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Outlook on Romania for 2016

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Romania has been one of the best performing economies in the European Union in 2015. The growth rate for Q3 places it second in the EU, after the Czech Republic, and we estimate an overall increase of the GDP close to 4% for 2015. We also expect further acceleration for 2016, backed by the expansion of domestic consumption, investments supported by improved absorption of EU funds and low level of interest rates. Domestic consumption has picked up significantly in 2015 (nearly 5% growth) and it should further accelerate this year as a result of lower value added tax (VAT) and of salary increases in the public sector. As a result, the growth rate might even exceed 5% this year.

The macroeconomic fundamentals are also positive – the debt is less than 40% of the GDP, the budget deficit has been under control for several years, the current account deficit for the first time in 25 years is less than 1% of GDP and inflation is, as well, at record lows. Romania is, thus, in a good shape after the programme with the International Monetary Fund.

The high rate of the economic growth, along with the strong fundamentals and the positive perspectives should result in an improvement in foreign direct investments flow, which should also be helped by the trend of relocation of production capacities from Western Europe. Moreover, Romania's attractiveness for investors should also be boosted by fiscal improvements, such as the reduction of VAT from 24% to 20%, which entered into force at the beginning of this year, and the further cut to 19% starting 2017, the reduction of dividend withholding tax from 16% to 5% and the elimination of the special constructions tax starting 2017.

This year will be marked by two electoral campaigns which usually generate volatility that may affect investors' decisions in the short term, but we hope they will not interfere with the reformist agenda undertaken by the new Government and which is determinant for continuing the strong FDI and portfolio investments flows in Romania.

It is also important for the fight against corruption to continue, as it should lead to improvement of governance and increased efficiency of state institutions, which are the backbone to economic activity.

Sectors where we see growth potential are energy, transport, IT, banking, constructions, agriculture and healthcare. The IT and agriculture, for example, have an increasing share in the GDP - the IT industry accounts for 6%, but, in our view, it has the potential to reach at least 10% of GDP in the coming years due to the strong networking infrastructure, low costs and the labor skills base. Also, the agriculture sector's huge potential is still waiting to be unlocked, with the most important opportunity for large players in this sector remaining the absorption of EU funds.



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The capital market also has a strong potential to develop and this was visible last year, given the fact that it was among the only three frontier markets which recorded a positive performance in 2015. We consider that the new government should take advantage of this momentum, by going forward with the structural reforms, continuing the proper implementation of corporate governance standards, which result in increased profitability and efficiency in SOEs, respecting the liberalization schedule of electricity and gas prices and by listing companies on the stock exchange.

IPOs represent the key driver in developing the capital market, which currently stands at 14% of the GDP, one of the lowest levels in the region (Poland 64%, Hungary 55%, Austria 26% and Czech Republic 22%). New companies on the stock exchange would not only boost the liquidity and attract new investors, but could also ensure a higher exposure of the pension funds to the local capital markets (they can currently invest up to 35% in equities), as well as continued growth of mutual funds sector. Only new IPOs could support the upgrade of the local capital market to emerging market status from the current frontier one.

An important point of attraction for investors is the fact that Romania's market is undervalued. However, in light of strong economic growth and very positive perspectives, the gap between perceived valuations and fundamentals will start to close. Therefore we think that now is the right time for investors to consider buying Romanian equities.

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