UniCredit Bank

Macroeconomic and Strategic Analysis

Quarterly Report

UniCredit Bank

15 October 2024

“Fiscal uncertainty to shape economic outlook”

Outlook – We are downgrading our 2024 growth forecast to 1.7% due to the poor performance in 1H24 and a slower recovery in the EU than we had anticipated, but we are upgrading our 2025 outlook to 1.9% owing to base effects. The private sector will have less funding next year, leading to a slowdown in consumption, while investment is likely to continue to support growth and exports could start to recover. Moreover, we could see better performance in construction, real estate transactions and industry. Inflationary risks remain high and we expect inflation to miss target in 2024-25, with the NBR cutting rates to 5% by the end of 2025 in order to support economic activity. We see EUR-RON moving to a higher trading range of 5.00-5.10 at the beginning of 2025.

The information contained in this report represents UniCredit Group’s view upon Romania, as it was included in the CEE Quarterly report, distributed in October 2024. The report includes updates as of the date of the publication.

Fiscal uncertainty to shape economic outlook

Polls indicate continuity for the Romanian government

Romania entered its busiest and most important quarter of the year on the political front, with parliamentary elections scheduled for 1 December and presidential elections scheduled for 24 November and 8 December (first and second round, respectively). According to the most recent polls, the future government is very likely to include the PSD and the PNL, which are currently polling close to 33% and 22%, respectively. Four more parties could enter parliament, namely the Save Romania Union (USR), polling at around 15%, followed by the Alliance for the Union of Romanians (AUR) at 12%, SOS Romania at around 7% and the Hungarian Minority Party (UDMR) at around 5%. Thus, we expect continuity within the Romanian government, with minor changes (if any) to the current coalition. The polls for the presidential elections indicate no clear preference for a candidate, with the winner likely to be decided in the second round. The role of Romanian president is less important for internal policy than it used to be as the Romanian Constitutional Court has limited the powers of the president.

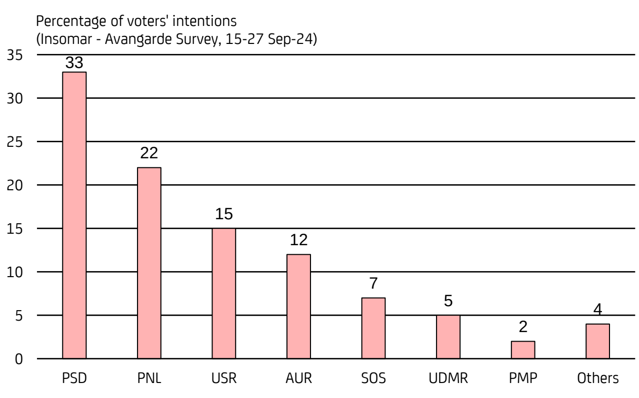
Budget deficit to end 2025 at around 6% of GDP and fall only gradually afterwards

The budget deficit remains very high and although we expect an improvement in 2025, according to our calculations a deficit around 6% of GDP is the best that can be hoped for. We continue to see a rise in taxes as inevitable in 2025, with excise duties, commodity taxes and higher tax rates for most microenterprises being the likeliest. We also pencil in a potential 2pp increase in the main VAT rate on goods and services, but only from the second half of next year. Romanian officials wish to extend the horizon for deficit reduction to seven years from the regular four years, taking advantage of the laxer European fiscal rules for public investment. We believe that the EUR 6.7bn (almost 2% of GDP) in cofinancing to access the EUR 13.7bn under NRRP in 2025-26 could be accommodated in the budget even if the deficit is reduced. We see several risks associated with a long adjustment period: 1. we cannot rule out an economic shock in the following seven years, which would derail the adjustment; 2. there is a persistent risk of capital outflows and lower foreign investment if sentiment deteriorates due to large fiscal and external imbalances; 3. there will be at least one change in government, which might affect old pledges; 4. borrowing costs could increase due to rising public debt; and 5. the retirement of the largest cohort of workers from 2028 will significantly increase the pension bill, while reducing contributions. We do not see any danger of a rating downgrade for now, but a lack of fiscal adjustment next year would increase the risk of future rating actions.

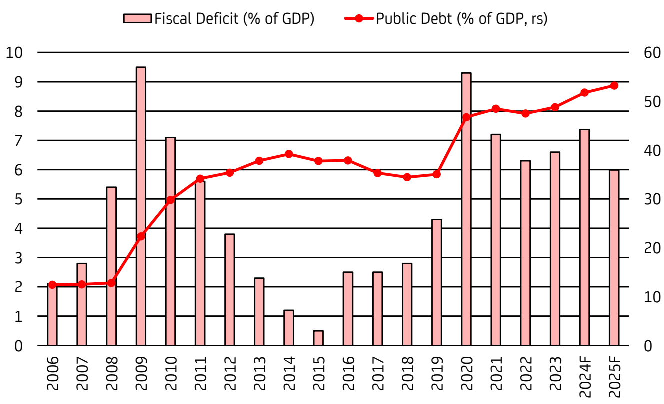
We forecast GDP growth of 1.9% in 2025, helped by base effects…

We forecast GDP growth of 1.9% in 2025, after a below-expectations 1.7% estimated for this year. In our view, the private sector will have less funding next year in light of plans to reduce the budget deficit. This could come through 1. the government improving revenue collection or increasing taxes and/or 2. public sector salaries growing by less than anticipated, leading to a slowdown in consumption, albeit supported by the recent pension hike. In nominal terms, the pension increase amounts to RON 28.5bn (1.5% of

POLLS INDICATE NO MAJOR GOVERNMENT CHANGE



BUDGET DEFICIT HAS EXCEEDED 3% OF GDP SINCE 2019



Source: Ministry of Finance, Eurostat, Polls Insomar-Avangarde, UniCredit Group Investment Strategy

GDP) per year, with only RON 9.45bn being disbursed in September-December 2024 and the remaining RON 19bn expected to support consumption in 2025.

…and several sectors that could see improved development

At the same time, public investment is likely to continue to support growth. The evolution of external demand has so far been weaker than expected. Yet, sentiment indicators are showing optimism for the future (although they remain in contractionary territory), leading us to expect improvements in industry and exports in 2025. Construction will benefit from cheaper loans and larger transfers from the EU, while the number of building permits issued rebounded in 2Q24 across all sectors and is likely to grow further. Real estate transactions could also start to grow again, after an expected contraction this year. The weakness in IT could extend to 2025 and it might take longer before new projects reach Romania to boost the sector. Agriculture could benefit from a favorable base effect as well, as this year's summer drought and extreme temperatures affected agricultural yields on 40% of the area cultivated for wheat, maize, rapeseed and sunflower[1]. Consequently, we expect higher food prices and food imports in 2025. Energy imports could also increase next year during times of extreme weather, unless Romania manages to improve its capacity for storing renewable energy to better manage the mismatch of supply and demand for energy at various times.

We expect the C/A deficit to narrow in 2025 and EUR-RON to increase to the 5.00-5.10 trading range

We expect the structural C/A deficit to narrow by 1pp to 6% of GDP in 2025 amid weaker domestic demand and a possible recovery in exports, with the external shortfall fully covered by FDI, EU transfers and government borrowing from abroad. Thus, we see no significant depreciation pressure on the RON and expect FX reserves to rise further. Yet, we expect EUR-RON to move to the 5.00-5.10 trading range in the first quarter of 2025, followed by a gradual uptrend until the end of the year.

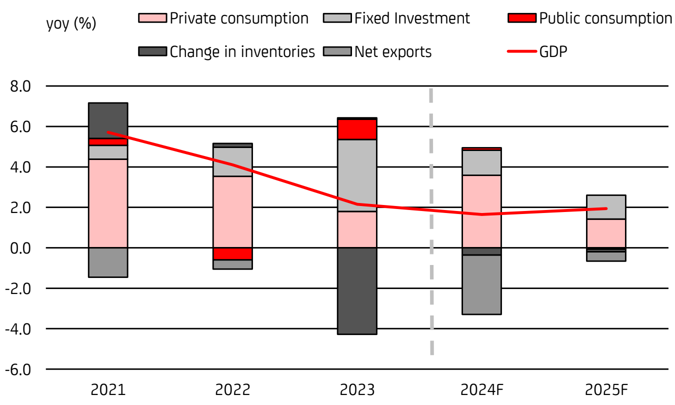
We expect inflation at 5.0% in 2024 and 4.4% in 2025

We forecast inflation will miss the target in 2024-25 due to tax increases and the robust purchasing power of households. Our baseline forecast is that inflation will be around 5% at the end of 2024 and 4.4% at the end of 2025, with weaker domestic demand sending core inflation, excluding tax changes, inside the 1.5-3.5% target range at the beginning of 3Q25. We continue to expect core inflation to remain stickier than in the rest of the region due to a traditionally high propensity to consume. At the same time, headline inflation will remain subject to upside risks in 2025 due to the rising probability of higher food prices, higher energy prices and tax increases.

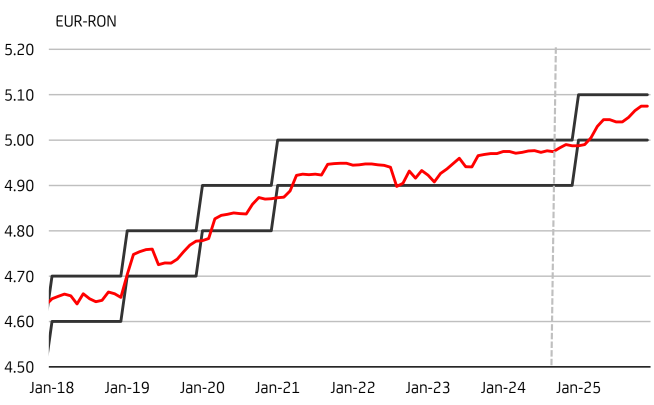
NBR on hold in 4Q24, but to cut the key rate further to 5% in 2025

We expect the NBR to stay on hold in 2024 at 6.5% due to fiscal uncertainty. We believe that the NBR will resume key-rate cuts in February 2025 and will take the key rate down to 5% at the end of 2025, with risks skewed towards faster cuts if the economic activity eases significantly. Monetary conditions are currently much laxer than implied by the key

ECONOMIC GROWTH WILL STAY CLOSE TO 2%



WE EXPECT THE RON TO DEPRECIATE NEXT YEAR



Source: NBR, UniCredit Group Investment Strategy

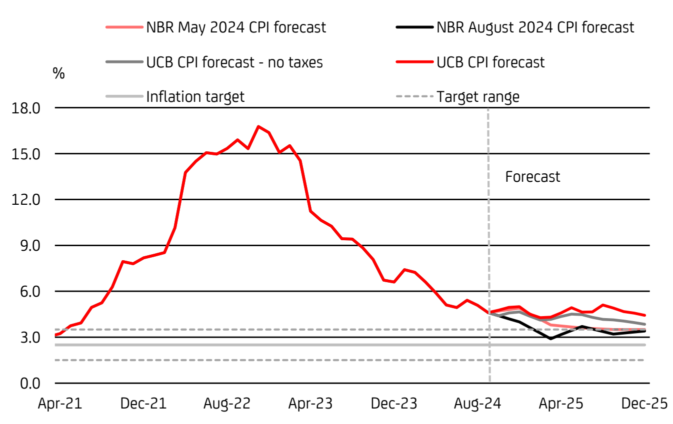
[1] According to statements from the President of the PRO AGRO National Federation

rate, as ample excess liquidity is keeping all ROBOR rates close to the deposit facility. In the event of pressure on the RON or risks of capital outflows, the NBR stands ready to resume reverse repos at the key rate to tighten monetary policy.

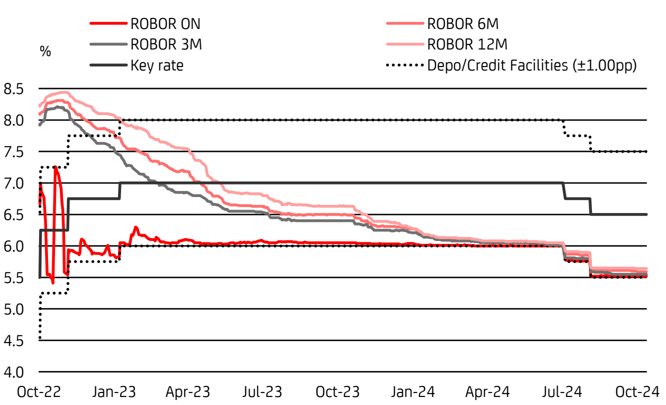
KEY DATES/EVENTS

- 8 November: monetary policy decision
- 12 November, 11 December: inflation
- 14 November, 6 December: 3Q24 GDP (flash, structure)
- 1 December: parliamentary elections
- 24 November, 8 December: presidential elections

ANNUAL INFLATION ABOVE THE TARGET RANGE IN 2024 AND 2025



AMPLE LIQUIDITY KEEPS ROBOR AT THE DEPO FACILITY



Source: NIS, NBR, UniCredit Group Investment Strategy

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MACROECONOMIC DATA AND FORECASTS

	2021	2022	2023	2024F	2025F
GDP (EUR bn)	241.7	284.1	324.6	349.6	374.5
Population (mn)	19.2	19.0	19.1	19.1	19.0
GDP per capita (EUR)	12,567	14,917	17,035	18,346	19,685
Real economy, change (%)					
GDP	5.7	4.1	2.1	1.7	1.9
Private Consumption	7.2	5.8	2.8	5.8	2.2
Fixed Investment	2.9	5.9	14.4	4.6	4.2
Public Consumption	1.8	-3.3	6.0	0.7	-0.4
Exports	12.6	9.7	-1.4	-0.9	4.7
Imports	14.8	9.5	-1.4	5.8	4.9
Monthly wage, nominal (EUR)	1175	1303	1489	1717	1807
Real wage, change (%)	2.0	-2.2	3.6	9.7	1.7
Unemployment rate (%)	5.6	5.6	5.6	5.4	5.6
Fiscal accounts (% of GDP)					
Budget balance	-7.2	-6.3	-6.6	-7.4	-6.0
Primary balance	-5.7	-4.2	-4.7	-5.5	-4.2
Public debt	48.5	47.5	48.8	51.8	53.2
External accounts					
Current account balance (EUR bn)	-17.5	-26.0	-22.6	-24.6	-22.5
Current account balance/GDP (%)	-7.2	-9.2	-7.0	-7.0	-6.0
Extended basic balance/GDP (%)	-1.5	-3.6	-2.9	-3.2	-2.1
Net FDI (% of GDP)	3.7	3.1	2.0	2.0	2.0
Gross foreign debt (% of GDP)	56.5	50.7	52.4	52.8	52.9
FX reserves (EUR bn)	40.5	46.6	59.8	59.7	60.6
Months of imports, goods & services	4.3	3.9	5.0	4.9	4.8
Inflation/Monetary/FX					
CPI (pavg)	5.0	13.7	10.5	5.8	4.7
CPI (eop)	8.2	16.4	6.6	5.0	4.4
Central bank target	2.50	2.50	2.50	2.50	2.50
Central bank reference rate (eop)	1.75	6.75	7.00	6.50	5.00
3M money market rate (Dec avg)	2.83	7.66	6.25	5.66	4.72
USDRON (eop)	4.37	4.63	4.50	4.49	4.49
EURRON (eop)	4.95	4.95	4.97	4.99	5.07
USDRON (pavg)	4.16	4.68	4.57	4.55	4.51
EURRON (pavg)	4.92	4.93	4.95	4.98	5.04

GOVERNMENT GROSS FINANCING REQUIREMENTS

EUR bn	2023	2024F	2025F
Gross financing requirement	**35.1**	**42.9**	**42.0**
Budget deficit	18.2	23.7	20.4
Amortization of public debt	16.9	19.2	21.7
Domestic	14.8	15.0	17.4
Bonds	10.5	7.6	8.0
Bills	1.1	3.7	4.0
Loans and retail bonds	3.1	3.7	5.4
External	2.1	4.3	4.2
Bonds and loans	1.7	3.7	3.9
IMF/EU/Other IFIs	0.4	0.6	0.3
Financing	**35.1**	**42.9**	**42.0**
Domestic borrowing	28.7	27.5	25.0
Bonds	20.6	19.0	18.0
Bills	3.7	4.0	3.0
Loans and retail bonds	4.4	4.5	4.0
External borrowing	12.6	15.0	14.0
Bonds	10.3	14.0	10.0
IMF/EU/Other IFIs	2.3	1.0	4.0
Fiscal reserve change (- = increase)	-6.2	0.4	3.0

GROSS EXTERNAL FINANCING REQUIREMENTS

EUR bn	2023	2024F	2025F
Gross financing requirement	**58.5**	**63.5**	**62.1**
C/A deficit	22.6	24.6	22.5
Amortization of medium and long term debt	14.2	15.9	15.6
Government/central bank	3.0	5.0	5.0
Banks	4.9	4.7	4.4
Corporates/Other	6.3	6.2	6.2
Amortization of short-term debt	21.7	23.1	24.0
Financing	**58.5**	**63.5**	**62.1**
FDI (net)	6.6	7.0	7.5
Portfolio equity, net	0.6	0.1	0.1
Medium and long-term borrowing	26.3	26.4	24.5
Government/central bank	15.0	16.7	15.1
Banks	4.4	3.7	3.5
Corporates/Other	6.9	5.9	5.9
Short-term borrowing	22.7	23.6	23.9
EU structural and cohesion funds	6.6	6.3	7.1
Change in FX reserves (- = increase)	-4.2	0.1	-0.9
Memoranda:			
Nonresident purchases of LC govt bonds	6.7	2.5	2.3
International bond issuance, net	8.6	10.3	6.1

Data Source: Eurostat, NBR, NIS, Ministry of Finance, UniCredit Group Investment Strategy

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Glossary

A comprehensive glossary for many of the terms used in the report is available on our website: https://www.investmentinsights.unicredit.eu/glossary.

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