FRANKLIN TEMPLETON INVESTMENT MANAGEMENT LIMITED UNITED KINGDOM Bucharest Branch
Premium Point Building
78-80 Buzesti, 8th floor
Bucharest 011017
Romania

Tel: +40 (0) 21 2009 600
Fax: +40 (0) 21 2009 631

What to Expect in 2019: Overall Well-performing Economy, Essentially Conditioned by Legal Stability and Investments

2019 Outlook on Romania

By Johan Meyer, CEO Franklin Templeton Investments Bucharest Branch and Portfolio Manager of Fondul Proprietatea

Romania has again been one of the best performing economies in the European Union in 2018, with an estimated 4% real GDP growth year-on-year. However, following record growth and significant acceleration in the last couple of years, Romania's economy is currently set for a rather uncertain future. The unexpected fiscal changes in critical sectors of the Romanian economy adopted in December 2018 presents the risk to severely impact the country's growth potential

In our view, 2019 will bring along a decrease in private consumption growth, moderate inflation, low unemployment, as well as upward pressure on interest rates. This year is also set to be the playing field for a host of rising imbalances – widened current account deficit and budget deficit, as well as rise of inflation, which should be tackled however in a transparent and consistent way. While the macro-economic indicators are still likely to be sound, much of their evolution depends on the Romanian State's capacity to attract, facilitate and manage investments, as the need for inflows of investments – including via EU funds absorption – will become more pronounced.

Romania's growth was heading towards a moderate slow-down in 2019 compared to 2018 even before the adoption of Government Emergency Ordinance (GEO) 114/2018 at the end of December, which has forced us to reconsider our expectations. On the one hand, we believe the economic deceleration could be even more pronounced, on the other, more accurate predictions are hampered by the uncertainty and lack of impact studies for the measures introduced. Nonetheless, we believe the measures introduced could have dire and far-reaching effects, including for the capital market.

Top sectors and trends to watch out for in 2019

We believe 2019 will mark a downwards trend for consumer sector, as well as further upward movement of the interest rates, in order to ensure that inflation remains under control. We estimate a moderate level of inflation of 3-4%.

Our expectations regarding the energy sector have changed following the adoption of GEO 114/2018. While we had initially been quite optimistic regarding its potential for job creation and contribution to State revenues on the long-term, the capping of gas and energy prices and new taxation regime , but also potentially put the country's energy independence at severe risk.

The banking sector has been hit hard, too. The recently introduced tax on bank might backfire, creating a snowball effect for the entire economy, especially on the background of growing

FRANKLIN TEMPLETON INVESTMENTS

FRANKLIN TEMPLETON INVESTMENT MANAGEMENT LIMITED UNITED KINGDOM Bucharest Branch
Premium Point Building
78-80 Buzesti, 8th floor
Bucharest 011017
Romania

Tel: +40 (0) 21 2009 600
Fax: +40 (0) 21 2009 631

macroeconomic imbalances which call for prudent, market-friendly fiscal policies. In fact, with such a measure, Romania inexplicably inflicts pain on itself and it is regular citizens who will probably have to pick up the bill eventually.

On the other hand, infrastructure remains an area with perpetual – but never fulfilled – potential, while Romania's labor market continues to be anchored in strong figures. Unemployment is likely to remain at a low rate, below 5%, but more and more companies complain of a growing deficit of skilled workers. We encourage the authorities to make the labor market more easily accessible for foreign laborers in sectors where there are critical needs. Other sectors worth keeping an eye on include real estate, agriculture and IT.

In this complex context, it is crucial for Romania to foster an environment where companies are confident to invest in businesses on the long-term, so that they continue generating income for the State in a sustainable way though dividends and taxes on profits. A sound governmental investment strategy coupled with a predictable legal and regulatory framework that works to the benefit of – and not *against* – the private sector will be of particular use. Equally important for the country's overall economic performance will be the maintaining of the budget deficit below 3%.

The capital market to remain attractive, yet in need of higher liquidity

The Romanian capital market remains attractive, providing a high dividend yield, as we have witnessed at the end of 2018. Nevertheless, foreign investors currently face options mainly limited to two sectors – energy and financial services. As such, the capital market's "2019 wish-list" should include the listing of large SOEs from a variety of fields, as a means to encourage capital market investments, and through the resulting increase of liquidity, a prerequisite for Romania to acquire the Emerging Market status.

It is worth taking a lesson from the end-of-year capital market crash, which happened in reaction to the Government's unexpected announcement of harsh fiscal measures, as a reminder that an unpredictable legal framework can single-handedly threaten investors' confidence and implicitly the stability of the entire capital market. Moreover, the changes on the private pension system risk damaging the Pension Pillar II and the sustainability of the future pensions will become uncertain. These specific measures can have significant impact on the entire capital market, whose growth has been steadily supported by the private pension funds in the last years.

In conclusion, we believe that Romania remains an attractive investment destination in 2019, with the economic landscape remaining fertile, while significantly more volatile compared to last year. There is much potential to be tapped into, but it is crucial for the Government and lawmakers to foster a predictable, legally-stable environment that encourages and facilitates investments, in addition to carrying out sound economic policies engineered for a longer-term horizon.