

Romania update

The credit crunch and the Romanian market May, 2008

General macro review

GDP-expectations of 8% for 2008

The first quarter of 2008 saw a 7.5% increase in GDP, the highest jump since 1990 according to data released by the Ministry of Economy and Finance. According to estimates from this institution, services increased 6.7%, while construction went up 32%. Also, a role was played by the 2% fall in primary energy consumption. Linked with a good agricultural year, some estimate GDP will grow 8% in 2008.

Inflation

The annual inflation rate reached 8.63% yoy at the end of Q1 mainly as a result of the domestic currency depreciation and the increase in fuel prices. These have driven energy and transportation costs. However, current estimates from the National Bank place year end inflation around 6%, the improvement being expected to come from the results of a good agricultural year reversing food price inflation.

FX rate: slight strengthening of RON at the end of April.

Given the existing macroeconomic imbalances, the RON remains exposed to any deterioration in the international markets. The main risks the RON is exposed to are:

- A downgrade in country rating/outlook
- Increase in wages above labour productivity

On the other hand, positive impact could come from:

- new monetary policy rate increases by NBR
- Improvement in investors' sentiment

Exchange rate forecast

Currency	Apr-08	Jun-08	Sep-08	Dec-08
EUR/RON	3.68	3.65	3.50	3.50
USD/RON	2.36	2.40	2.41	2.45

Source: Raiffeisen Bank estimates

NBR monetary policy rate at 9.75%

On May 7, 2008, NBR raised the reference interest rate 20 bps to 9.75%. According to NBR, it will continue to pursue a firm management of money market liquidity via open-market operations. The main reason for the new increase in interest rates is of course the high level of annualized inflation rate (8.6%) which if not countered by a strong position could result in a wage inflation spiral.

Consolidated budget at surplus

The total consolidated budget registered a 0.14% surplus at the end of the 4 months of 2008 (press releases from the Minister of Finance). Total revenue was RON 62.15 billion (compared to RON 38.3 billion for the same period last year) while expenses reached RON 61.5 billion.

Consumption and production still growing

Household consumption remained strong at the beginning of the year with increases in retail sales (18.3% yoy in Jan-Feb) and in the turnover volume of market services to the population (13.8% yoy). Of course, this excess of aggregated demand in the economy has a downside effect on inflation rates.

Apartment prices in Bucharest getting flat

The average price per square meter in Bucharest at the beginning of May around EUR 2,070 only 1% higher than in March and only 2% above January 2008, according to an index computed by Ziarul Financiar (the index is based on 2 bedroom apartments built between 1980 and 1990). This follows a year when the increase was 4-5% per month.

The credit crunch and the Romanian market

Currently Eastern European countries and Romania in particular show less evidence of being affected by the US credit crunch. Of course, the consumers are acting cautiously and some of the very expensive apartments in Bucharest remained un-sold, but at the same time, there has been no evidence of increasing defaulting rates on existing mortgages or on the reduced availability of mortgage products.

Threats and mitigates

Liquidity shortage

It can be argued that the continuing worsening of global credit conditions could make life more difficult for the fast-growing economies of Eastern and Central Europe. So far, Eastern European economies have seen growth rates twice those in more mature markets, mainly on the back of foreign investments. But with Western finance providers tightening conditions, liquidity may become a problem in the near future.

However, there is a structural excess of liquidity in the Romanian banking system. This is mainly the result of higher RON denominated deposits than credits. Over time, people have preferred RON deposits because interest rates were higher than FX ones, while they have borrowed in FX because of lower interest rates. Consequently many of these RON surpluses have been either invested in government securities or placed with the NBR.

FDIs and the level of debt

All FDIs flowing into the country are creating more and better paid jobs. At the same time, debt is still new to Romania, but it is catching on fast. Mortgage debt for 2007 was estimated to be around 3% of GDP. Although rising fast (30%+ p.a.) it is coming from a very low level. Even with the level of mortgage debt increasing, most Romanians already own an apartment and by trading that the level of debt is actually around 20%-30% of a new property

Romania Household Forex Borrowing March 2008

According to NBR data, household borrowing continued to rise in March. Household borrowing in RON went up by 43% on the same month last year, while household FX borrowing (mainly EUR) was up a 140.3%. However, the total balance as of March 2008 actually went down a little from 142.3 % in February and 143.4% in January.

The new residential stock

There is no doubt that there is a huge shortage of new build product on the market. According to a survey conducted by Ziarul Financiar, around 8,000 new homes, which are parts of projects started in 2006 or 2007, will be delivered to their owners in 2008, about 5 times more than in 2007. However, it could be argued this is very low for a city of 3 million.

But apart from these fundamentals sustaining the long term growth, the current market turbulences have discouraged many of the speculative investors. So, in the short term, many developers that have based their plans on such a client base (some of the residential developments have been bought 50% by speculative investors) will be affected, while developers that have always targeted the final consumer will still manage.

The Romanian real estate market

Opinions and strategies differ between investors.

Some investors on the Romanian real estate market have announced they will alter previously announced plans or completely disinvest their assets. Equest and Fabian, listed with the London Stock Exchange, announced the plan to sell assets bought a few years ago. Equest says it will leave Romania's market, following difficulties encountered in receiving financing.

Other investors are instead very optimistic about the country's potential and plan significant investments in the real estate market. ING Real Estate Development (ING RED), announced investments worth at least EUR 600m in Romania, and views the financial shock caused by the subprime mortgage crisis as positive for large investors, especially as a result of speculators exiting and moving further east. The portfolio is expected to include residential (40%), retail (40%), with the rest distributed among logistics and offices.

Differences between Bucharest and second tier cities

The residential market in Bucharest appears to be showing some early signs of a slowdown, mostly due to demand and offer rumors circulating on the market. In the short term these rumors that the residential market will decrease could cause consumers to be more cautious. But, in the long term only purchasing power is the real factor to influence the evolution of the market. Of course these short term negative outlooks will most probably determine a reduction in speculative investors, with the upside being that they will be replaced by long term investors.

The most affected city is expected to be Bucharest, where estimates are that in the short term prices will stagnate or even decline. This is mostly because Bucharest has also witnessed the most rapid increase in real estate prices.

However, the situation is different in second tier cities. These cities such as Constanta have been less exposed to rapid growth in prices while at the same time population growth, infrastructure and economic development was not as widespread.

As such, market reports suggest real estate prices in these secondary locations will increase between 5-15% in 2008, driven by infrastructure and economic development of the region.

Constanta as a region will benefit from EU regional funding to various infrastructure projects including, motorways, rail links and canal transportation which will significantly enhance the local economy providing further momentum to the growth of industries around the Port of Constanta – the largest on the Black Sea and 4th largest in Europe.

Furthermore, the region will continue to prosper from the development in tourism through the expansion of the Constanta airport, which is attracting an increasing number of international carriers (including Ryan Air in 2008), large commercial leisure projects on Mamaia and the planned construction of the channel between Lake Ovidiu (Lake Siutghiol) and the Black Sea.

An interesting 2008

After joining the EU Romania has witnessed record rates of economic growth and it is still considered cheaper than the other eastern European countries that joined the EU in 2005. But there is concern that as financial turbulences continue around the world, it could hit investor confidence in countries like Romania as well.