



National Bank of Romania

Romania: Recent Macroeconomic & Banking System Developments

October 2014



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Macroeconomic snapshot

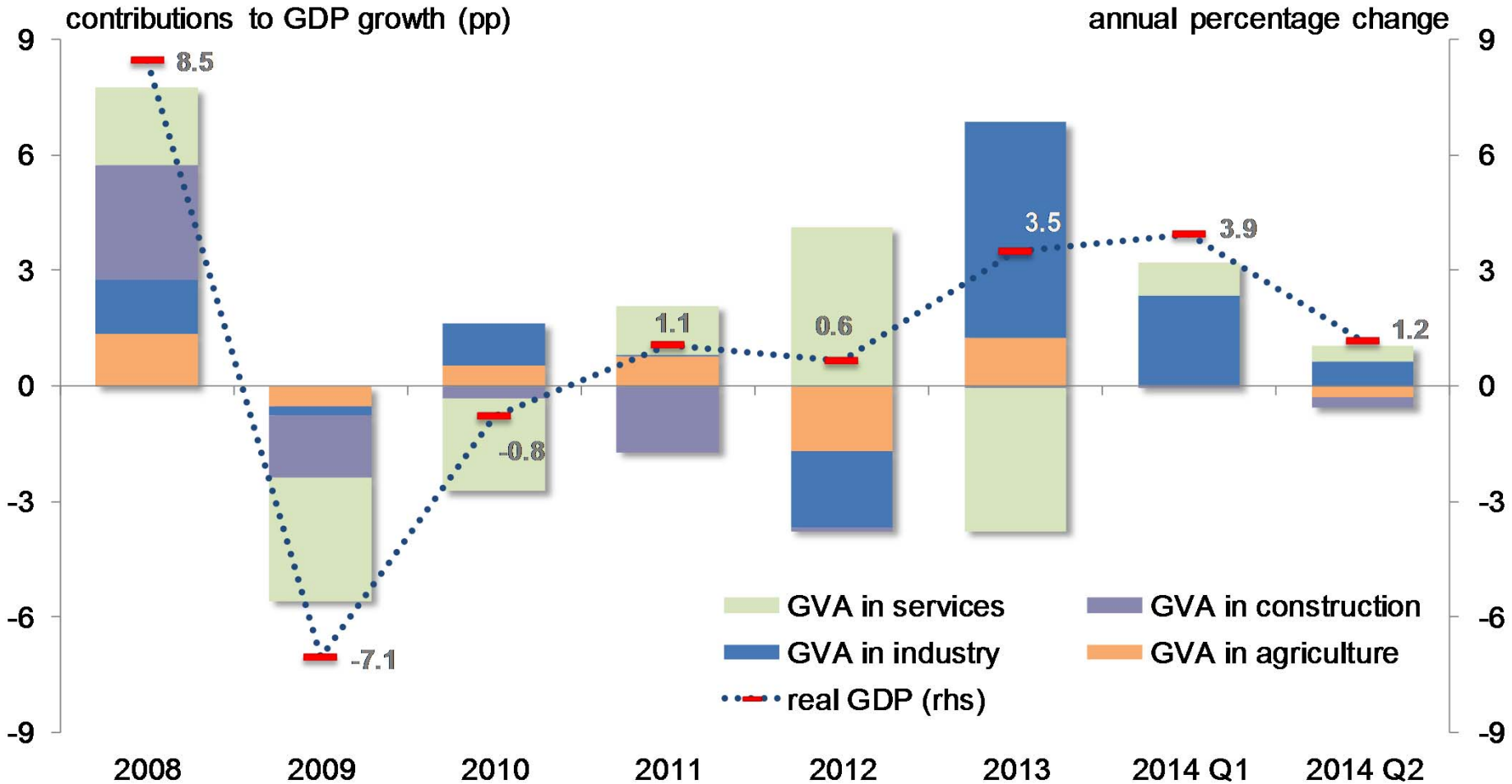
- Expected macroeconomic outcomes in 2014:
 - ✓ So far, slower-than-expected economic growth
 - current forecasts average around 2.5%, as compared to the more optimistic forecasts (around 3%) at the beginning of the year
 - the downward revision was triggered by poor investment activity, in both public and private sectors, while the available data indicate that the agricultural output will be as good as last year
 - ✓ Average annual HICP inflation stood at 1.3% in September, level compliant with the Maastricht inflation criterion
 - ✓ The fiscal deficit will remain below the Maastricht Treaty limit of 3% of GDP
 - ✓ The current account deficit stood below 1% of GDP in 2014 H1, very close to the 2013 figure and well below the MIP scoreboard benchmark (4%)
- Given its macroeconomic fundamentals, Romania has the potential to grow sustainably in the medium run, yet actual outcomes depend on regional, European and global developments
- Romania envisages entering a special cooperation agreement with the Banking Union by the end of next year and joining the euro area in 2019

GDP Dynamics

GDP growth decelerated in 2014 H1

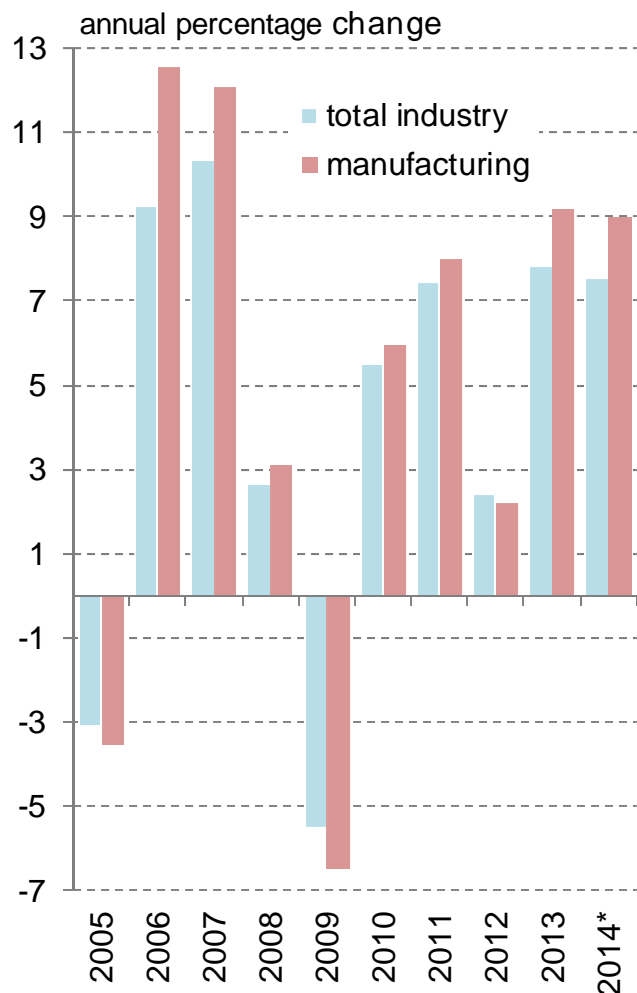
- Economic growth slowed down in 2014 H1 to 2.4%, as compared with 3.5% in 2013
 - ✓ Net exports maintained their positive contribution, which was however significantly lower than in the previous year
 - ✓ Low investment spending
- Economic activity is expected to slow down further in 2014 in annual terms, as suggested by current developments in short-term indicators (industrial production, retail sales and construction works in particular)
 - ✓ Moreover, the succession of two exceptional agricultural years adds an almost zero contribution to annual growth, as compared to last year's outcome (1.2 pp contribution to real GDP growth)

The slowdown was mainly driven by industry and agriculture on the supply side ...



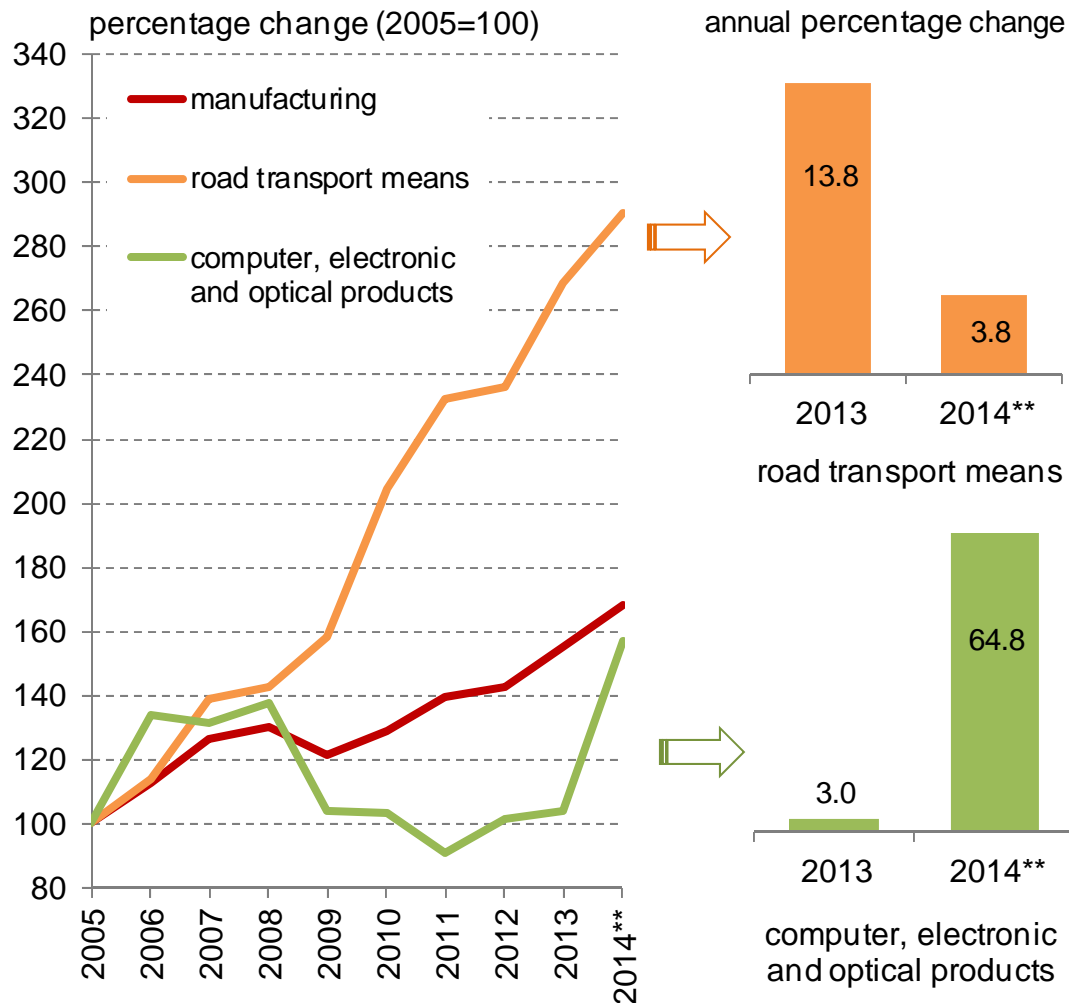
Source: National Institute of Statistics, NBR calculations

... although growth in manufacturing output remains robust, as greenfield investment in electronic industry offset the automotive sector losing steam ...



*) Jan.-Aug.

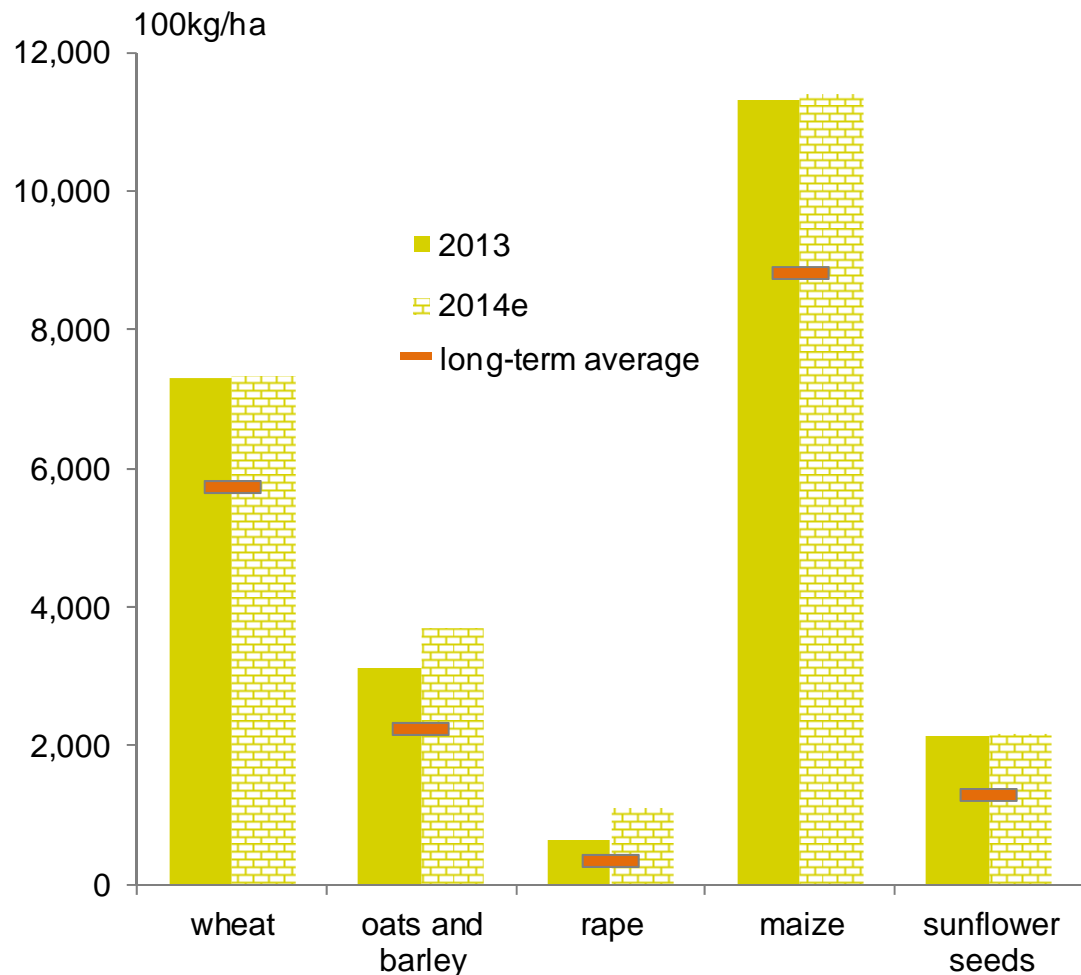
Source: NIS



**) Jan.-Jul.

... and the agricultural production for 2014
is expected to be similar to that of 2013

Agricultural Output



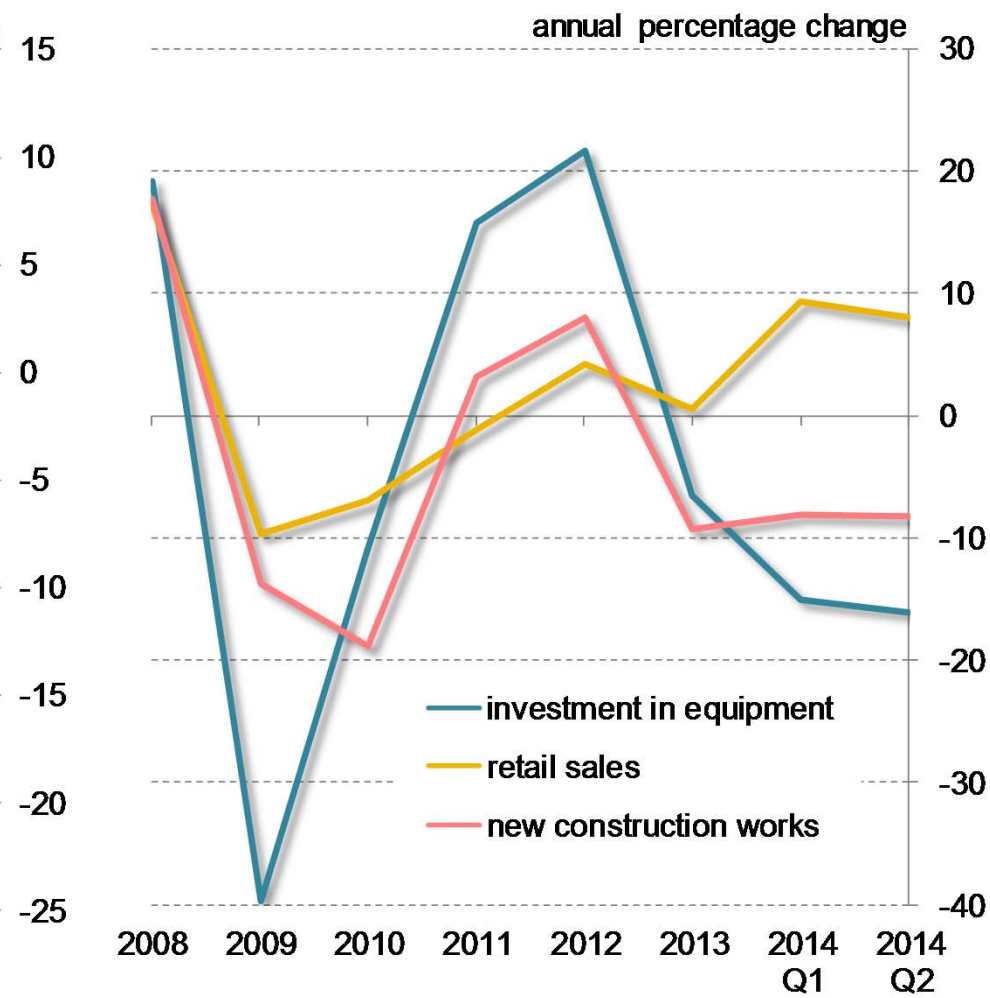
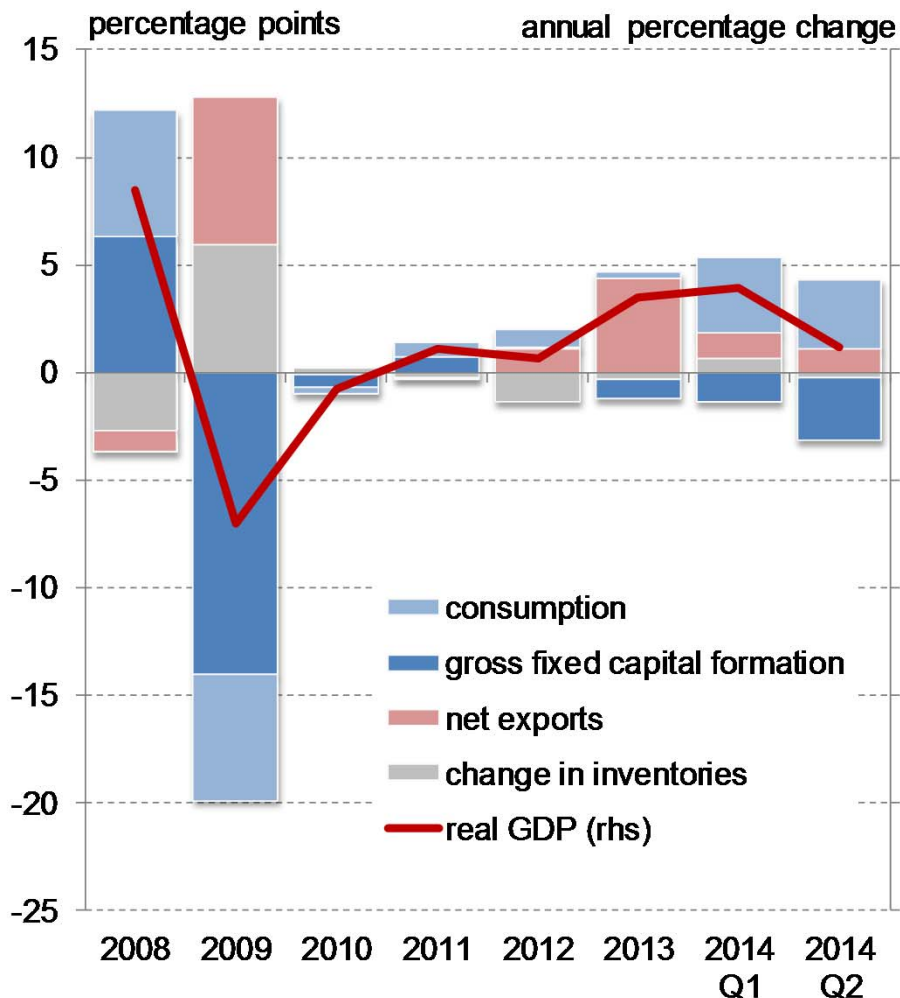
Yields

100 kg/ha

	2013	2014
wheat	34.8	35.0
oats and barley	3.0	3.3
rape	24.2	24.7
maize	44.1	44.5
sunflower seeds	20.0	21.2

Source: European Commission, Eurostat

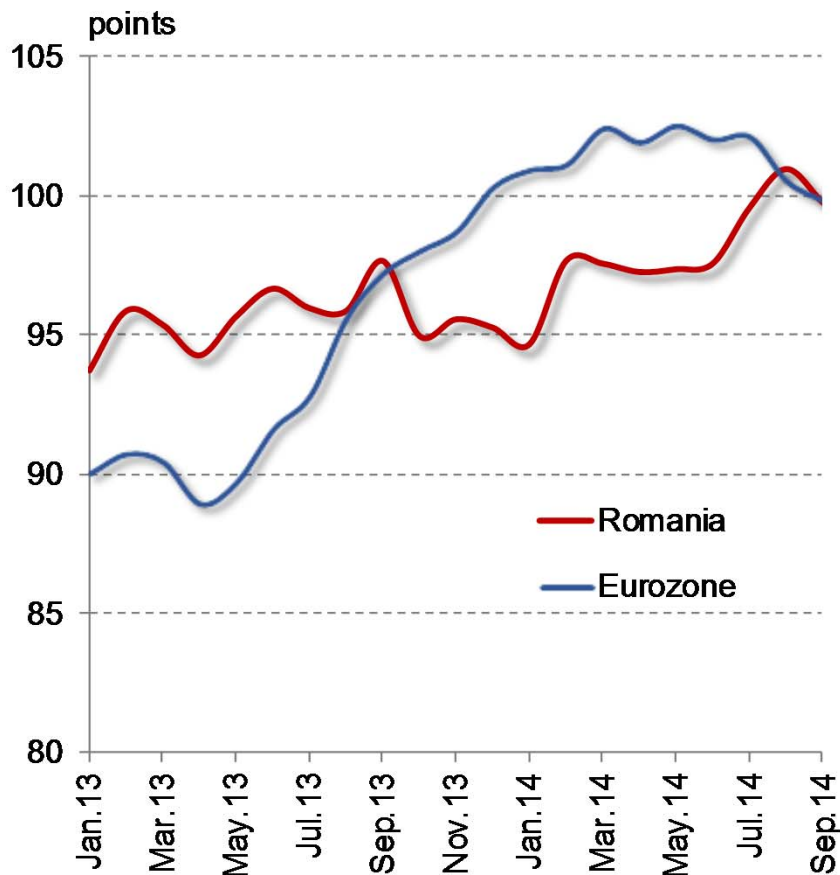
Weaker exports and poor investment activity were the main contributors to the slowdown on the demand side



Source: National Institute of Statistics, NBR calculations

The economic sentiment has deteriorated, while the recovery of the Eurozone proves fragile

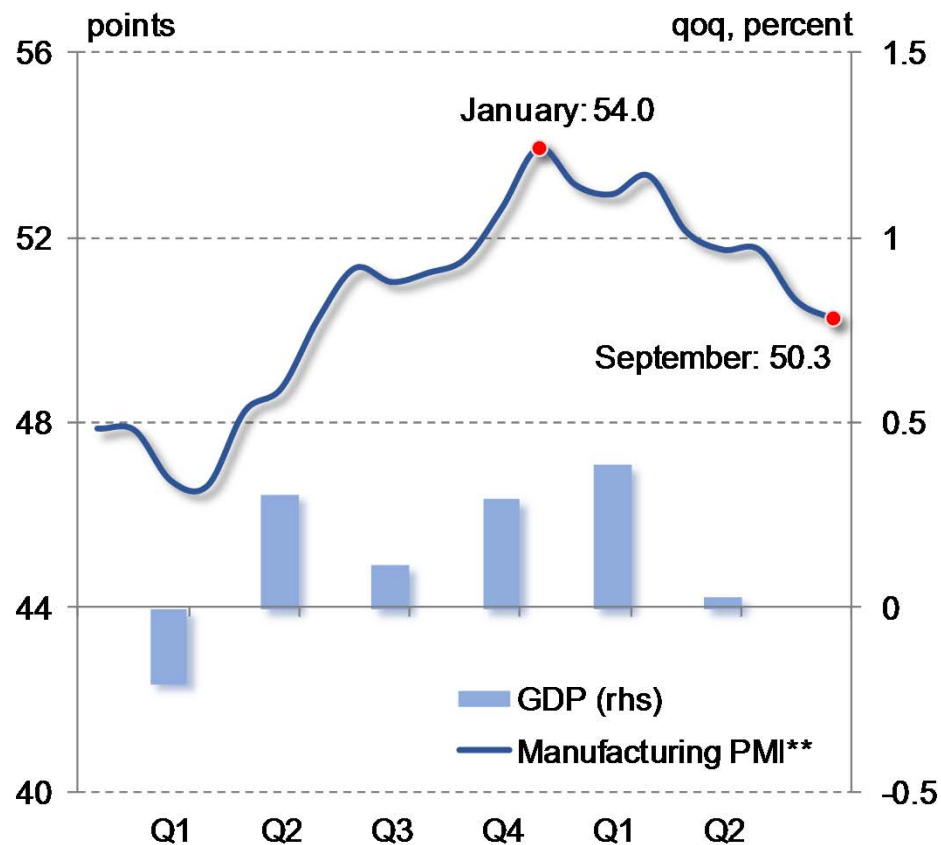
Economic Sentiment*



* Values greater than 100 points indicate an above long-term average economic sentiment

Source: DG ECFIN

Eurozone



** Values greater than 50 points indicate that manufacturing is generally expanding and below 50 that it is generally declining

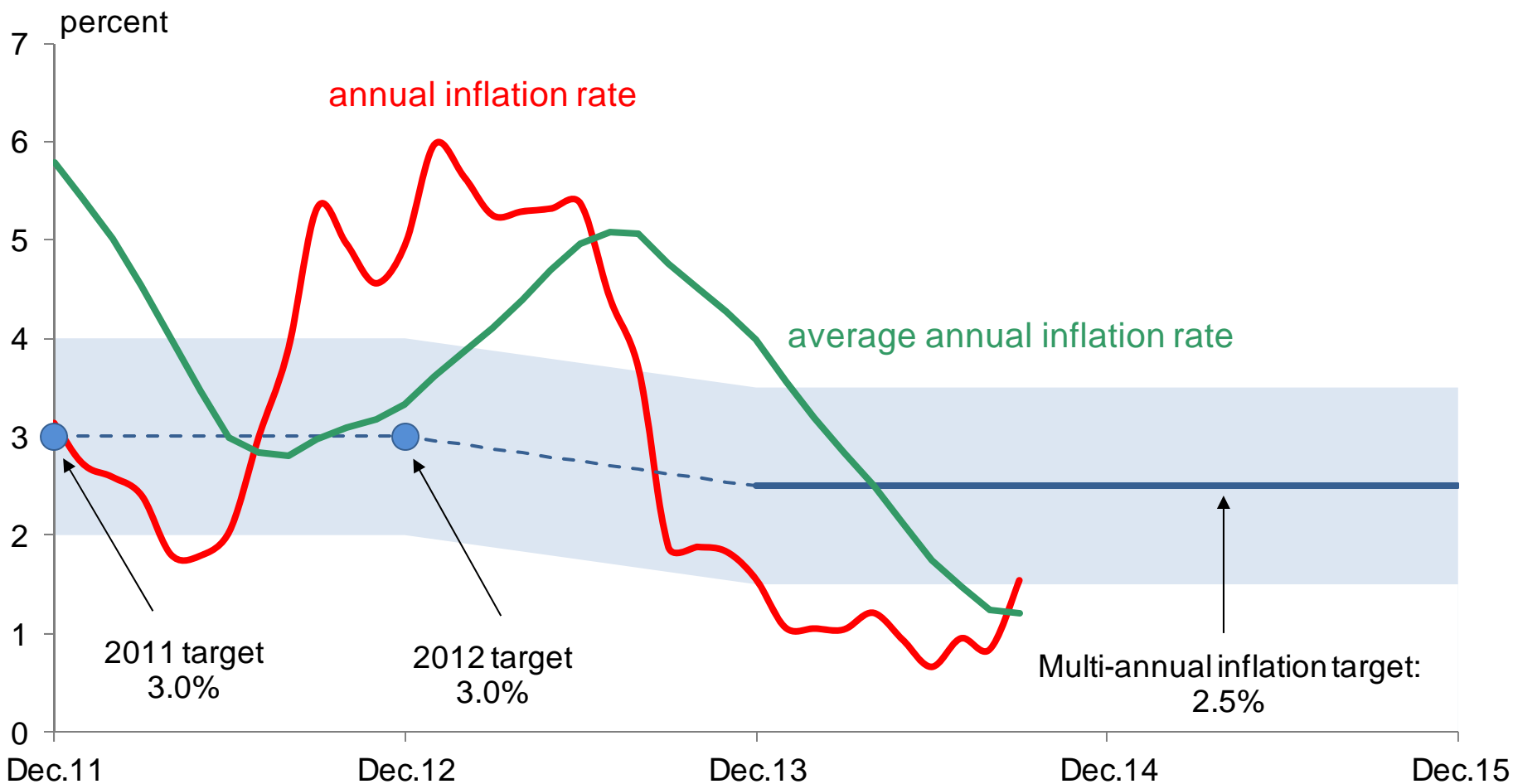
Source: Eurostat, Markit Economics

Inflation Developments

Romania joined the club of low-inflation countries

- Annual CPI inflation returned inside the variation band in September 2014 (1.54%), as a result of the dissipation of the statistical effect induced by the cut in the VAT rate on some bakery products from 24% to 9% as of 1 September 2013
- Low inflation levels throughout 2014 were driven by:
 - ✓ Persistence of the negative output gap and improved inflation expectations
 - ✓ Favourable supply-side developments
 - good harvest & oversupply for some fruit and vegetables due to the import ban imposed by Russia
 - decline in global commodity prices
 - ✓ Corrections and downward statistical base effects linked to past increases in administered prices
- The annual inflation rate is now in line with the ECB's quantitative definition of price stability
- Inflation is expected to stay within the variation band over the projection horizon

CPI inflation fell to record lows in 2014 as a result of both persistent and transitory shocks

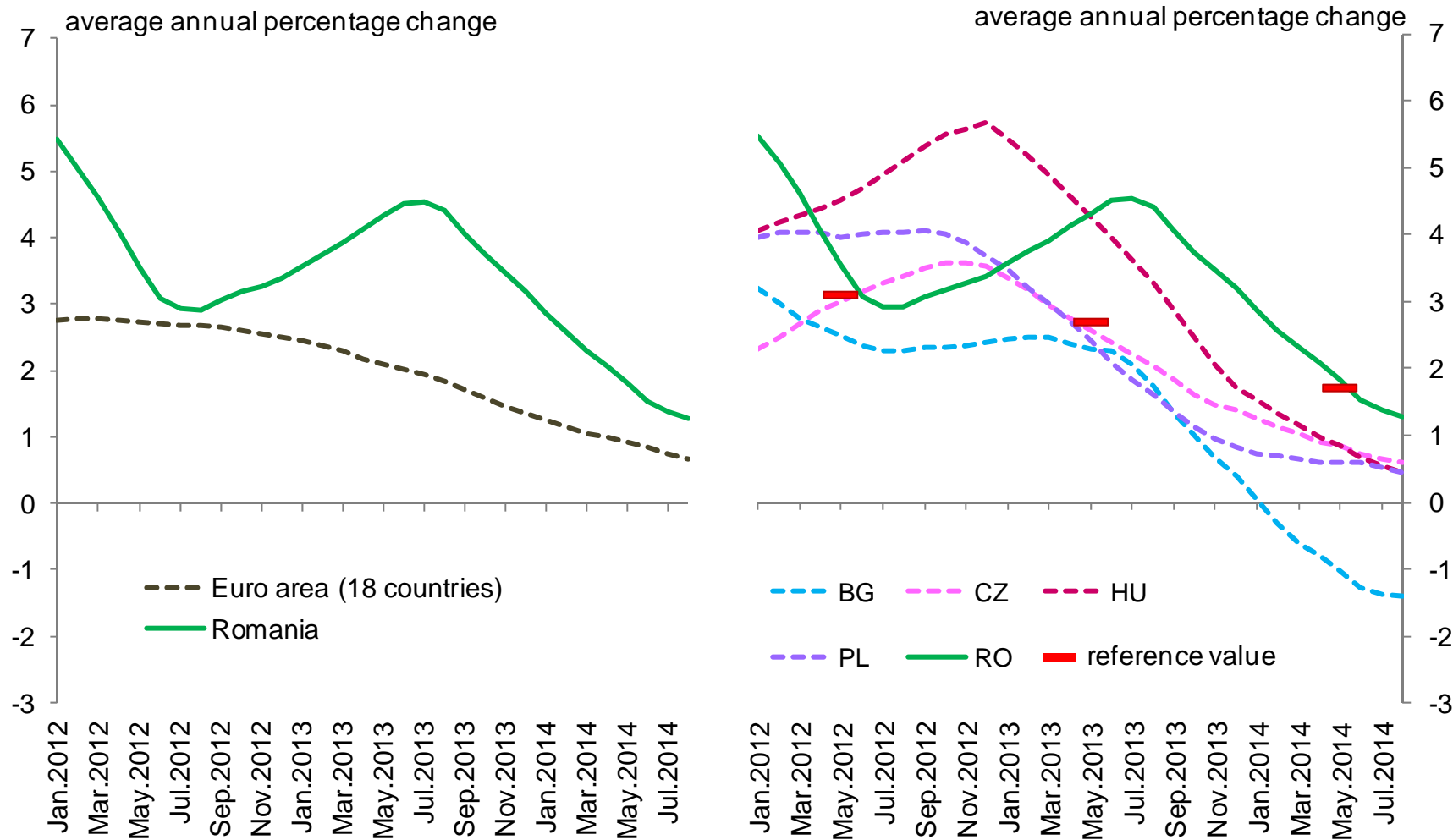


Note: Variation band is ± 1 percentage point around the central target.

Source: NIS, NBR

The disinflationary process continued in line with regional peers,....

Harmonised Index of Consumer Prices



Source: Eurostat

...ensuring the cumulative fulfilment of nominal convergence criteria

Maastricht Criteria (Nominal Convergence Indicators)

Nominal Convergence Indicators	Maastricht Criteria	Romania	Fulfilment of the criteria
Inflation rate (HICP) (percent, annual average)	<1.5 pp above 0.0%* (average of the three best performing Member States)	1.3 (September 2014)	Yes
Long-term interest rates (percent per annum)	<2 pp above 3.4%* (average of the three best performing Member States in terms of price stability)	4.9 (September 2014)	Yes
Exchange rate (vs. euro)** (percentage change)	±15 percent	+4.5 / -1.8	Yes
General government deficit*** (percent of GDP)	below 3 percent	2.3	Yes
Government debt*** (percent of GDP)	below 60 percent	38.4	Yes

*) reference level, September 2014 (Portugal, Slovakia, Spain).

**) Maximum percentage deviations of the bilateral exchange rate against the euro from its September 2012 average level in October 2012 to September 2014 based on daily data at business frequency. An upward/downward deviation implies that the currency was stronger/weaker than the average exchange rate in September 2012.

***) 2013; ESA95 methodology.

Source: Eurostat, National Institute of Statistics, National Bank of Romania, European Commission

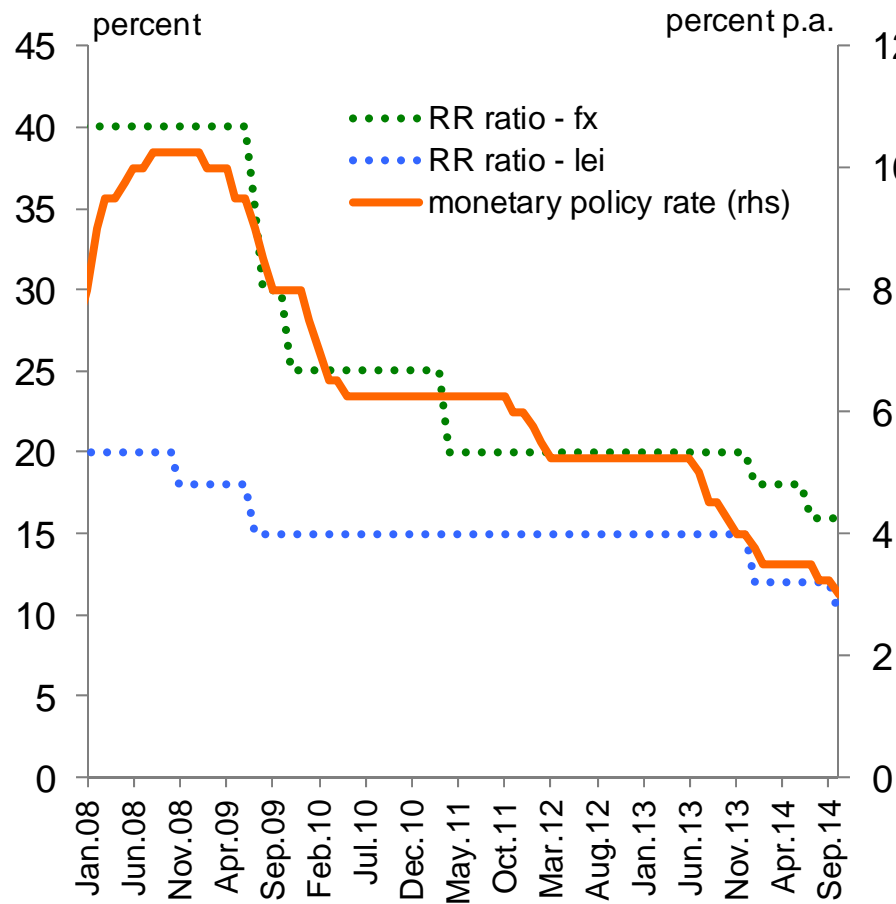
Monetary Policy

The improved inflation outlook warranted the further easing of monetary policy ...

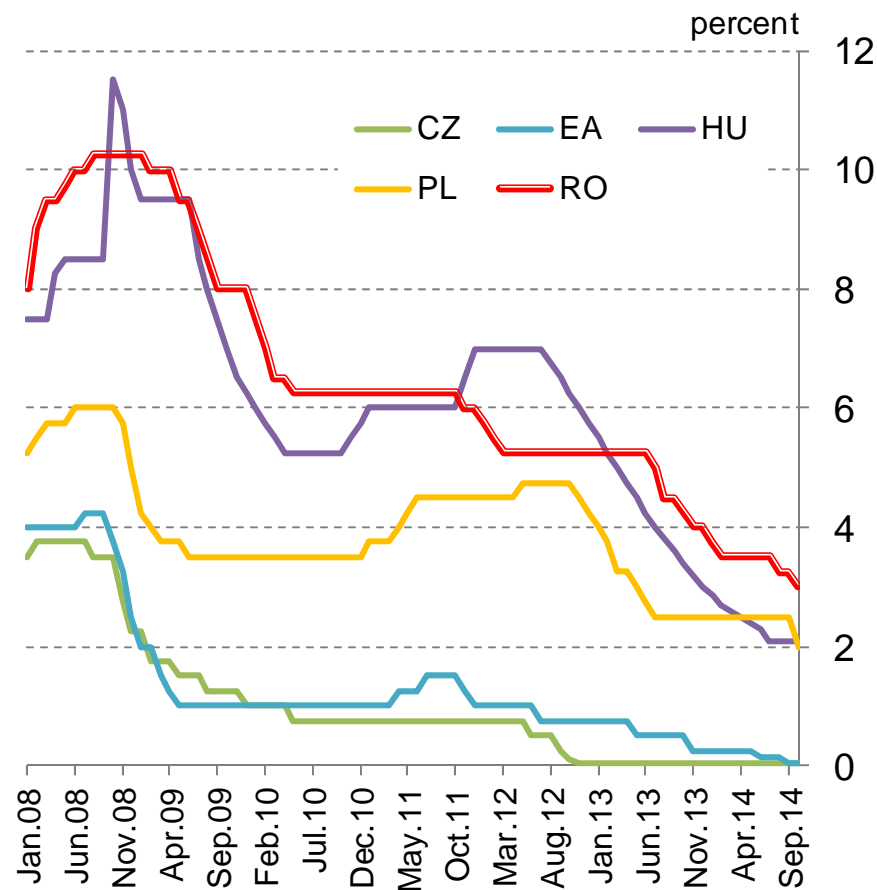
- Over the past years, the NBR maintained a prudent stance of monetary policy, by gradually reducing the policy rate:
 - ✓ Between February 2009 and March 2012, the NBR cut the policy rate by a cumulative 500 basis points, to 5.25%
 - ✓ Rapid decreases in the annual inflation rate made it possible for the NBR to resume the downward adjustment of the policy rate: between July 2013 and October 2014, the NBR cut the policy rate by a cumulative 225 basis points, to 3.0%
- Current policy and money market rates, as well as lending and deposit rates for non-bank customers, are broadly in line with regional levels
- In order to support sustainable lending, but also to bring the minimum reserve requirements mechanism closer to ECB standards, the NBR cut the MRR:
 - ✓ On foreign currency-denominated liabilities from 18% to 16% in July 2014
 - ✓ On leu-denominated liabilities from 12% to 10% in October 2014

... similarly to regional peers

Policy Rate and RR Ratios

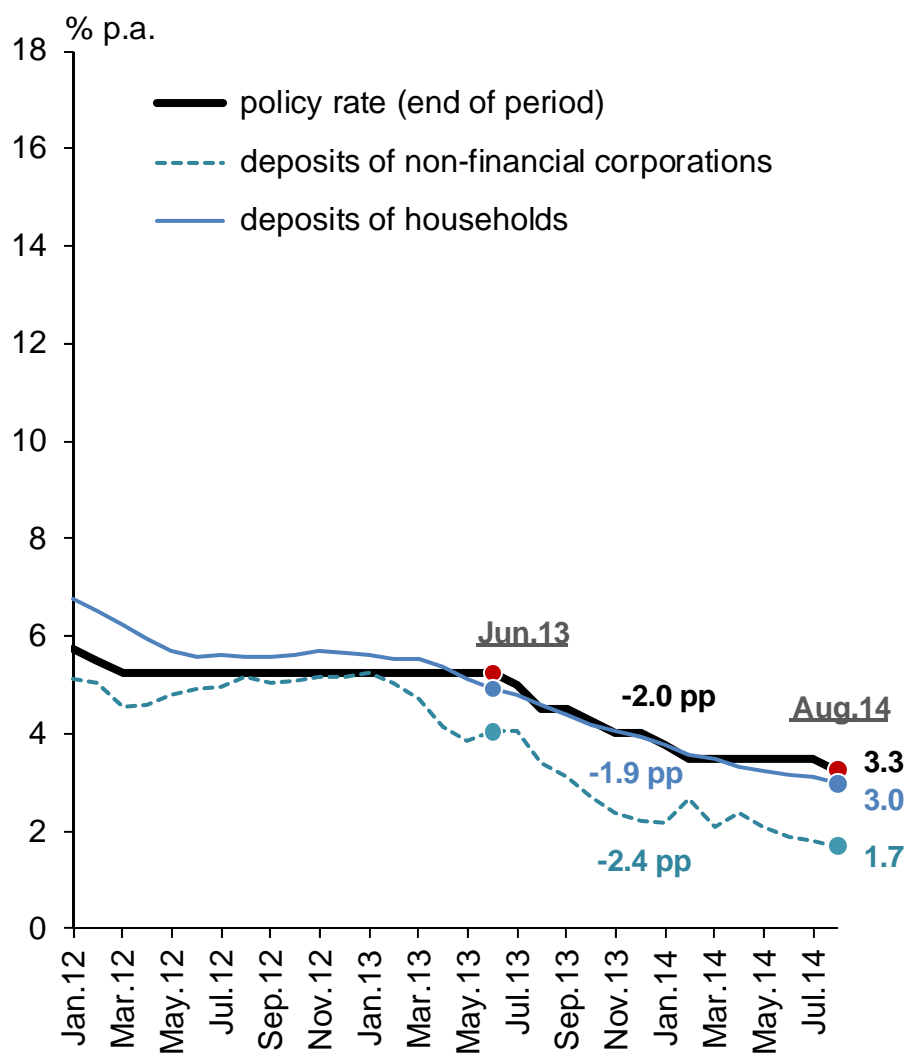
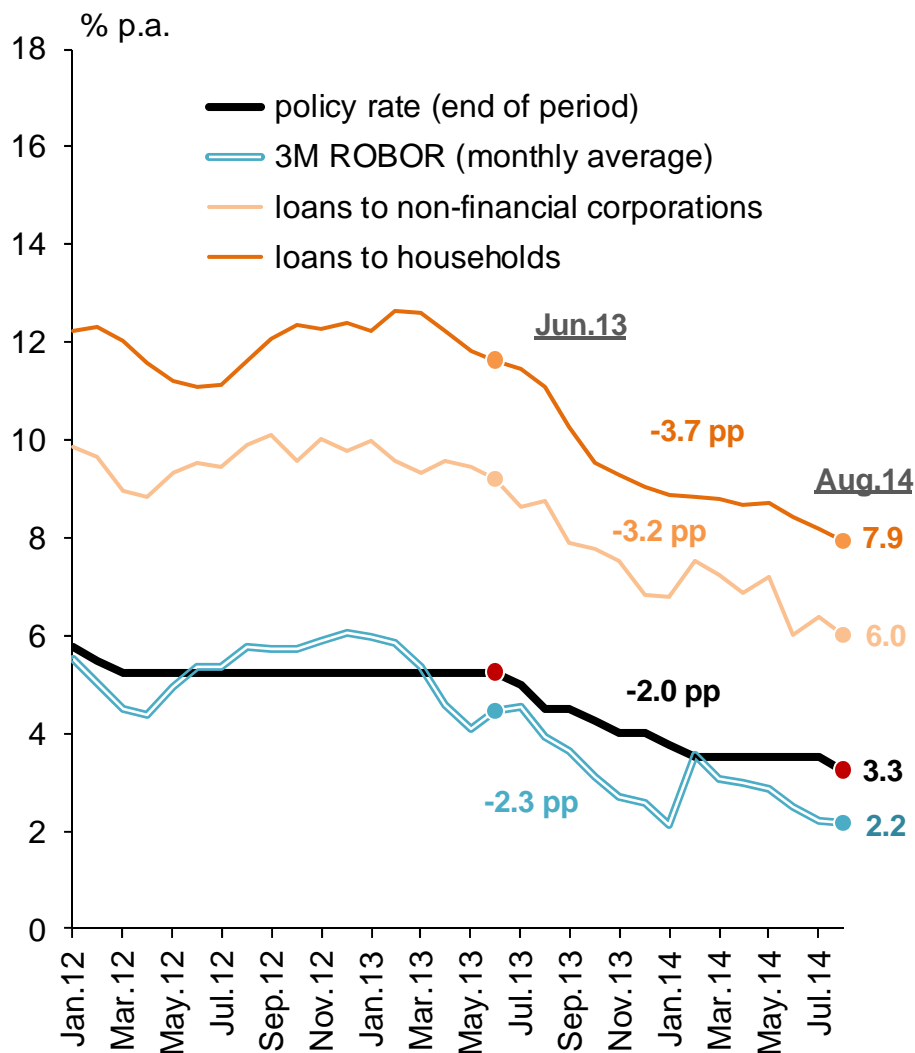


**Policy Rate
(international comparison)**



Source: National Bank of Romania, national central banks

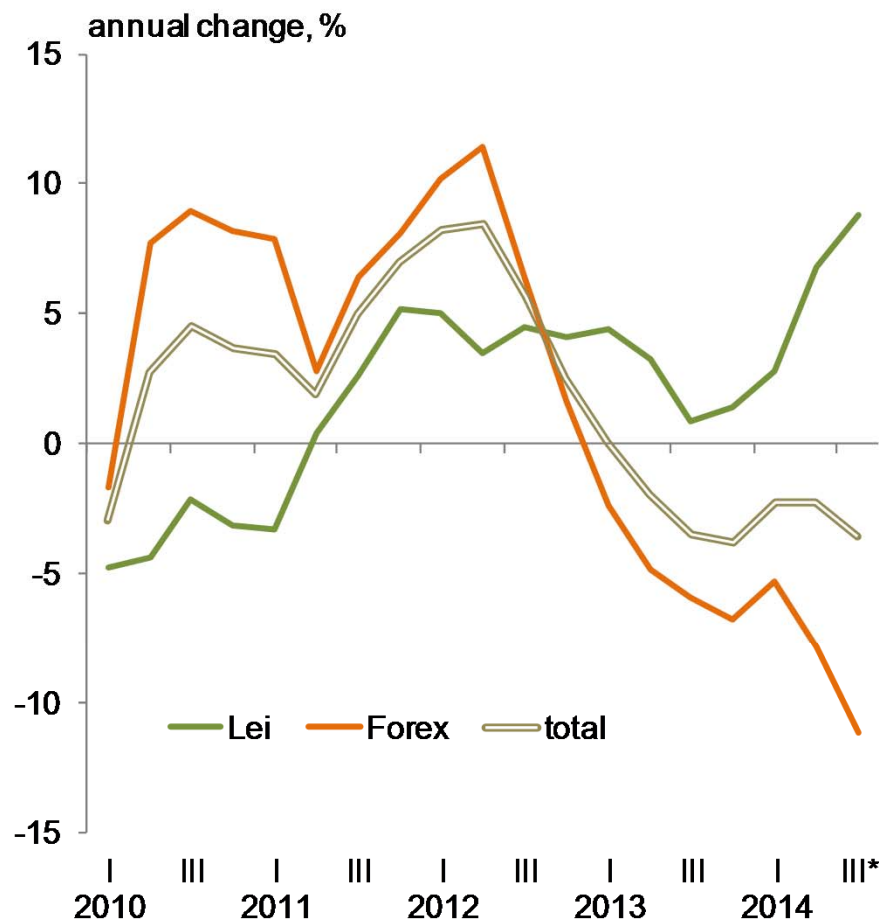
The policy rate cut fed through to a larger extent to lending rates on new business than to the rates on new time deposits



Source: National Bank of Romania

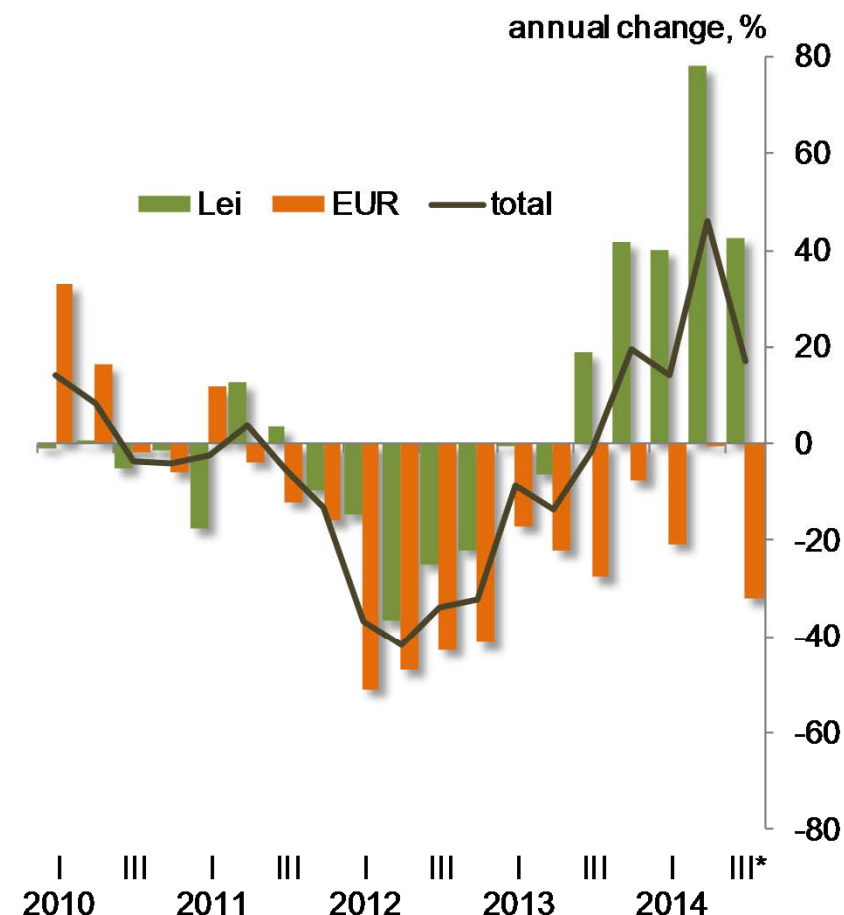
Steady recovery in lending in local currency to the private sector

Outstanding



Source: NBR

New Business



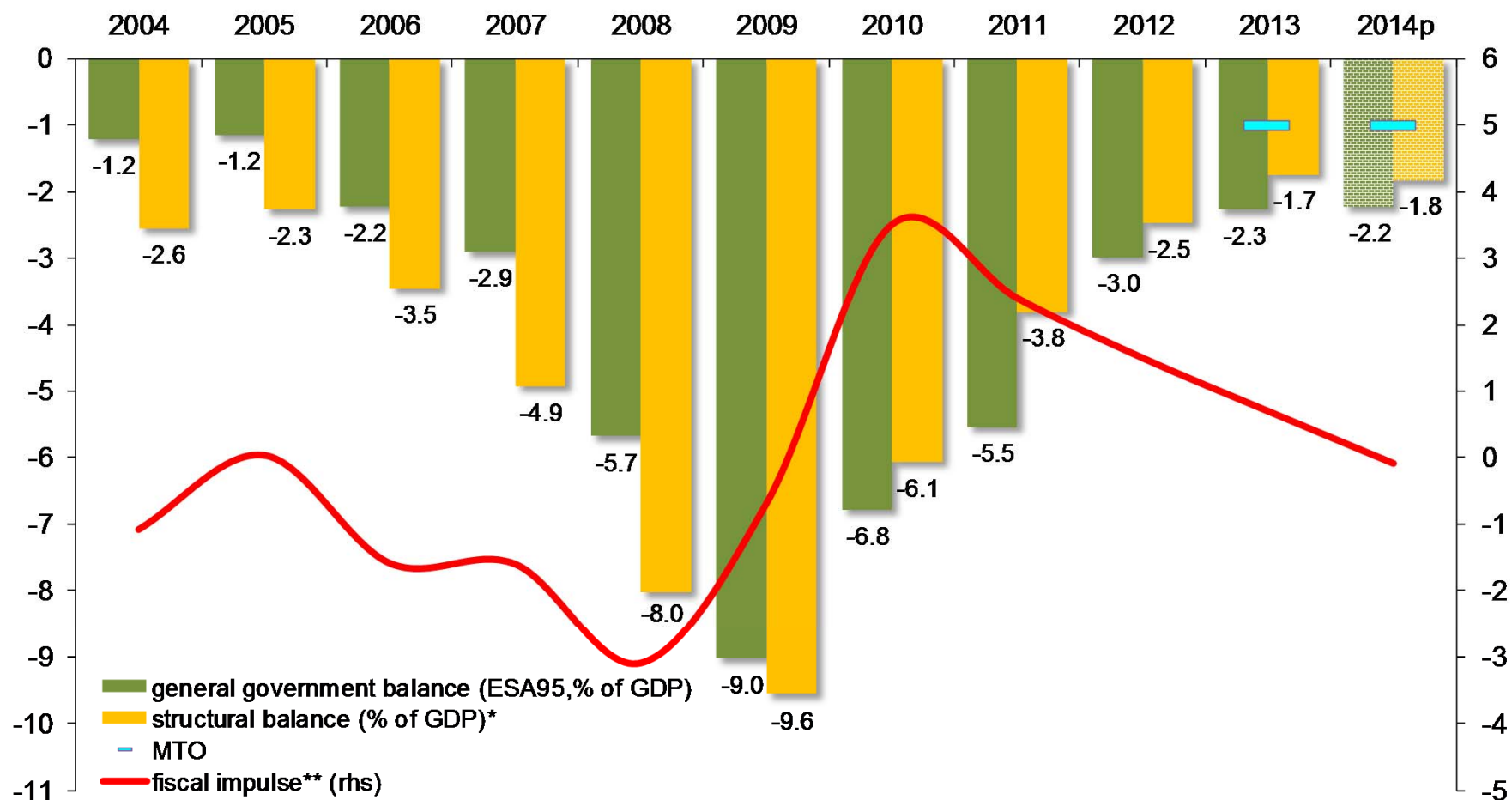
* Jul.-Aug.

Fiscal Policy

Fiscal consolidation largely completed

- After peaking at 9.0% of GDP in 2009, the public deficit was successfully brought down to just below 3% as of end-2012, thus complying with the deadline under the excessive deficit procedure
 - ✓ The deficit declined further to 2.3% of GDP in 2013 and is projected to remain close to this level in 2014 (2.2% of GDP)
- The structural adjustment effort amounted to a cumulative 7.8 pp of GDP during 2010-2013 (the second largest in the EU) and it was achieved through a mix of revenue and expenditure measures, with the latter accounting for the larger share
 - ✓ Overperformance as regards fiscal consolidation in 2013 allowed for a quasi-respite in 2014
- A structural adjustment effort of 0.8 pp of GDP, comparatively smaller than past achievements, is needed in 2015 in order to ensure the medium-term structural deficit objective (MTO) of 1% of GDP is met, thus complying with commitments under the Fiscal Compact

Constraints to aggregate demand stemming from fiscal consolidation are nearing the end



* defined as cyclically-adjusted balance net of one-off and temporary measures

** defined as the change in the structural primary budget balance; a negative (positive) figure indicates fiscal stimulus (tightening)

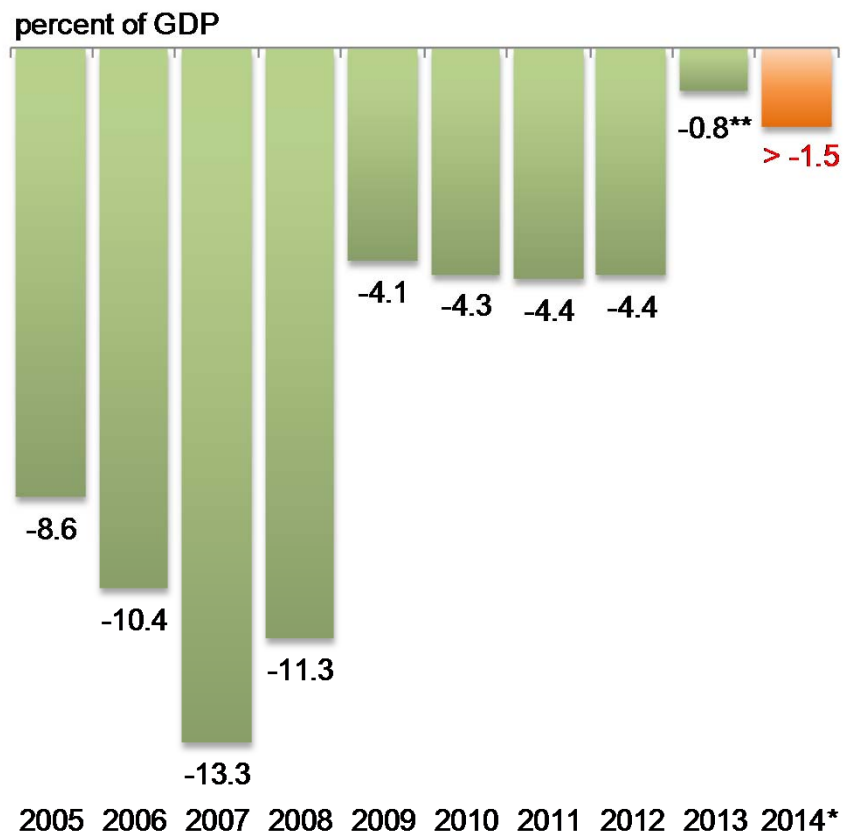
Source: AMECO, Ministry of Public Finance, European Commission

Current Account

Further adjustment of the external imbalance

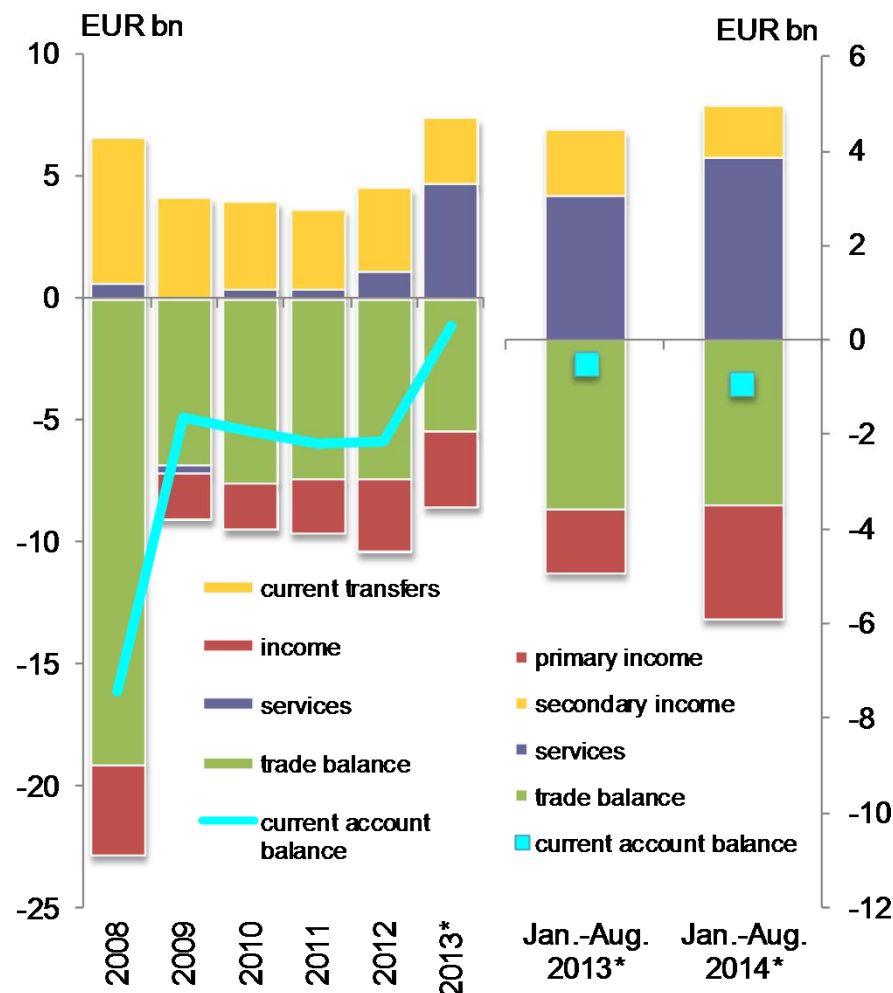
- After the severe adjustment seen by the current account deficit in 2009 (to 4.1% of GDP from 13.3% in 2007), a new narrowing occurred in 2013 (to 0.8% of GDP)
- In 2014 H1 the current account deficit painted a similar picture to that of 2013 (0.7% of GDP) and was further financed entirely from non-interest bearing capital inflows
 - ✓ FDI: up 33% as against 2013 H1, consisting mainly of equity stakes
 - ✓ Capital transfers: 2.5 times larger than those in the similar year-ago period, on the back of enhanced EU fund absorption
- Recent projections for 2014 and 2015 point to levels below 2% of GDP, in line with the gradual consolidation of domestic demand
- At end-September 2014, international reserves stood at EUR 34.3 bn (out of which EUR 31.1 bn forex), covering around 6 months of prospective goods and services imports

Repositioning of current account deficit to low levels, driven mainly by: ...



*) forecast

**) according to IMF's BPM6



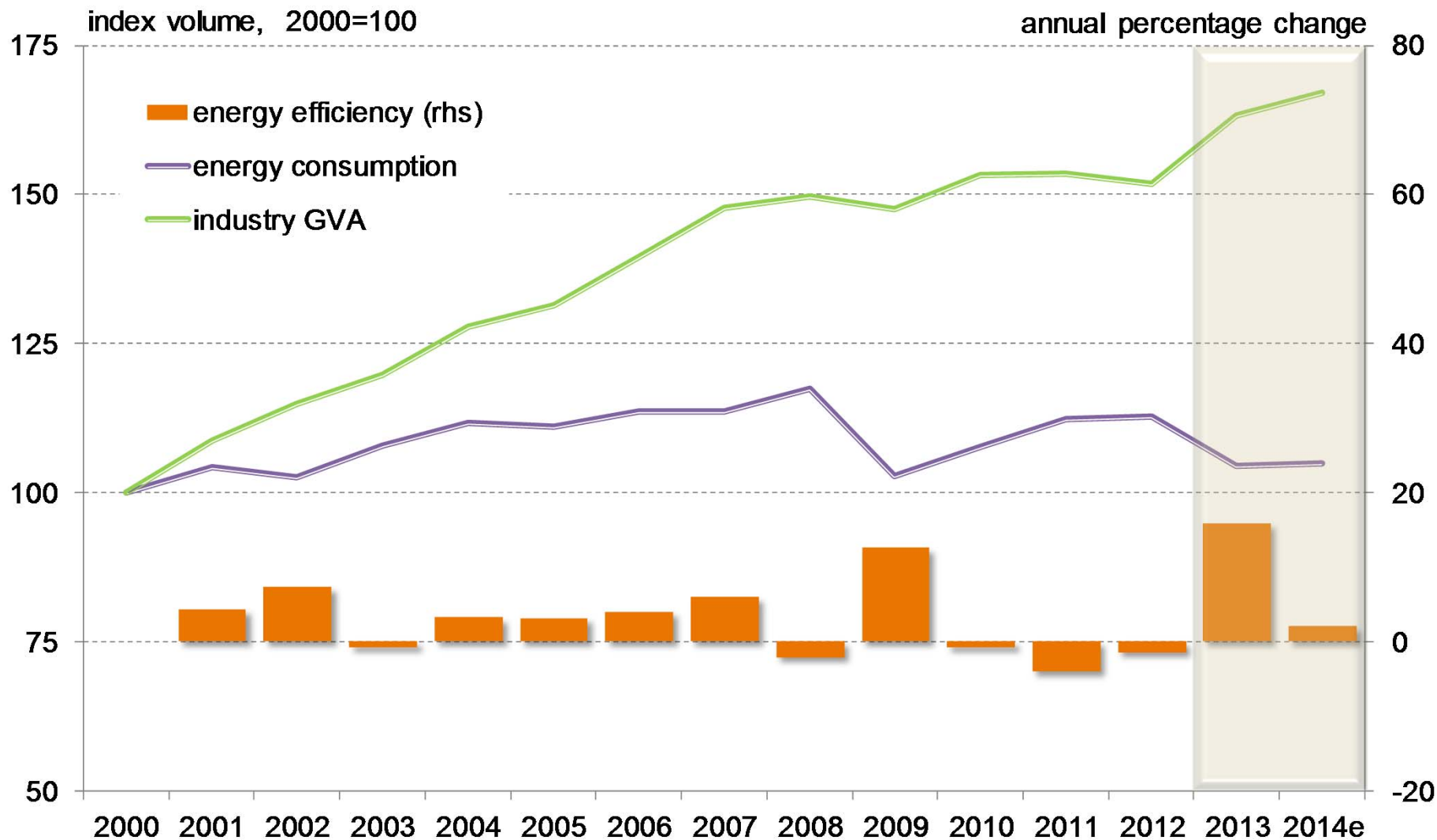
*) according to IMF's BPM6

Source: National Bank of Romania, National Institute of Statistics

Note: GDP compiled according to ESA2010 methodology

Source: National Bank of Romania, National Institute of Statistics

(a) Increased energy efficiency in the economy

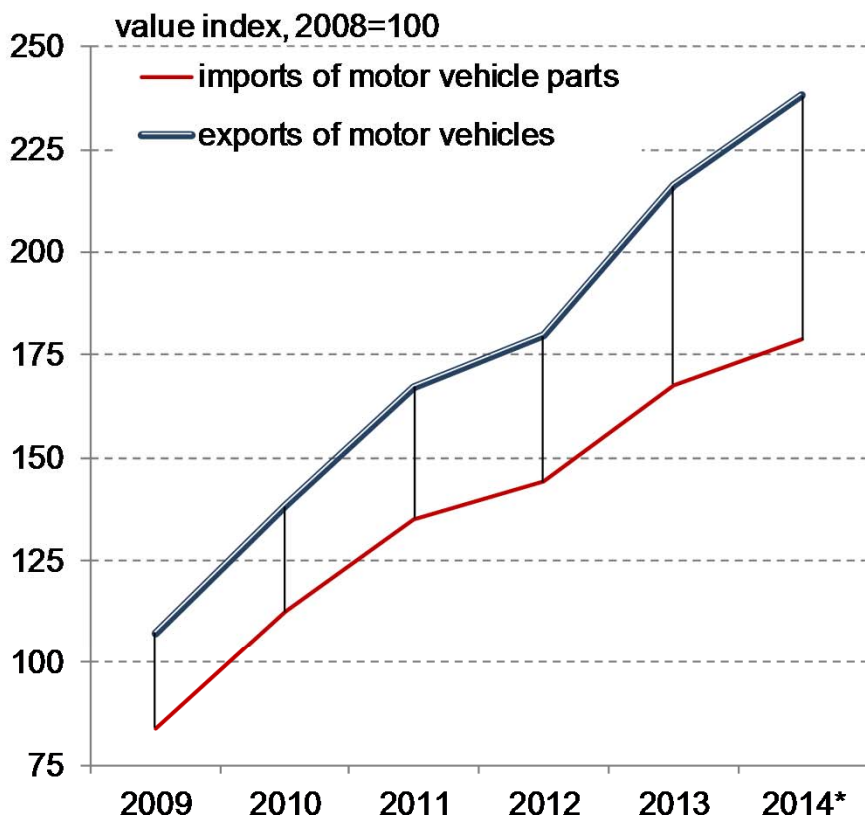


Source: NIS, NBR estimations and calculations

e) estimate

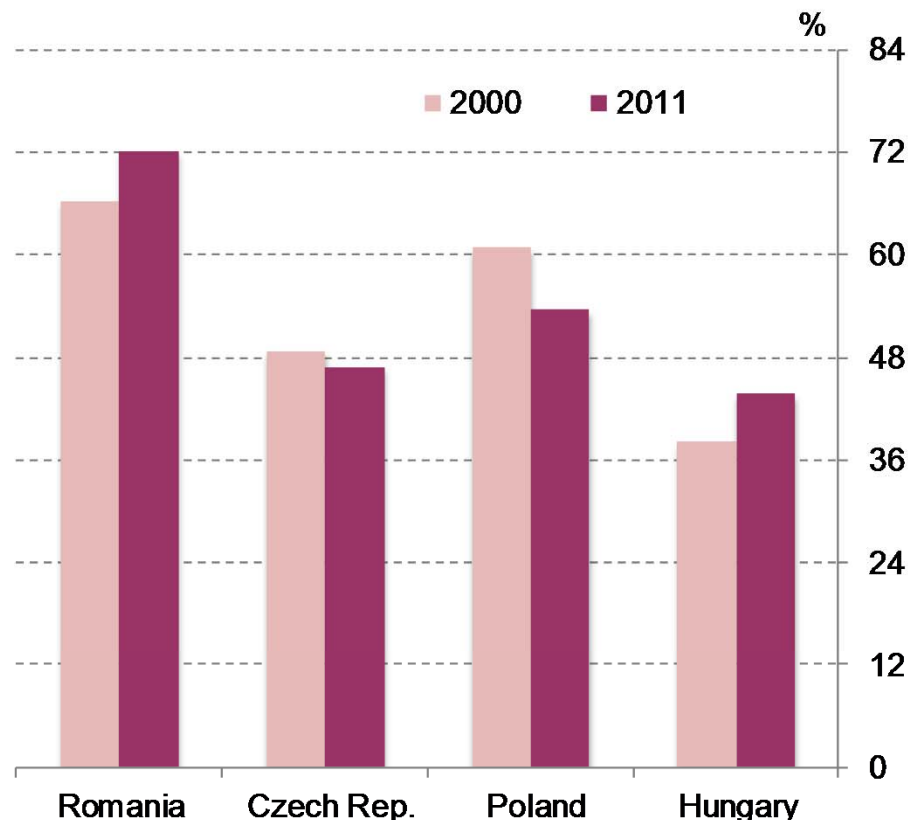
(b) Declining import content of exports in the automotive industry, given that a larger part of the production chain is locally captured

International Trade in Motor Vehicles



*) 2014 figure was the result of extrapolating 2014 H1 readings

**National Value Added in Final Production
– Transport Equipment Sector** –**

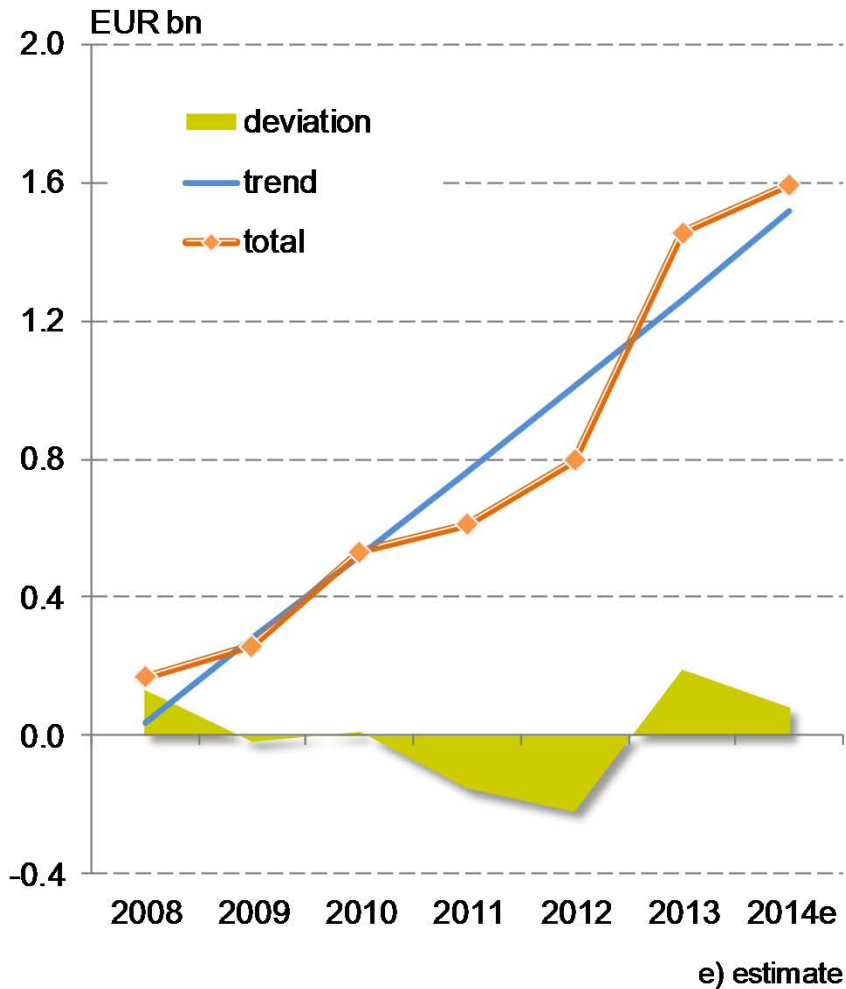


**) Transport equip. sector refers to motor vehicles, trailers, semi-trailers and other transport equip.

Source: Comext, WIOD, NBR calculations

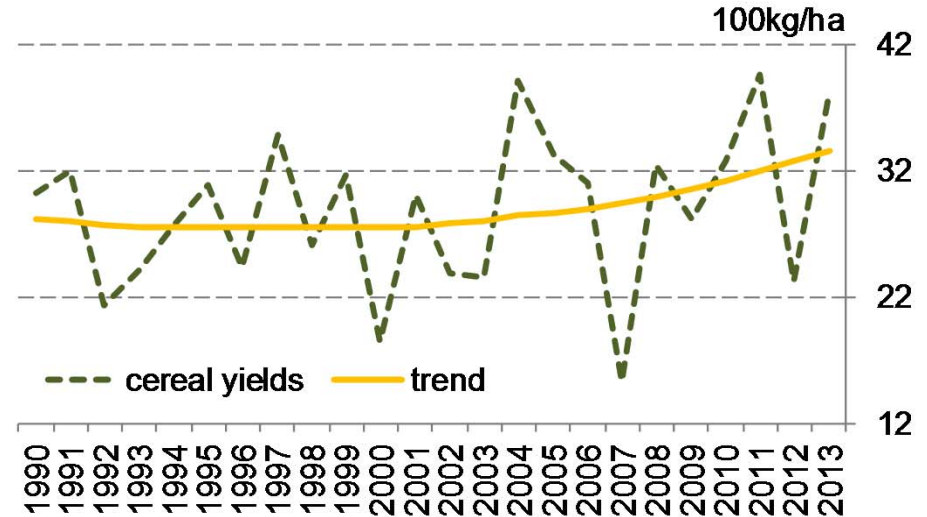
(c) Increased capacity of agri-food exports

Net Exports of Cereals

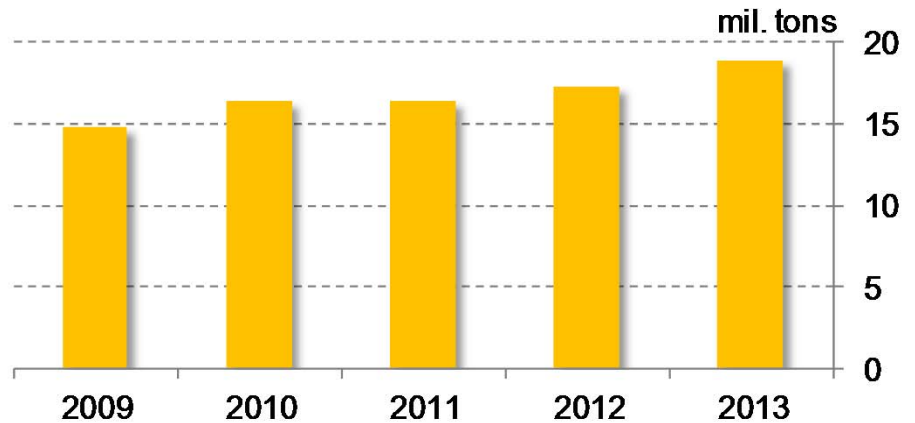


Source: Comext, Eurostat, NBR estimations

Cereal Yields

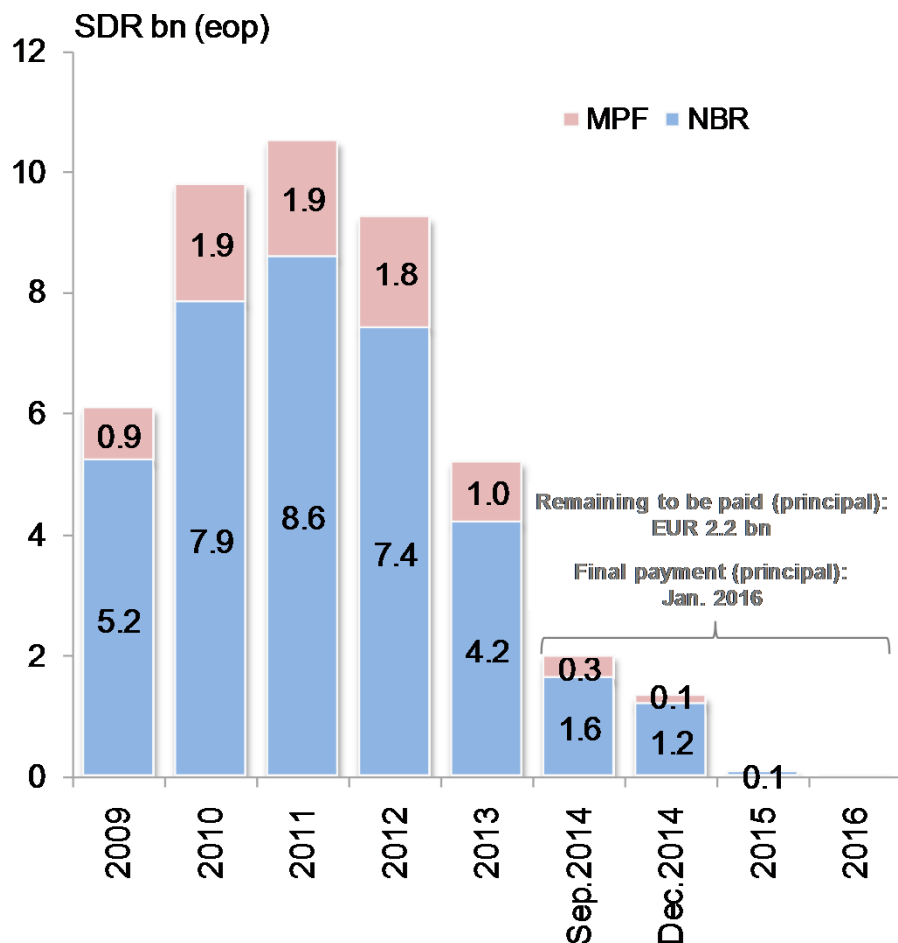


Cereal Storage Capacity

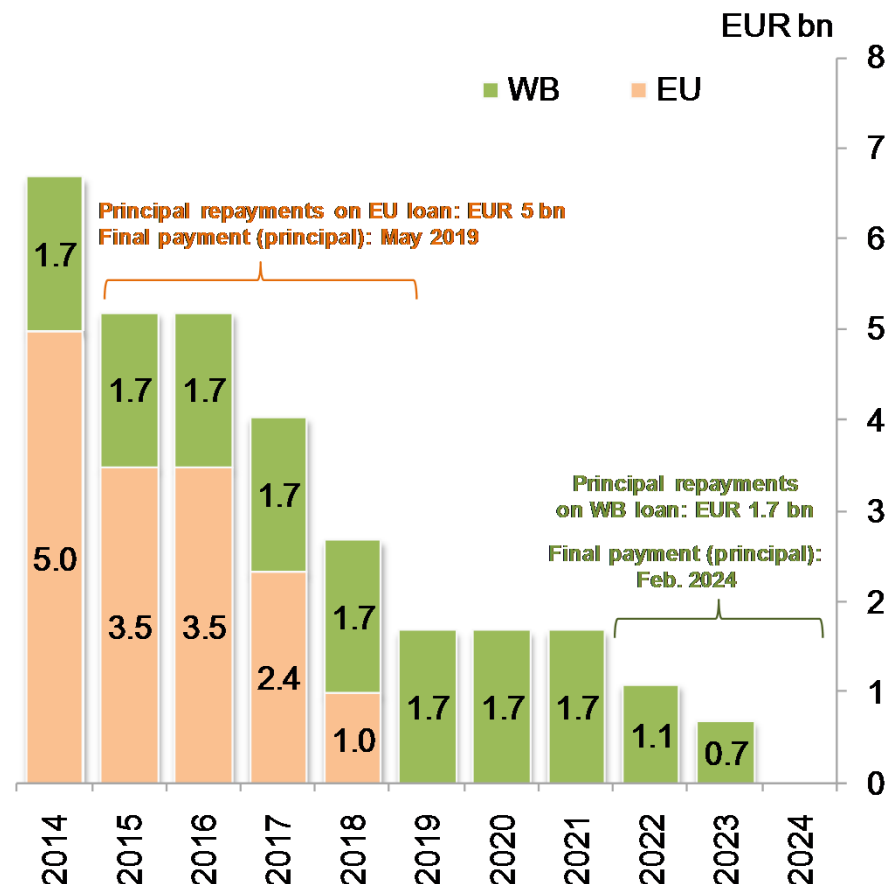


Most of the IMF loan has already been repaid, ...

Outstanding debt to the IMF



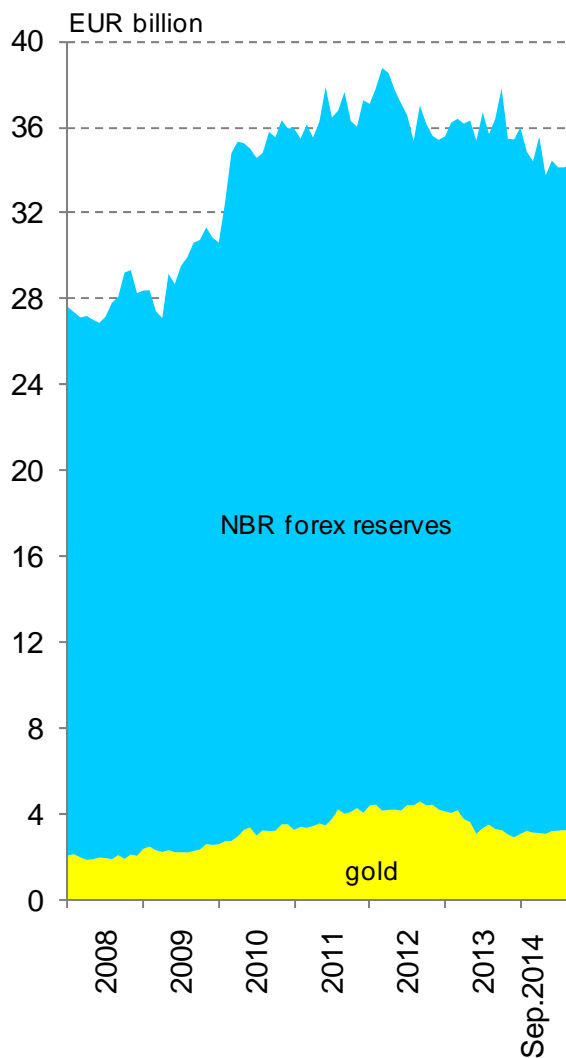
Outstanding debt to the EU and World Bank



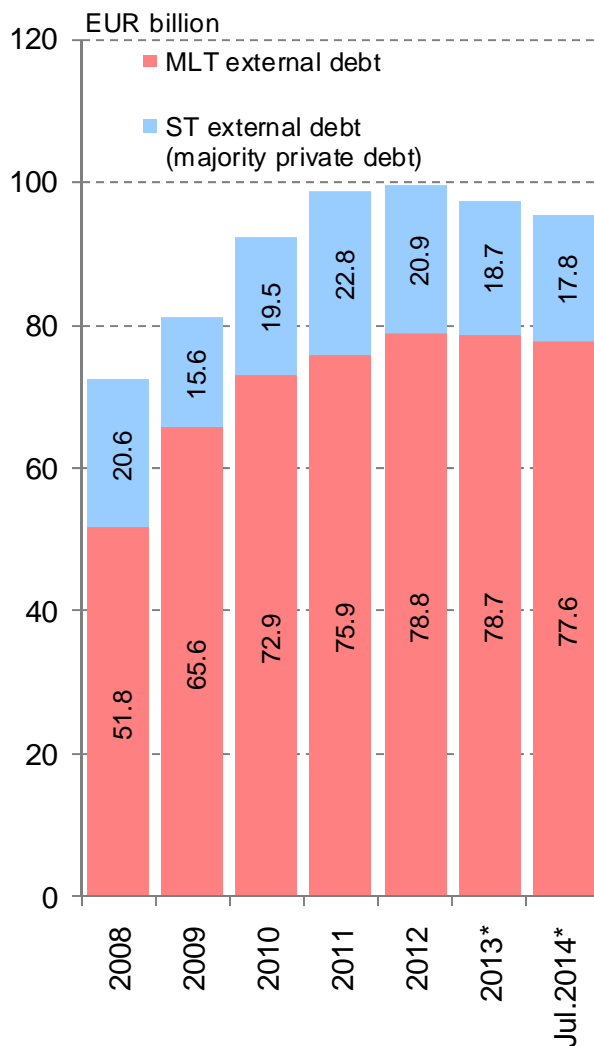
Source: NBR, MPF

... yet international reserves remained at a comfortable level

International Reserves

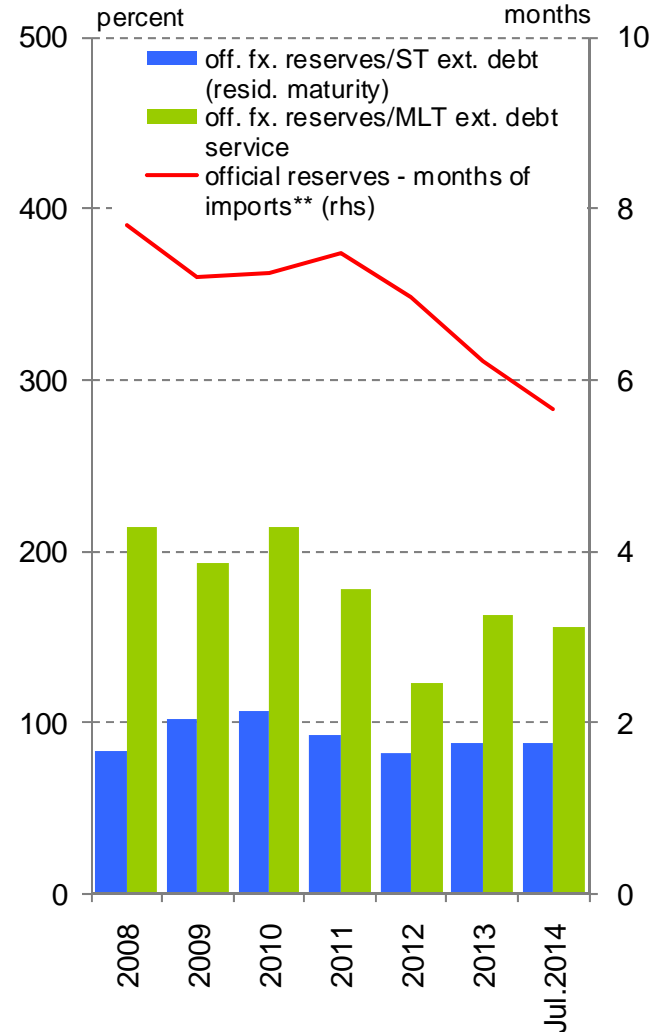


Total External Debt



*) according to the IMF's BPM6

Reserve Adequacy



**) prospective imports of goods and services

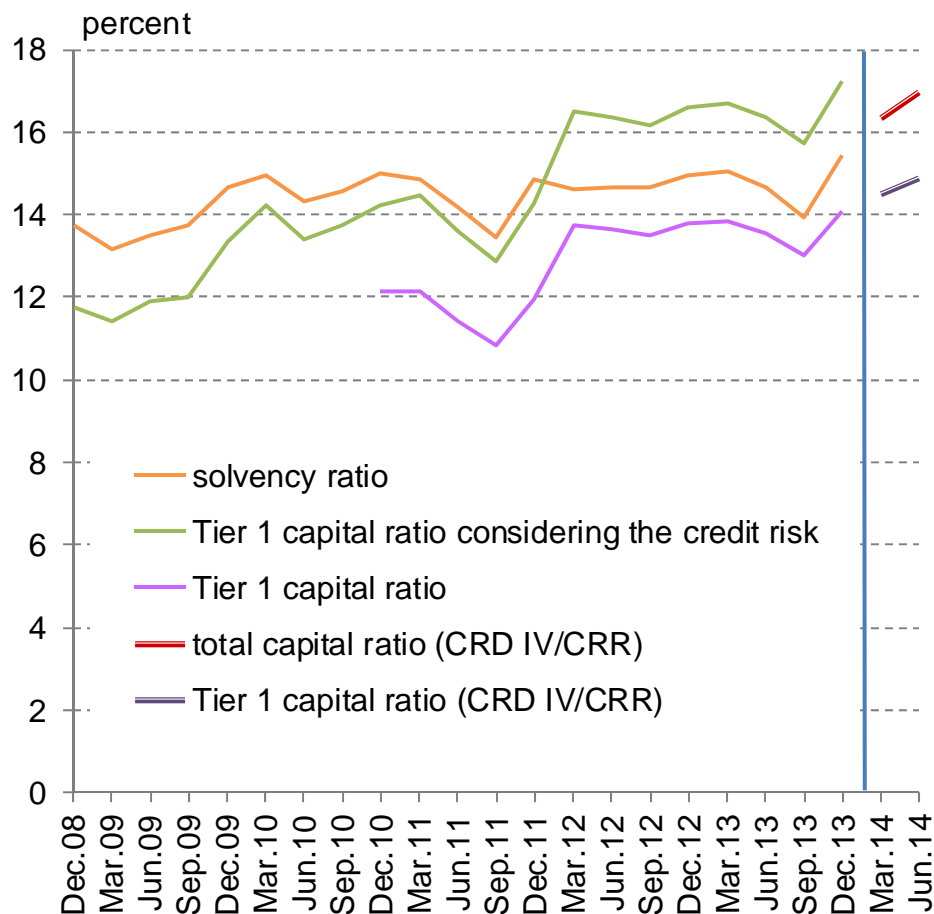
Source: National Bank of Romania

Banking System

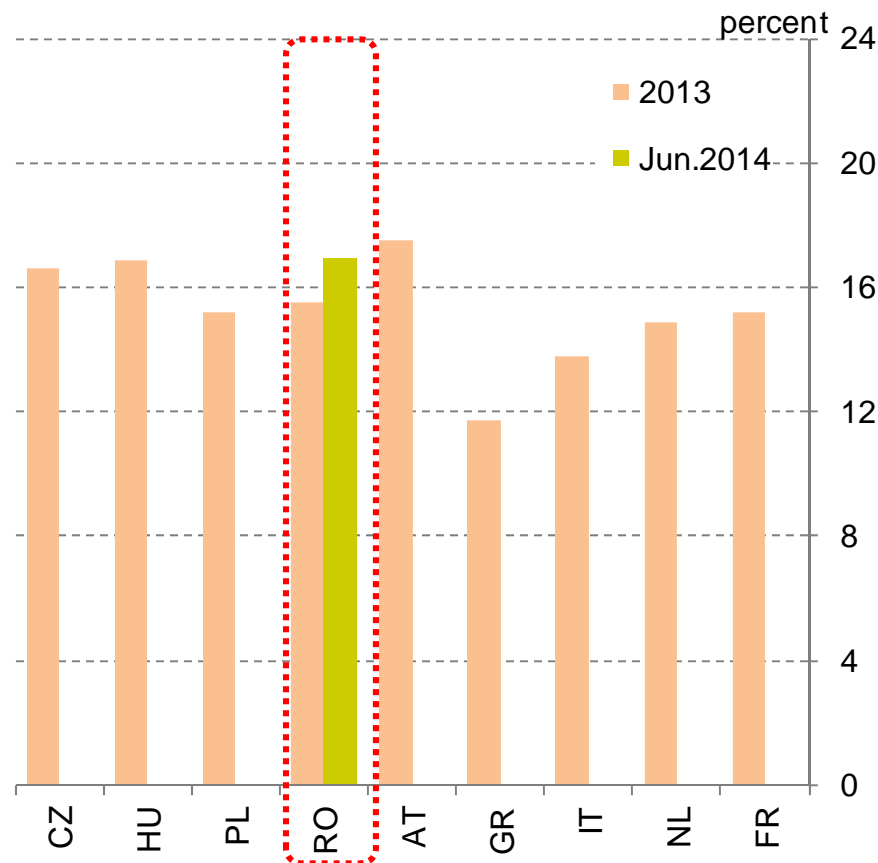
The banking sector remains resilient to possible adverse developments, given:

(a) an adequate level and proper quality of capital

Capital Adequacy Indicators



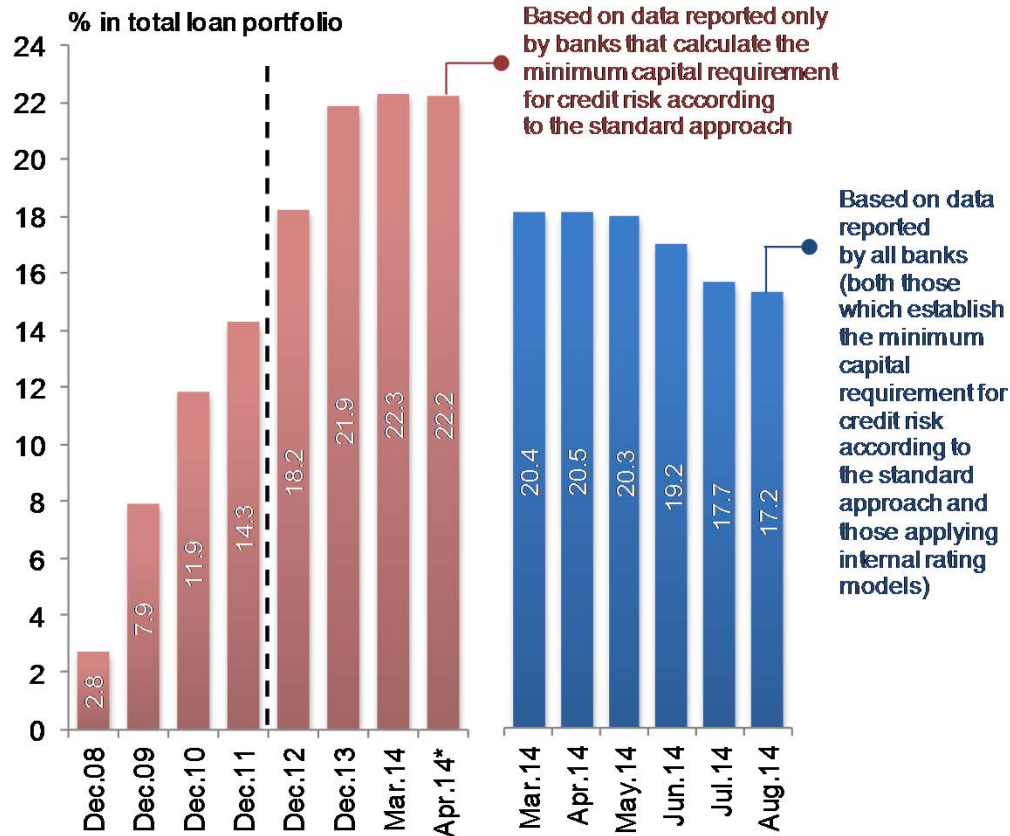
Solvency Ratio in Selected EU Countries



Source: IMF (Financial Soundness Indicators, FSI Tables, April 2014); NBR calculations

(b) good IFRS provisioning of non-performing loans

Non-Performing Loans Ratio

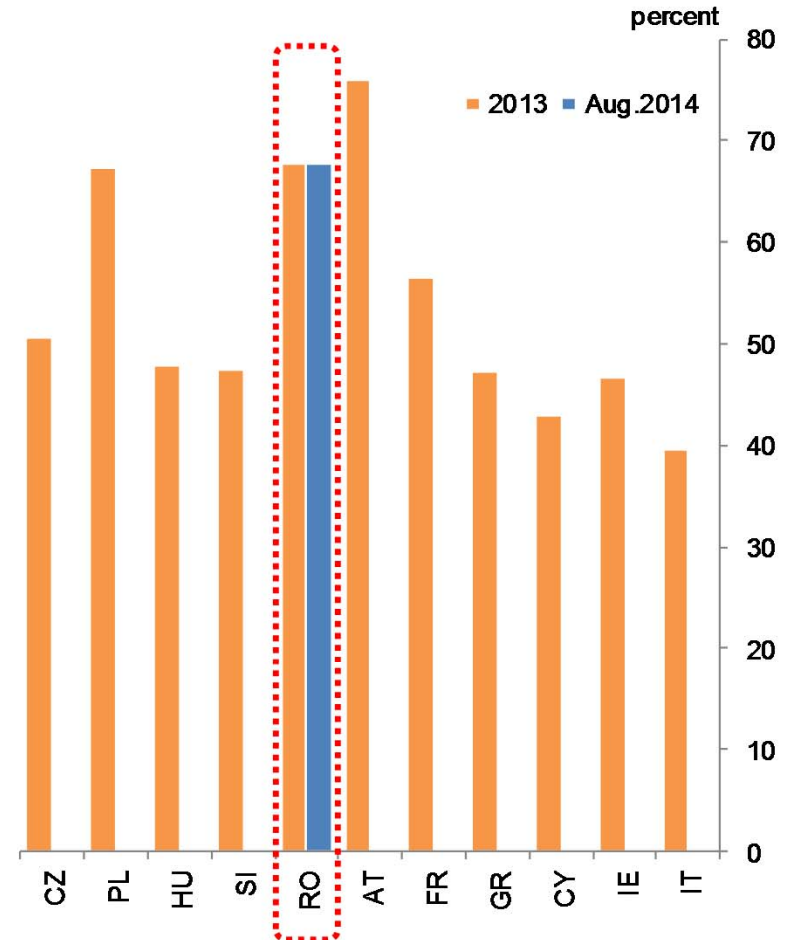


*) Last available data determined based on this definition.

Note: Starting 1 January 2012, Romanian credit institutions apply the IFRS.
The NPLs represent gross exposure of loans and related interest overdue for more than 90 days and/or for which legal proceedings were initiated.

Source: National Bank of Romania

Coverage of Non-Performing Loans in Selected EU Countries



Source: IMF (Financial Soundness Indicators, FSI Tables, April 2014), NBR

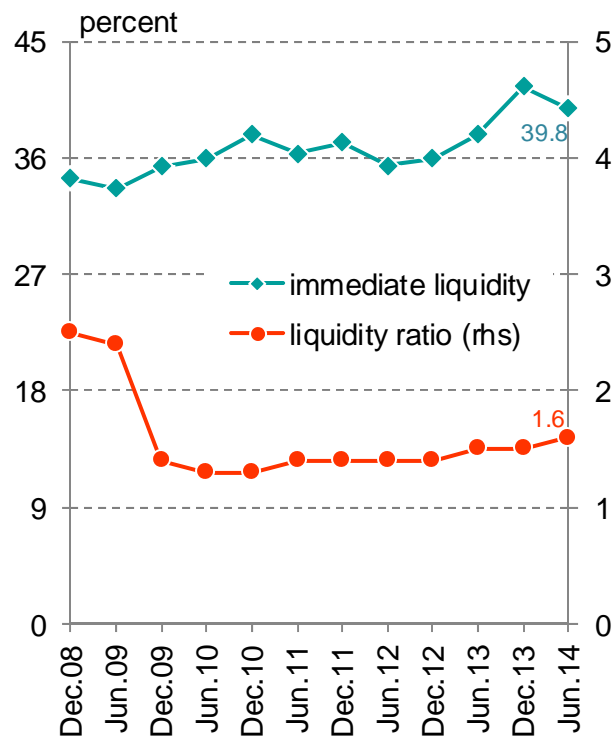
The NBR's proactive action to improve bank asset quality

The central bank recommended the implementation of a set of measures intended to lower the NPLs volume

- The removal from balance sheet of all exposures representing fully provisioned NPLs, preserving the right of future recovery of these claims
- Adjustments for impairment (IFRS provisions) for all loans overdue for more than 360 days and in which case legal proceedings were not initiated, followed by the removal of provisioned loans from the balance sheet
- Adjustments for impairment (IFRS provisions) for loans held by debtors (legal entities) undergoing insolvency proceedings, followed by the removal of provisioned loans from the balance sheet
- The external audit of adjustments for impairment (IFRS provisions) related to the loan portfolio as at 30 June 2014, as well as of collateral assessment

(c) good liquidity that was preserved also during the cross-border deleveraging

Liquidity Indicators

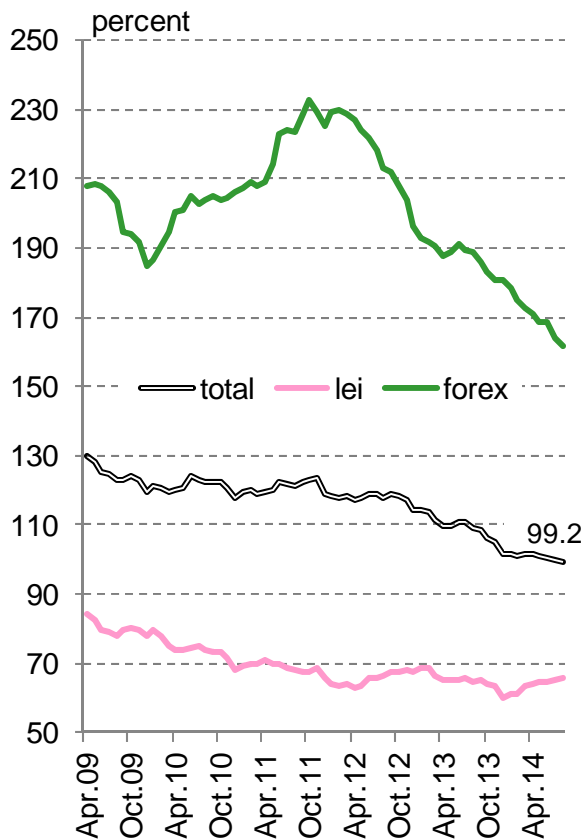


Immediate liquidity = (demand deposits and time deposits with banks + unpledged government securities) / Total liabilities (prudent level > 30%)

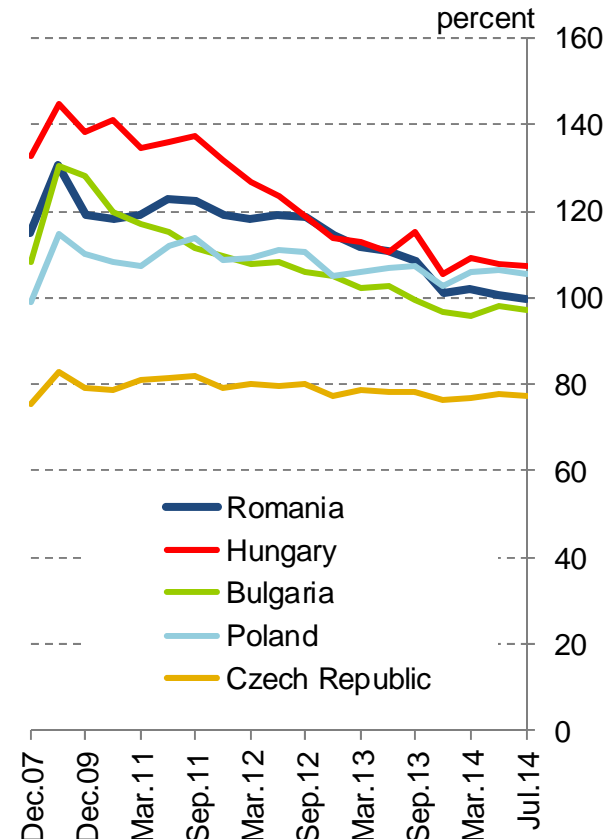
Liquidity ratio = effective liquidity/required liquidity (regulated threshold = 1)

Source: NBR

Loan-to-Deposit Ratio by Currency



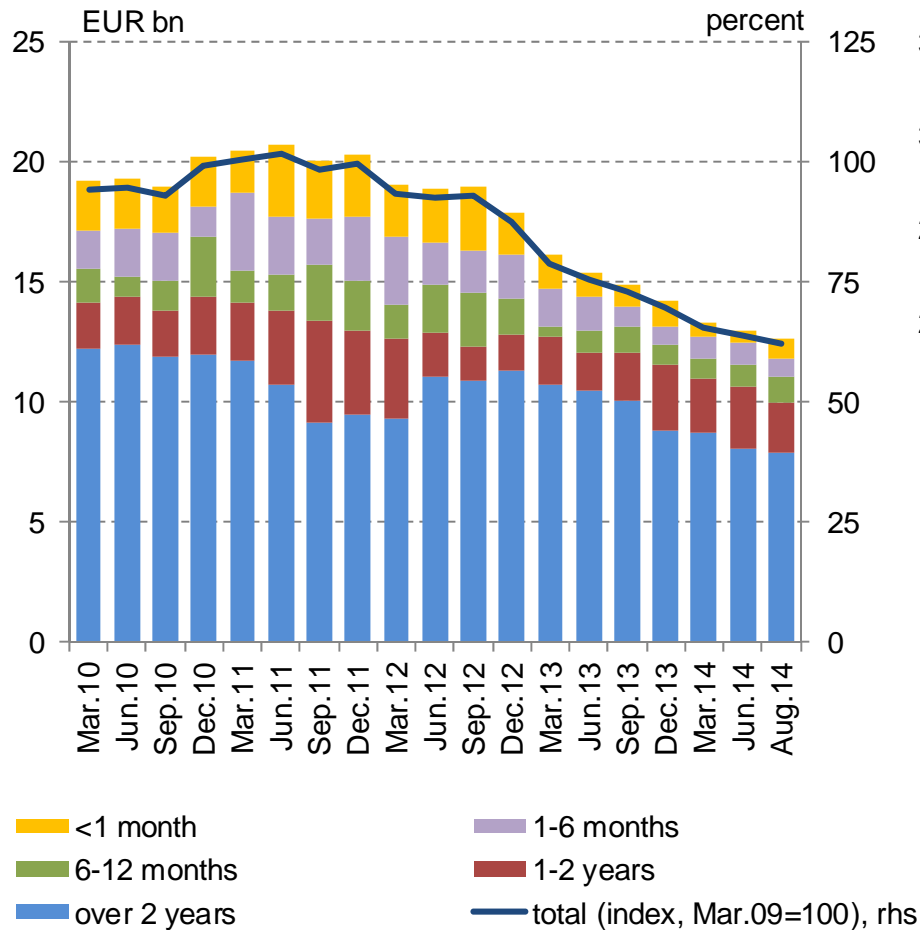
Loan-to-Deposit Ratio (regional comparison)



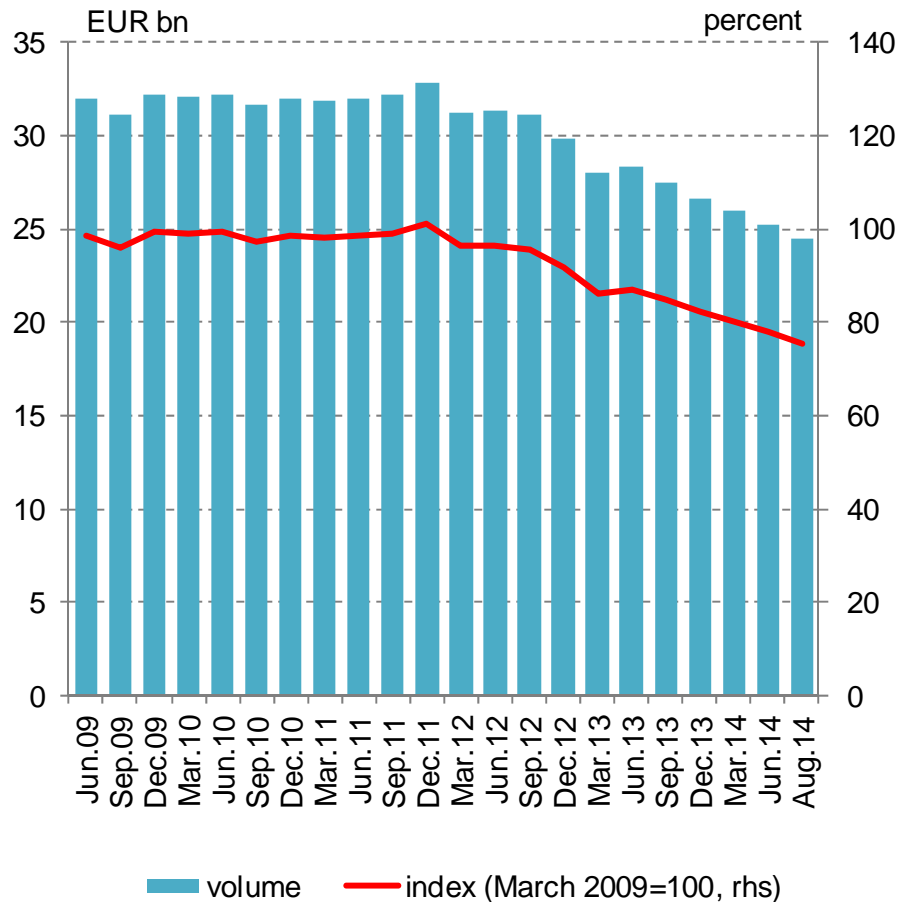
Source: ECB

Orderly deleveraging, yet unfolding at a faster pace

Term Structure of Financing from Parent Banks



Exposure of Banking Groups Participating in Vienna Initiative



Source: NBR

Spillovers from the Geopolitical Tensions in the Region

Tensions between Russia and Ukraine

– balanced risks for Romania –

➤ Trade restrictions or disruptions:

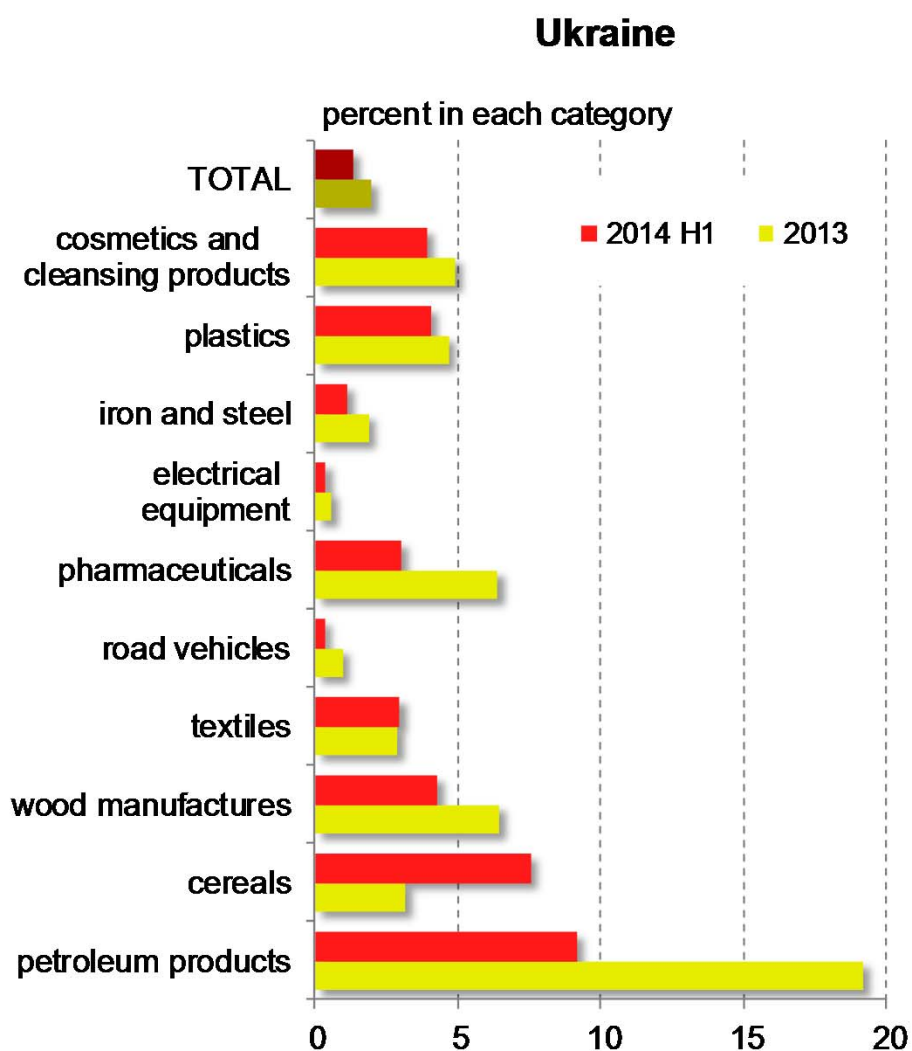
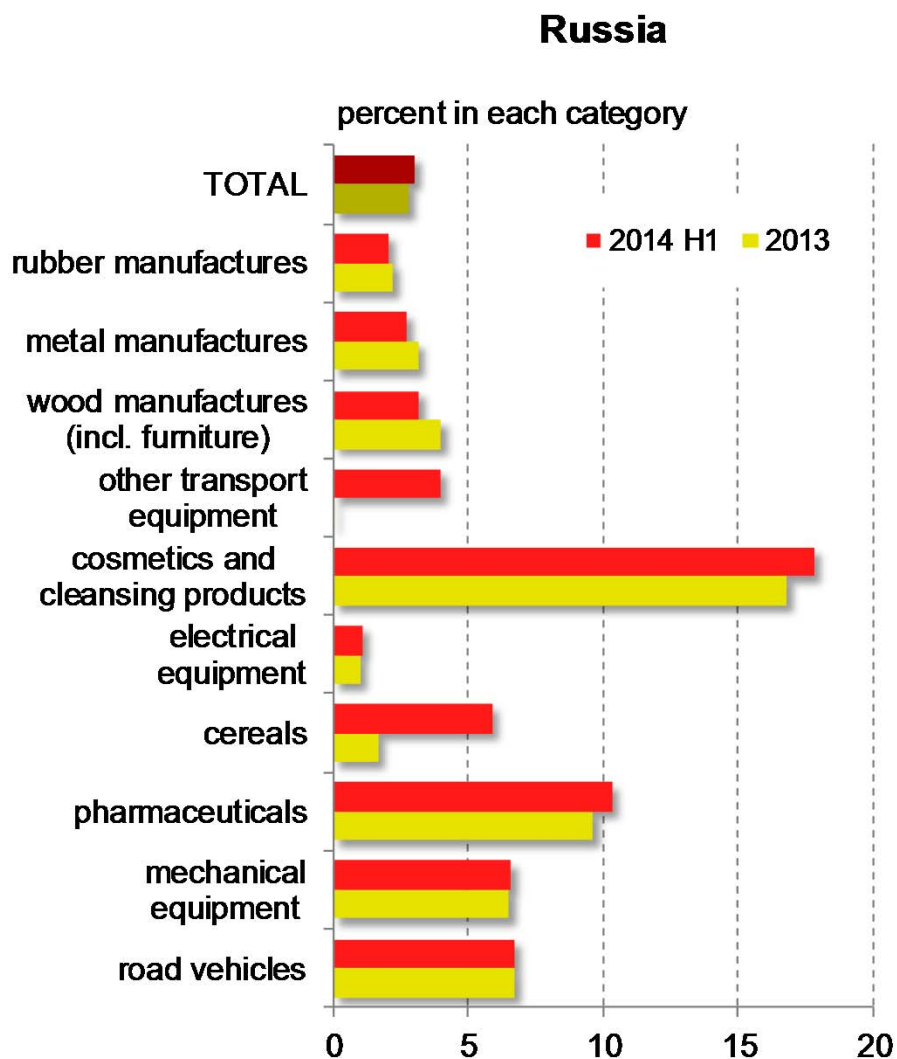
- ✓ Romania's exports to Russia and Ukraine have decelerated somewhat in 2014 H1, however the impact was small on cumulative export growth (-0.6 pp)
 - import food restrictions imposed by RU generated excess supply on the Romanian market, with a temporary downward impact on fruit and vegetables prices
- ✓ Improved energy intensity in the Romanian economy, along with comfortable domestic stocks of natural gas, lowered the economy dependence on gas imports (10% in 2014 H1)

➤ Financial sector:

- ✓ No direct links between the Romanian banking system and those of Russia and Ukraine
- ✓ Limited potential for spillovers through the common lender channel via the exposure of Austrian and French banks to Russia and Ukraine
- ✓ So far the impact of regional tension flare-ups on the capital and forex markets has been moderate and short-lived

- However, assuming the persistence and/or worsening of these tensions, significant changes in the balance of risks might occur, especially via second round effects (from unfavourable financial and confidence shocks)

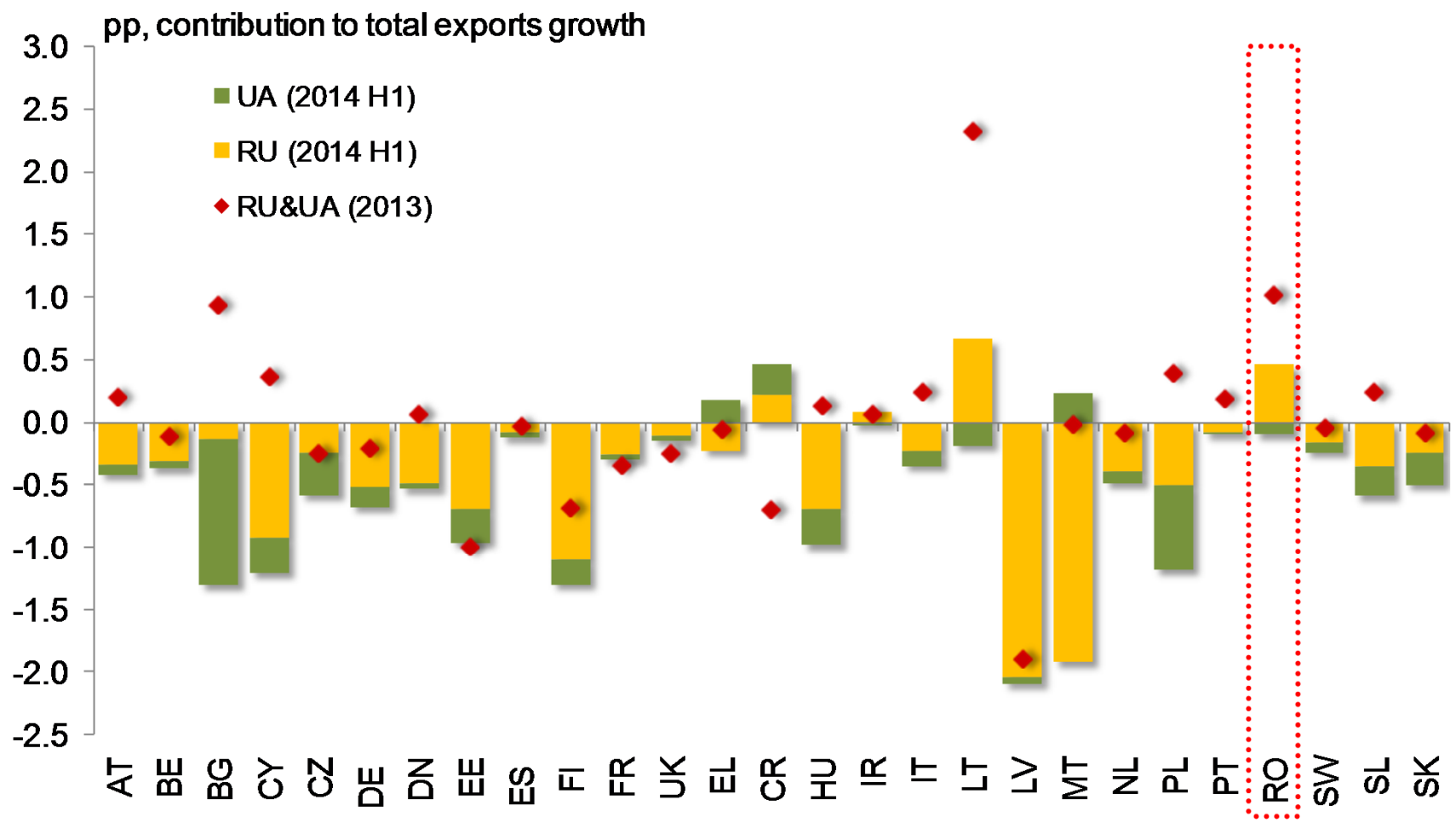
Share of the Russian and Ukrainian markets in Romanian exports



Source: Comext

Decelerating exports to Russia and Ukraine, albeit limited impact (so far) on the overall export growth of EU countries

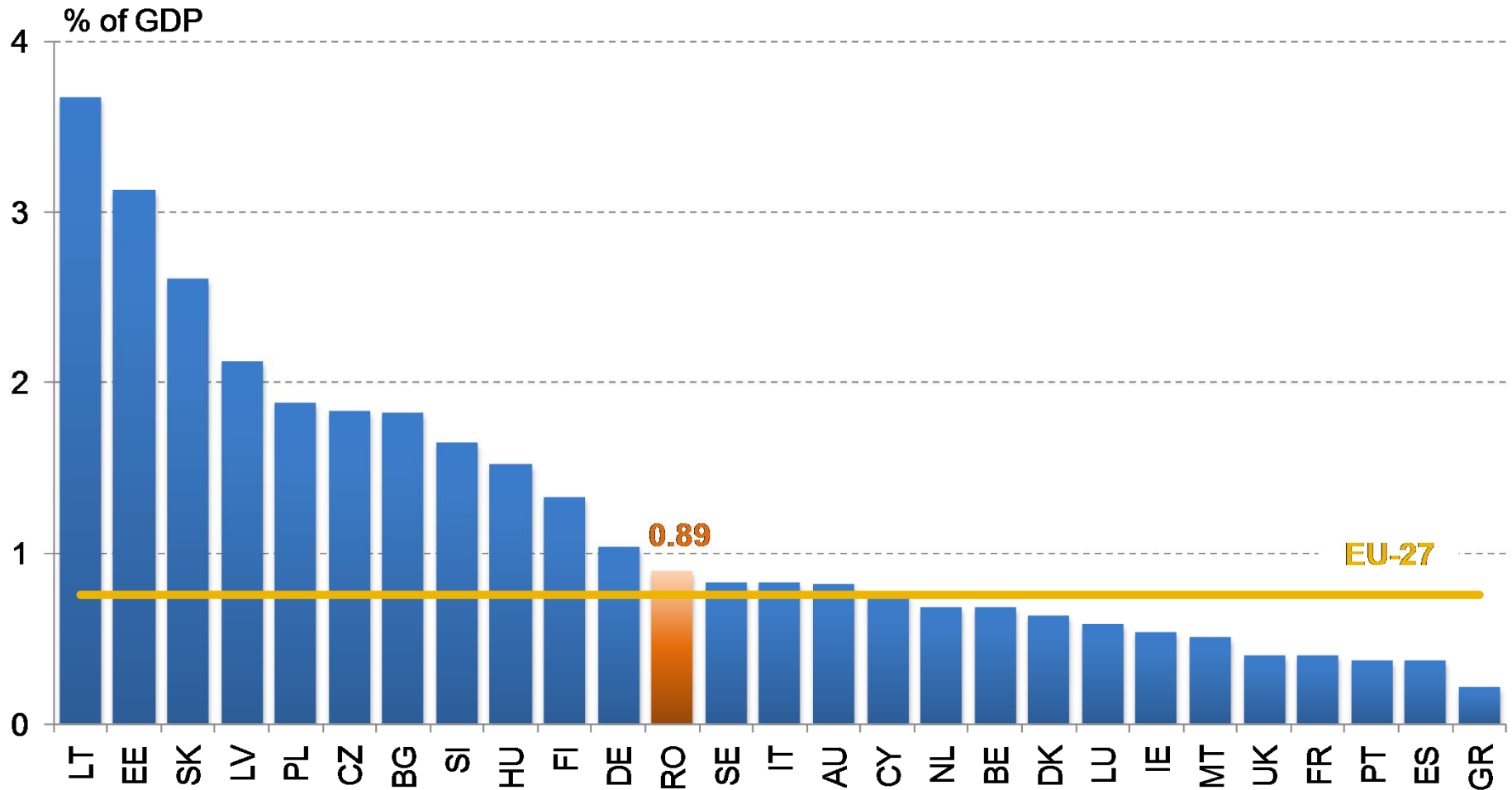
EU Exports to Russia (RU) and Ukraine (UA)



Source: Comext

Overall, Russia had a relatively small contribution
to Romania's GDP

GVA Generated by Russian Demand for Final Goods in 2011

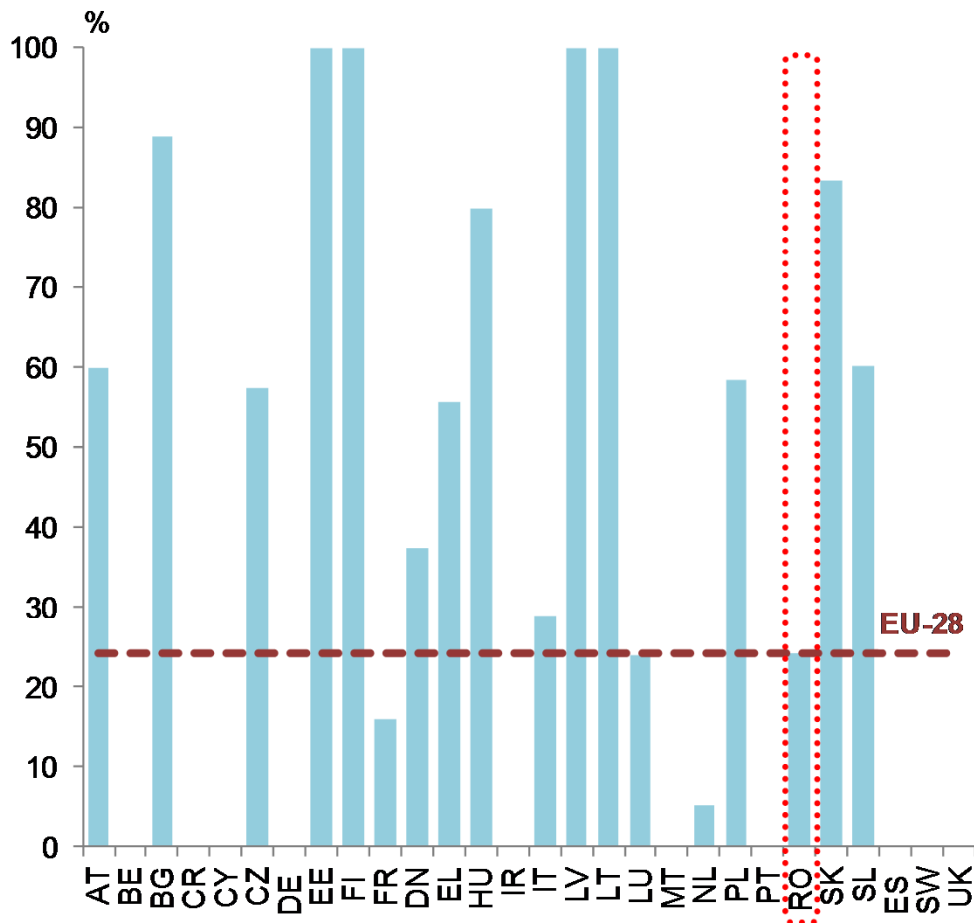


Source: WIOD, NBR calculations

Romania's dependence on imported gas has steadily decreased

Gas Imports from Russia in Total Consumption

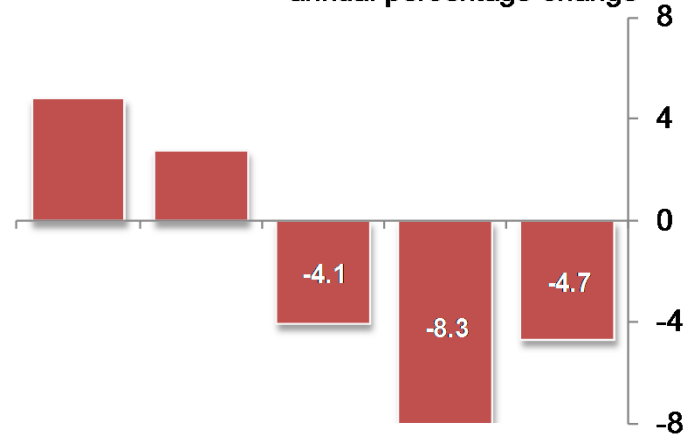
EU - 2012



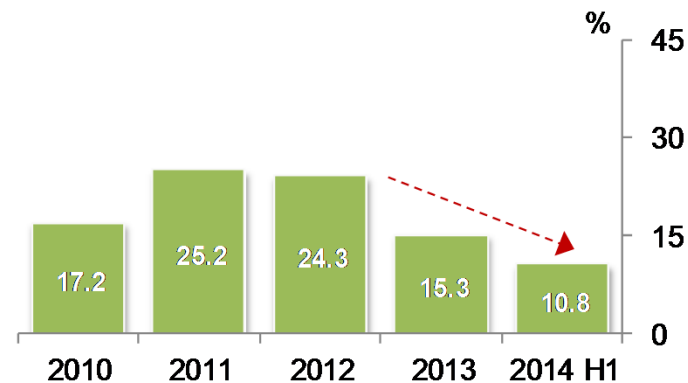
Source: Eurogas, ANRE

RO: Gas Consumption

annual percentage change

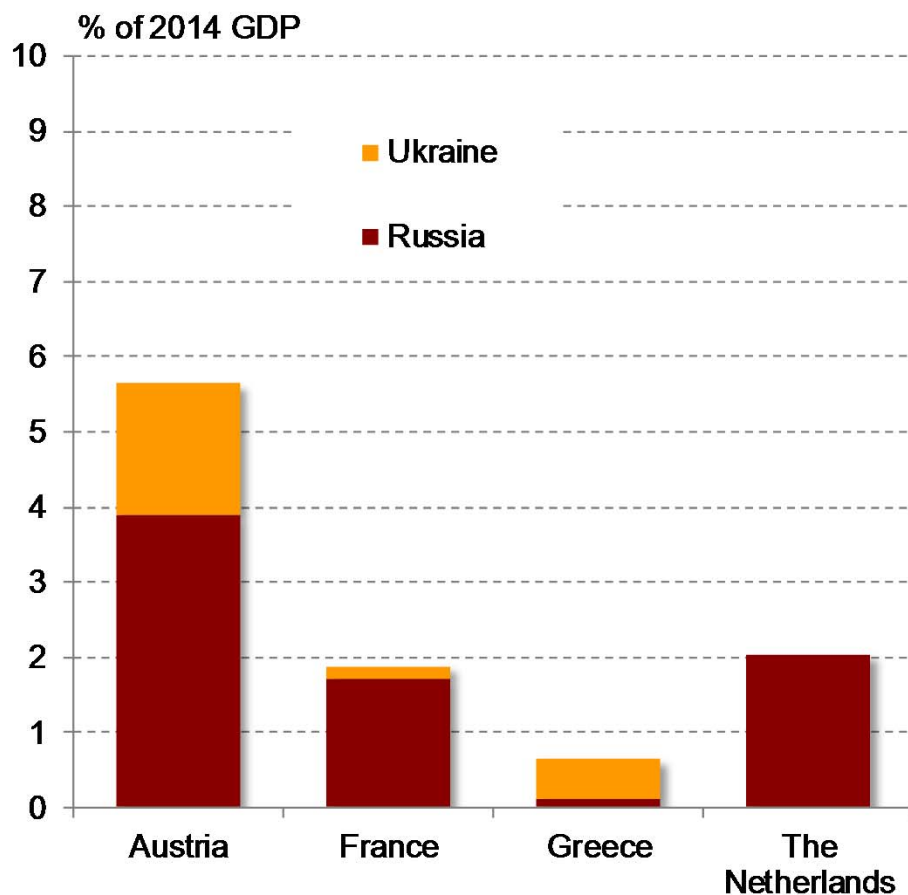


RO: Imported Gas/Consumption



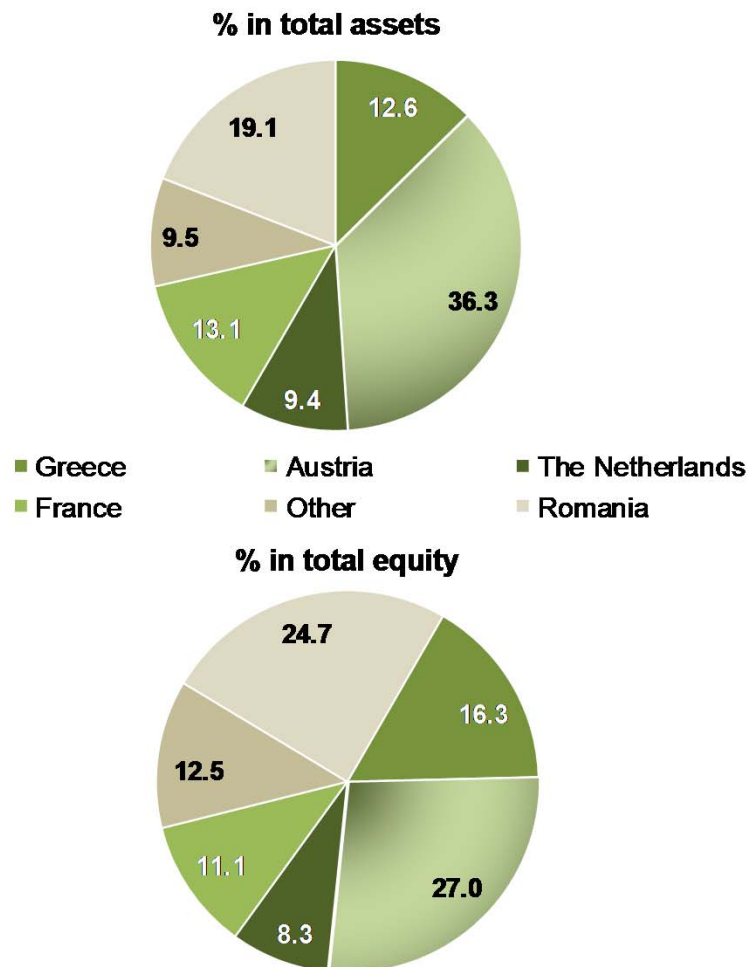
Potential for spillovers (albeit limited) through the common lender channel via the exposure of foreign-owned banks to RU&UA

**Foreign Claims of BIS Reporting Banks
(March 2014)**

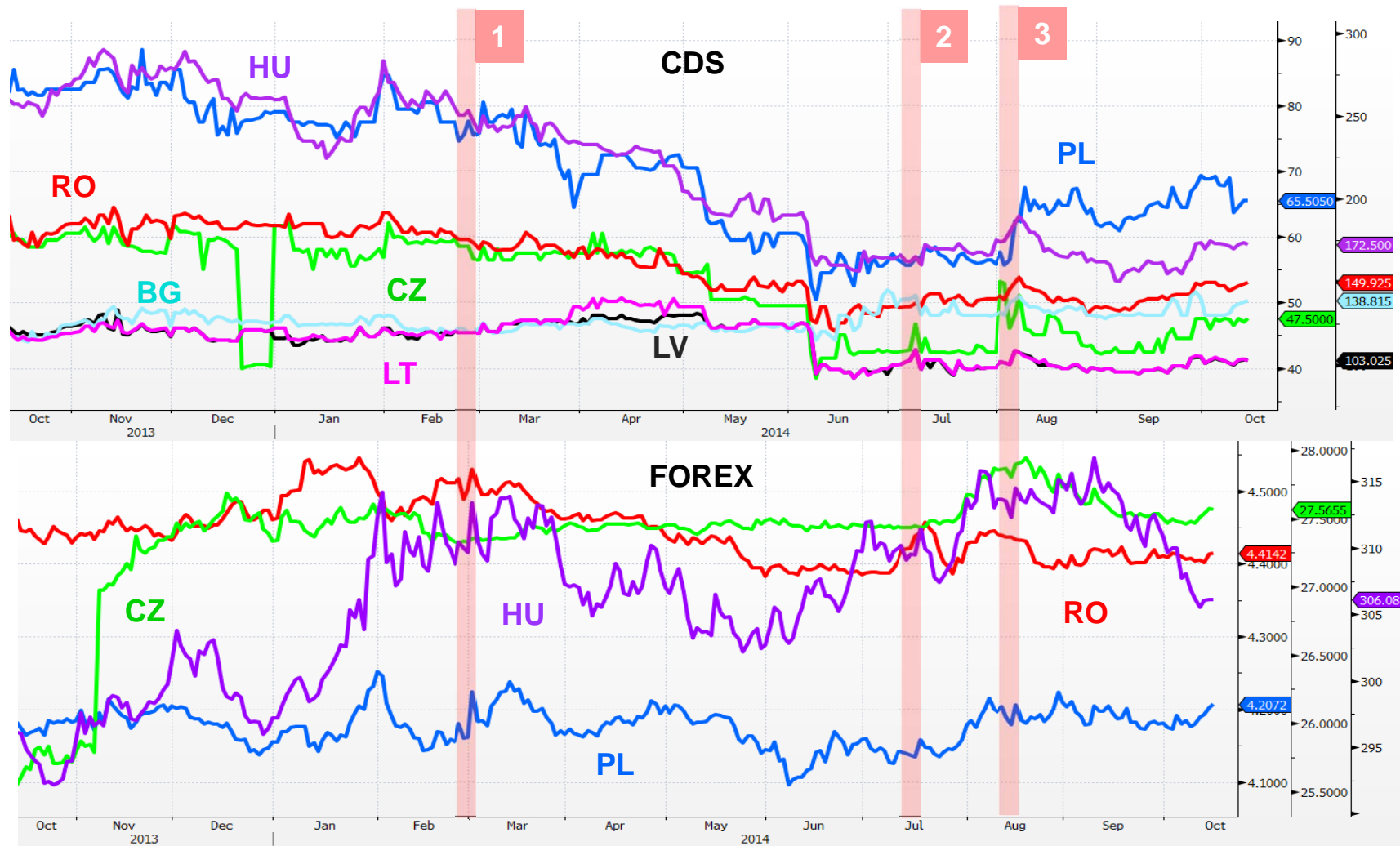


Source: BIS, IMF, NBR

**Banking System Ownership
(August 2014)**



The impact of regional geopolitical tensions on the capital and forex markets has been marginal



1 – Crimea invasion

2 – MH-17 plane downing

3 – More intense fighting in east Ukraine

Source: Bloomberg