ROMANIA: After export boom in 2013 recovery of consumption and investments expected

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Romania was one of the fastest growing European economies in 2013, driven by soaring exports of goods and services. One-time factors of growth such as the bumper harvest are expected to expire in 2014, reducing the rate of growth which may recover again in 2015 and 2016. The expanding, competitive manufacturing sector can drive further growth if external demand improves, FDI keeps flowing in and current infrastructure investment projects are finalised. While an IMF precautionary agreement anchors fiscal policy also in 2014, structural reforms and legislative improvements are expected to proceed sluggishly due to political crisis at the government level and the upcoming presidential elections.

Romania was one of the fastest growing European economies in 2013, with GDP up by about 3.5%. Growth was the result of improving net exports first of all, while consumption grew only marginally and gross capital formation declined. Manufacturing production and exports were robust especially in the sectors of transport equipment, electrical appliances and chemical products. Also other sectors of the economy including agriculture, communication and services showed upward trends. The setback of investment mirrored the government's efforts to terminate some costly projects and also the ongoing credit squeeze in the private sector. One-time factors of growth such as the bumper harvest or the success of a new Dacia model are expected to expire in 2014, reducing the rate of growth which may recover again in 2015 under normal external and internal conditions.

Economic policy has been firmly anchored in the IMF stand-by agreement. This stipulates prudent fiscal policy, accelerating structural reforms and diminishing fiscal arrears. As a precautionary agreement with quarterly assessments, it provides for the main components of economic policy and lends it political credibility. At the same time, it relieves the government of some of its responsibility and allows for half-hearted ownership reforms. Reforms important for strengthening democracy suffer delays and contain inconsistencies due to weak administrative capacity and governance (civil code, territorial re-organisation, constitutional amendments). In a wider context, 2014 is the year of European and, more importantly, presidential elections and all political forces are eager to improve their positions. It is part of this game that the liberals left the governing coalition in late February, while the Social Democrats have maintained a parliamentary majority. The outgoing President Traian Băsescu is active stirring conflict while playing the role of an anti-corruption champion. All these recent events signal increasing political uncertainty, but economic policy is not a disputed issue.

Public demand stagnated in 2013 as fiscal austerity continued with both revenues and expenditures being below the previous year in real terms. Collection of VAT and excises fell short of schedule due to sluggish consumption of the population. The budget rectification of October cut back expenditures in order to achieve the deficit target. On the positive side, fiscal discipline of local authorities improved, their payment arrears almost disappeared. The structure of fiscal outlays changed, lower investment outlays were offset by an expanding wage bill. Several construction projects were halted as the government focused on fewer but more realistic motorway projects as well as on accessing EU funds. The absorption rate doubled to 33% and the application rate finished at 92% at the end of the last eligible year. The country has now three years left to realise the EU-funded projects and to spend the allocated funds. The budget law stipulates further deficit contraction in 2014 (the medium-term target is a 1% of GDP deficit in 2017), allowing for some expansion of expenditures in real terms if adequate revenues can be collected. The government will continue the policy of raising excise taxes and increasing the royalties from oil and gas extraction, while the minimum wage goes up in two steps to RON 900 by the middle of the year.

In its national investment and job plan the government supports higher energy independence, discovery of new resources and new projects with high environmental standards, rural development, and farm modernisation. The development of industrial parks and assistance to SMEs are also on the agenda. The main projects are either privately or EU financed. The gold mining project at Roşia Montană was stalled in 2013 but not taken off the agenda. The oil and gas explorations in the Black Sea continue and exploitation has started. OMV Petrom will continue its almost EUR 1 billion investment in the development of new extraction projects. Two thermal power stations are under construction. The government plans to complete blocks 3 and 4 of the Cernavodă nuclear power station but has not found adequate funds and contractors yet. The investment projects in industry are more concrete as the major international companies such as Dacia, Ford, Daimler and Oracle continue expanding their facilities. The extension of the highway network is a priority of the infrastructure projects. About 230 km has been completed and this length should double by 2018 in the framework of EU-financed TEN-T projects. The main aim is to establish a connection between the Western border and Bucharest (the section to the seaport Constanţa is in use).

Wage increases in 2013 were modest in the private sector and unit labour costs in industry diminished for the first time in two years. Nominal wage growth was to a large extent compensated by inflation. Consumer prices increased in comparison with the previous year, first of all due to the carry-over effect of food price rises. By the end of 2013 inflation came down to below 2% annually but may have been boosted by currency weakening in the subsequent month. Excise duties and gas prices were repeatedly increased in 2013 and administrative price adjustments continue in 2014. There is a 4% pension and public sector wage fund indexation for 2014 which allows for a modest increase in the real disposable income.

The National Bank of Romania (BNR) started a period of rate cuts in mid-2013, bringing down the policy rate to 4.25% as of October and 3.5% in February 2014. It may stop at this point and the policy rate may remain positive in real terms to buffer capital inflow volatility. It seems that this threat is diminishing as the current account has become almost balanced and central bank reserves stocked up after depletion in the previous year. Monetary easing has lowered the cost of borrowing but banks have become more prudent in selecting customers, due to high and still rising non-performing loans rates. The government started a new loan guarantee programme to lower the risk and make new loans more easily accessible, at least for financially sound companies. A relief to households indebted in foreign currency may be introduced after a political agreement on its terms has been reached.

The nearly balanced current account is a novelty in Romania. This development is due to sweeping changes in several of its positions. Exports of goods and services increased at a double-digit rate while imports stagnated in 2013. The improved trade balance indicates that sales of Romanian products responded well to external market conditions while subdued domestic demand kept down imports. Services exports boomed exceptionally strongly and unprecedented surpluses were achieved in transports, partly due to changes in the reporting methodology.

The government continued its hesitant approach to the privatisation of state-owned companies. Several attempts have failed in recent years due to inadequate preparation of the privatisation process. More success was achieved by stock exchange listings of minority shares in state-controlled companies: 15% of Transgaz shares and 10% Nuclearelectrica. Further listings are planned for 2014, including the electricity companies Electrica and Hidroelectrica and the power complexes Oltenia and Hunedoara. Still there remain a number of state-owned companies which make losses and are in arrears with paying their suppliers.

Business sentiments have improved in recent months and foreign demand also seems to strengthen. Beyond exports, some of the factors of domestic demand are bound to improve in 2014. But agricultural production and rural consumption are to return to normal which is below the level of the previous year causing a setback in the rate of economic growth. The wiiw GDP forecast reckons with substantial risks both concerning external and domestic demand. The primary reason is that the current growth path is very narrowly based; it is a handful of foreign subsidiaries (beyond agriculture) which are responsible for the 2013 take-off, while insolvency and non-performing loan exposure depress the SME sector. Only a relief in the latter field would allow economic growth to rise again beyond 3%.

Table 1 / Romania: Selected Economic Indicators

	2009	2010	2011	2012	2013 1)	2014	2015	2016
							Forecast	
Population, th pers., average 2)	20367	20247	20148	20077	20000	20000	20000	20000
Gross domestic product, RON mn, nom.	501139	523693	557348	586750	626300	660600	698800	741400
annual change in % (real)	-6.6	-1.1	2.2	0.7	3.5	2.4	2.7	3.0
GDP/capita (EUR at exchange rate)	5800	6100	6500	6600	7100	.	.	.
GDP/capita (EUR at PPP)	11700	12400	12900	13500	14300	.	.	.
Consumption of households, RON mn, nom.	304667	327242	345047	358514	371100	.	.	.
annual change in % (real)	-10.4	-0.3	1.2	1.0	0.5	1.0	1.5	2.0
Gross fixed capital formation, RON mn, nom.	122442	129422	144558	156928	156800	.	.	.
annual change in % (real)	-28.1	-1.8	7.3	5.0	-3.0	4.0	3.5	5.0
Gross industrial production 3)								
annual change in % (real)	-5.5	5.5	7.4	2.4	7.8	5.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	-2.2	1.0	8.9	-21.9	24.9	.	.	.
Construction industry 3)								
annual change in % (real)	-15.0	-13.2	2.8	1.2	-0.4	.	.	.
Employed persons, LFS, th, average	9243.5	9239.4	9137.7	9262.8	9300.0	9300	9400	9500
annual change in %	-1.3	0.0	-1.1	1.4	0.4	0.0	1.1	1.1
Unemployed persons, LFS, th, average	680.7	725.1	730.2	701.2	740.0	.	.	.
Unemployment rate, LFS, in %, average	6.9	7.3	7.4	7.0	7.4	7.3	7.0	7.0
Reg. unemployment rate, in %, end of period	7.8	7.0	5.2	5.5	5.7	.	.	.
Average monthly gross wages, RON	1845	1902	1980	2063	2166	.	.	.
annual change in % (real, gross)	-0.8	-2.8	-1.6	0.8	1.0	.	.	.
Average monthly net wages, RON	1361	1391	1444	1507	1579	.	.	.
annual change in % (real, net)	-1.5	-3.7	-1.9	1.0	0.8	.	.	.
Consumer prices (HICP), % p.a.	5.6	6.1	5.8	3.4	3.2	2.5	3.0	3.5
Producer prices in industry, % p.a.	2.4	4.4	7.1	5.3	2.0	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	32.1	33.3	33.9	33.6	32.0	.	.	.
Expenditures	41.1	40.1	39.5	36.6	34.5	.	.	.
Net lending (+) / net borrowing (-)	-9.0	-6.8	-5.6	-3.0	-2.5	-2.4	-2.2	-2.0
Public debt, EU-def., % of GDP	23.6	30.5	34.7	37.9	38.0	38.0	39.0	40.0
Central bank policy rate, % p.a., end of period 4)	8.00	6.25	6.00	5.25	4.00	.	.	.
Current account, EUR mn	-4938	-5476	-5921	-5851	-1506	-3000	-4700	-5000
Current account, % of GDP	-4.2	-4.4	-4.5	-4.4	-1.1	-2.0	-3.0	-3.0
Exports of goods, BOP, EUR mn	29091	37333	45281	45022	49563	53000	56700	60700
annual change in %	-13.6	28.3	21.3	-0.6	10.1	7.0	7.0	7.0
Imports of goods, BOP, EUR mn	35959	44901	52664	52393	52986	56200	59600	63200
annual change in %	-31.8	24.9	17.3	-0.5	1.1	6.0	6.0	6.0
Exports of services, BOP, EUR mn	7061	6622	7253	8395	10327	10900	11600	12300
annual change in %	-19.3	-6.2	9.5	15.7	23.0	6.0	6.0	6.0
Imports of services, BOP, EUR mn	7352	6216	6911	7264	7740	8200	8700	9200
annual change in %	-9.1	-15.5	11.2	5.1	6.6	6.0	6.0	6.0
FDI inflow, EUR mn	3490	2227	1798	2127	2713	2500	3000	3000
FDI outflow, EUR mn	-61	-12	-25	-88	100	.	.	.
Gross reserves of NB excl. gold, EUR mn	28249	32606	33166	31206	32525	.	.	.
Gross external debt, EUR mn	81206	92458	98724	99681	96442	.	.	.
Gross external debt, % of GDP	68.7	74.4	75.1	75.8	68.0	.	.	.
Average exchange rate RON/EUR	4.2399	4.2122	4.2391	4.4593	4.4190	4.47	4.45	4.45
Purchasing power parity RON/EUR	2.1082	2.0873	2.1466	2.1574	2.1904	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2011. - 3) Enterprises with 4 and more employees. - 4) One-week repo rate.
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.