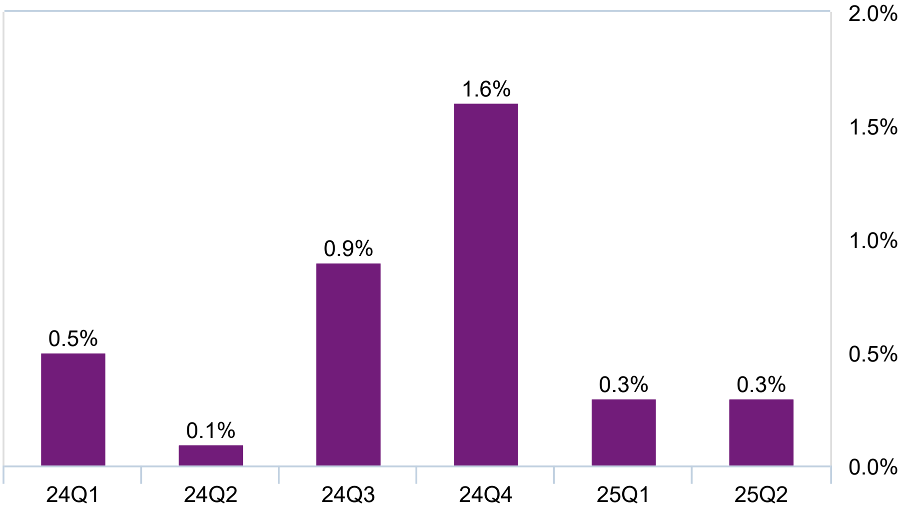
## GDP

### Consumption boom supports growth, but abroad

The Romanian economy barely expanded by +0.1% q/q and +0.8% y/y in 2Q24. The economy advanced by 0.7% y/y in 1H24. The positive contributions from household consumption and investments to the annual growth of GDP were offset by net exports and inventories. Domestic demand is mostly accommodated by imports, which is a structural problem for the Romanian economy. At the same time, cyclical headwinds are affecting exports. After a disappointing first half of the year, we revised full-year GDP growth to +1.9%, from +2.6% previously. The GDP growth forecast for 2025 is subject to fiscal uncertainties as budget consolidation is overdue.

On the demand side, the main growth driver was household consumption, adding +4.7pp to the +0.8% annual GDP growth in 2Q24. Gross fixed capital formation also had a positive contribution of +1.4pp. Most of the growth in consumption came on the back of higher demand for imported items coupled with weak demand for Romanian exports. Net exports had a -4.4pp contribution to the annual growth in 2Q24. Inventories also shaved off some of the growth momentum in the second quarter with a -1.4pp contribution. Statistical carry-over and base effects are likely to boost 2025 GDP growth, which we see at 2.8% y/y.

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




*Source: Erste Group Research*

| Annual | 2022 | 2023 | 2024e | 2025e | 2026e |
|---|---|---|---|---|---|
| GDP real | 4.1% | 2.1% | 1.9% | 2.8% | 3.7% |
| CPI (y/y) | 13.7% | 10.5% | 5.2% | 3.7% | 3.2% |
| Private Consumption | 5.8% | 2.8% | 7.8% | 3.0% | 3.1% |

*Source: Erste Group Research*

## Inflation

### Disinflation driven mainly by non-core components

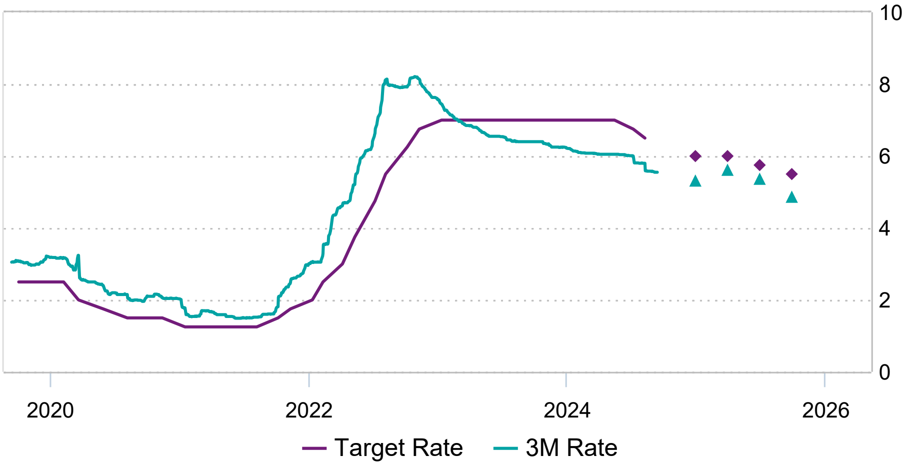
We forecast headline inflation at 4.0% y/y and 3.7% by end-2024 and end-2025, respectively. We forecast core inflation above the headline for most of the two-year-ahead projection horizon, at 4.9% and 4.4% for end-2024 and end-2025, respectively. The deceleration in core inflation this year has been mainly driven by the food component, with core services and core non-food components displaying more stickiness. This is further evidence of a wage-price spiral. The tight labor market, strong nominal wage growth (driven by public sector pay rises), minimum wage hikes and sharp rise in public pensions should fuel demand-side inflationary pressures.

## Monetary Policy

### More room to remove policy restrictiveness

We perceived the NBR governor as cautiously dovish at the latest press conference, signaling further rate cuts if inflation performs in line with the central bank forecast, in the absence of an event which might trigger capital outflows, as he reiterated that the exchange rate remains a policy anchor. The governor considers the current monetary policy stance relatively firm and, by cutting the rate, the central bank removed some of the policy restrictiveness. Provided that the external environment remains benign and the domestic political scene does not boil over ahead of presidential and general elections, we see another 50bp of rate cuts this year.

**Short Term Yields**




*Source: FactSet, Erste Group Research*

| Market (%) | Spot | 24Q4 | 25Q1 | 25Q2 | 25Q3 |
|---|---|---|---|---|---|
| Target Rate | 6.50 | 6.00 | 6.00 | 5.75 | 5.50 |
| 3M Rate | 5.55 | 5.32 | 5.62 | 5.37 | 4.87 |

*Source: FactSet, Erste Group Research*

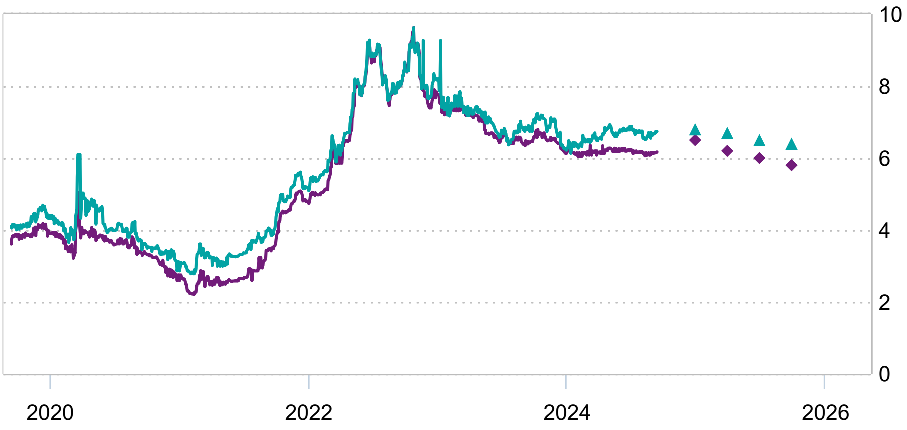
## Bond Yields

### Additional supply weighs on sovereign debt performance

The government revised upward the issuance plan for 2024 to RON 217bn, including pre-financing for 2025, from RON 181bn at the start of the year, corresponding to a cash budget deficit of 6.94% of the official GDP estimate. The FinMin covered 75% of the new gross financing needs plan. Therefore, ROMGBs underperformed peers during the recent global bond rally. The FinMin announced the intention to tap the international markets two more times in 2024, after the government already issued EUR 12.5bn equivalent in external debt so far this year.

The patience of both rating agencies and sovereign debt investors has been tested over the past couple of years, with budget deficits overshooting initial targets. Without a meaningful and credible fiscal correction in 2025, both categories are likely to run out of patience, triggering a market-driven adjustment. Our models show that the 10Y ROMGBs yield is currently trading around 30bp below fair value. We see scope for steepening of the ROMGBs yield curve, with the 10Yv2Y spread fair value estimated at above 100bp, driven by the front-end.

**Generic Bond Yields (%)**




*Source: FactSet, Erste Group Research*

| Market | Spot | 24Q4 | 25Q1 | 25Q2 | 25Q3 |
|---|---|---|---|---|---|
| 2Y Bond* | 5.79 | 5.70 | 5.80 | 5.50 | 5.30 |
| 5Y Bond* | 6.17 | 6.50 | 6.20 | 6.00 | 5.80 |
| 10Y Bond* | 6.74 | 6.80 | 6.70 | 6.50 | 6.40 |

*Source: FactSet, Erste Group Research*

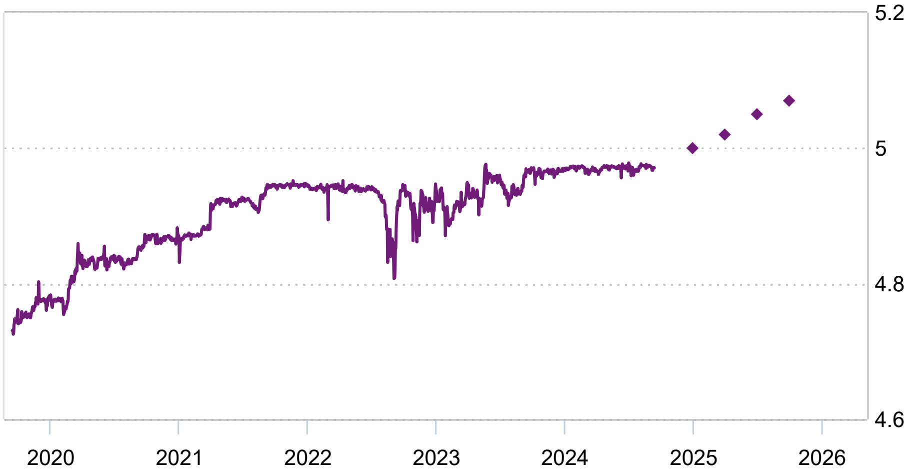
## Romanian Leu

### EUR/RON should remain broadly stable in 2024, asymmetric risks

The NBR governor reiterated that exchange rate stability remains a policy anchor and it should be preserved, while the central bank has enough FX reserves and the option to increase the cost of carry to the key rate level via liquidity sterilization auctions. The 4.98 level for the EUR/RON seems to be the new NBR 'line in the sand'. The risk to the EUR/RON outlook is asymmetrical, as the NBR governor reiterated that the economy cannot afford leu appreciation, due to the wide current account deficit, and the NBR stepped in to curb RON firming.

We expect C/A deficit widening this year to 8.1% of GDP, from 7.0% in 2023. Thus, Romania remains the outlier in terms of external imbalances vs. peers. We noticed some currency overvaluation issues, affecting especially sectors employing a low-skilled labor force with tight margins. Our models suggest that the RON is overvalued in real terms by roughly 6% vs. the EUR. We expect some gradual RON nominal weakening and improving fundamentals, converging the RON towards its fair value over time.

**EUR/RON**




*Source: FactSet, Erste Group Research*

| | Spot | 24Q4 | 25Q1 | 25Q2 | 25Q3 |
|---|---|---|---|---|---|
| EUR/RON | 4.97 | 5.00 | 5.02 | 5.05 | 5.07 |
| *vs. Spot* | | *0.6%* | *1%* | *1.6%* | *2%* |
| USD/RON | 4.51 | 4.42 | 4.40 | 4.43 | 4.45 |
| *vs. Spot* | | *-2%* | *-2.4%* | *-1.8%* | *-1.3%* |

*Source: FactSet, Erste Group Research*

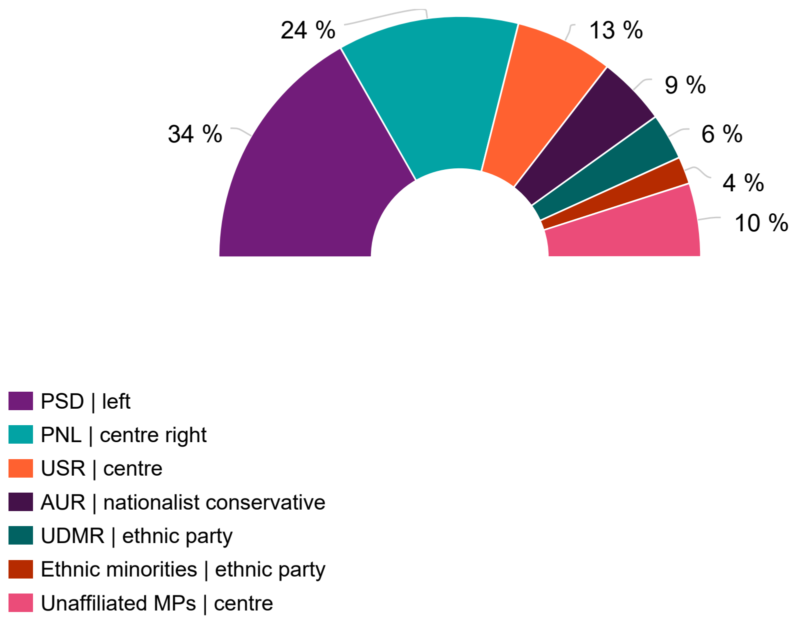
## Politics

### General and presidential elections into year-end

Presidential elections are scheduled for November 24 with the run-off on December 8, while the general election date is set for December 1. The government coalition parties - Social Democrats (PSD) and Liberals (PNL) – had strong showings at the European and local elections held in mid-2024. This cemented the expectations of a similar grand government coalition beyond general elections. The government coalition between PSD and PNL functioned quite smoothly, offering political stability, which was praised by the rating agencies.

Political noise is likely to rise ahead of the elections, though a governmental crisis is unlikely. The leaders of the two major political parties are running for the presidency in what seems to be a three-candidate race along with former NATO deputy-secretary general Mircea Geoana. Strong support for the presidential candidate in the first round could have a significant positive impact for its party score at the general elections. Barring a black swan event, the two major parties should secure a majority in the new parliament, based on polls.

**Parliament Seats**




*Source: Erste Group Research*

**Last Election:**
Dec-20

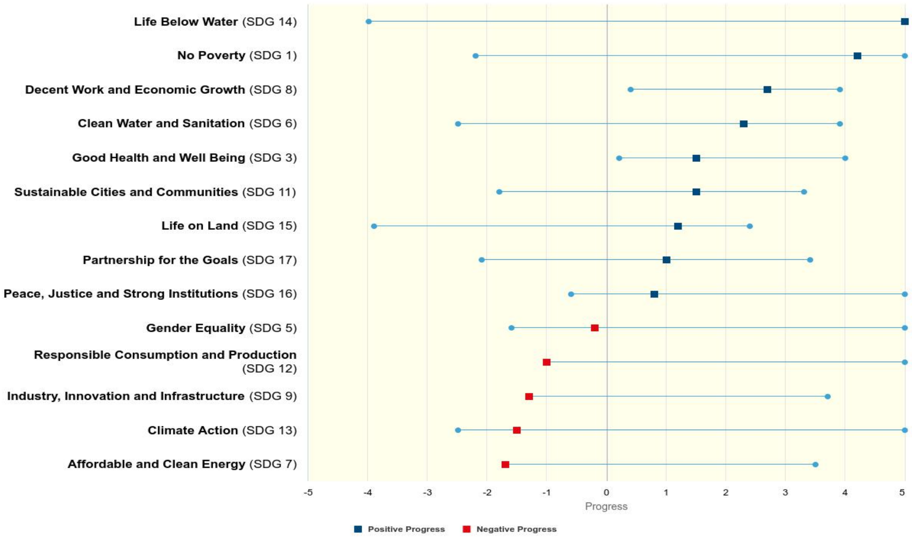
**Next Election:**
Nov-24

## Sustainable Development Goals

### SDG – Moving closer to EU standards from low levels

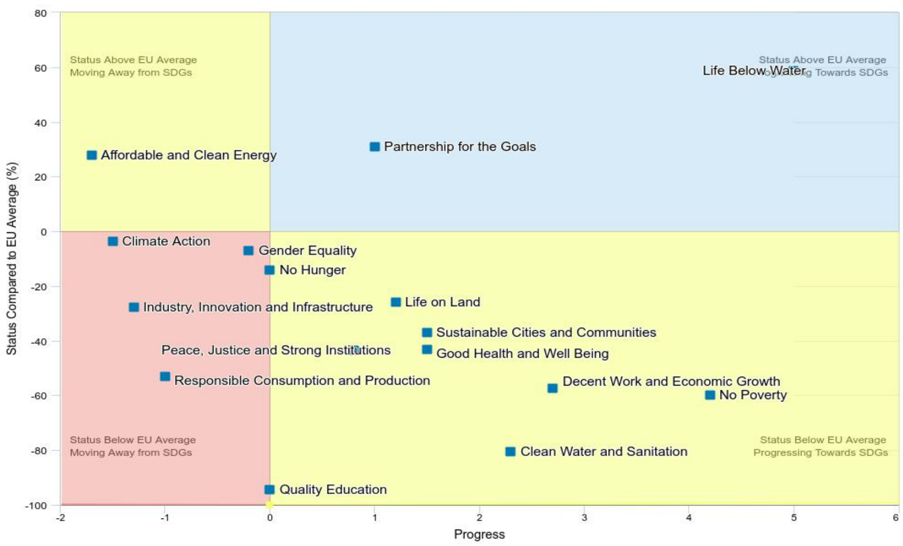
Partnerships for the Goals and Life below Water are the SDG topics where Romania has a better position than the EU average and is making progress. Most of the other goals find Romania with a weaker starting point vs. the EU, but making improvements, with the No Poverty and Peace, Justice and Strong Institutions performances standing out. Quality Education and Industry, Innovation and Infrastructure are key challenges for Romania, as its status is below the EU average and moving away from SDG. Making full use of EU funds and reforming the economy and society on the way towards OECD accession could improve the situation.

### Progress Overview




*Source: Erste Group Research*

### Progress Overview




*Source: Erste Group Research*

## Forecasts

| Annual | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024e | 2025e | 2026e |
|---|---|---|---|---|---|---|---|---|---|
| Real GDP growth | 6.0 | 3.9 | -3.7 | 5.7 | 4.1 | 2.1 | 1.9 | 2.8 | 3.7 |
| Inflation (CPI, avg) | 4.6 | 3.8 | 2.7 | 5.1 | 13.7 | 10.5 | 5.2 | 3.7 | 3.2 |
| Unemployment rate (avg) | 5.3 | 4.9 | 6.1 | 5.6 | 5.6 | 5.6 | 5.3 | 5.2 | 5.1 |
| | | | | | | | | | |
| Retail sales growth | 5.6 | 7.1 | 2.3 | 10.1 | 4.4 | 1.9 | 6.5 | 4.5 | 4.2 |
| Industrial output growth | 3.5 | -2.3 | -9.2 | 7.1 | 0.4 | -2.5 | 0.3 | 3.3 | 3.0 |
| | | | | | | | | | |
| Private consumption growth | 9.4 | 3.3 | -3.9 | 7.5 | 5.8 | 2.8 | 7.8 | 3.0 | 3.1 |
| Fixed capital formation growth | 0.0 | 12.6 | 1.1 | 2.9 | 5.9 | 14.4 | 3.6 | 5.1 | 6.6 |
| | | | | | | | | | |
| Percent of GDP | | | | | | | | | |
| Trade balance | -7.3 | -7.7 | -8.3 | -9.8 | -12.0 | -8.9 | -9.3 | -9.0 | -8.0 |
| Current account balance | -4.6 | -4.9 | -4.9 | -7.2 | -9.2 | -7.0 | -8.1 | -7.8 | -6.8 |
| Foreign direct investment | 2.6 | 2.3 | 1.4 | 3.7 | 3.8 | 2.0 | 2.0 | 2.2 | 2.3 |
| Budget balance | -2.8 | -4.3 | -9.3 | -7.2 | -6.3 | -6.6 | -7.0 | -5.5 | -4.0 |
| Public debt | 34.5 | 35.1 | 46.8 | 48.5 | 47.5 | 48.8 | 51.4 | 52.8 | 51.5 |
| External debt, gross | 48.4 | 49.0 | 57.5 | 56.5 | 50.6 | 52.2 | 52.0 | 52.3 | 51.9 |
| | | | | | | | | | |
| FX, money market | | | | | | | | | |
| USDLCY average | 3.94 | 4.24 | 4.24 | 4.16 | 4.69 | 4.57 | 4.53 | 4.43 | 4.56 |
| EURLCY average | 4.65 | 4.75 | 4.84 | 4.92 | 4.93 | 4.95 | 4.98 | 5.05 | 5.15 |
| EURLCY eop | 4.66 | 4.78 | 4.87 | 4.95 | 4.95 | 4.97 | 5.00 | 5.10 | 5.20 |
| | | | | | | | | | |
| (percent) | | | | | | | | | |
| CB policy rate (avg.) | 2.34 | 2.50 | 1.86 | 1.32 | 4.12 | 7.00 | 6.50 | 5.60 | 4.40 |
| 3m interbank offer rate (avg.) | 2.79 | 3.12 | 2.38 | 1.82 | 6.20 | 6.62 | 5.90 | 5.20 | 4.40 |
| 2Y Yield (average)* | 3.30 | 3.40 | 3.09 | 2.62 | 6.89 | 6.50 | 5.90 | 5.40 | 5.00 |
| 5Y Yield (average)* | 4.30 | 4.05 | 3.50 | 3.18 | 7.40 | 6.82 | 6.45 | 6.08 | 5.40 |
| 10Y Yield (average)* | 4.70 | 4.53 | 3.93 | 3.76 | 7.58 | 7.04 | 6.77 | 6.65 | 6.10 |

*Source: Erste Group Research*

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