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## **Romania: growth and disinflation continue**

The high rate of economic growth was again the main positive feature of Romania's economic development. Economic growth in 2003 was supported by the expansion of private demand and fixed investment. But stocks increased rapidly as well, illustrating the persistent commodity mismatch between supplies and demands.

Much of the popular policies that would have been expected for the election year 2004 took already place last year. Living standards increased more rapidly than in any of the past five years, even if unequally distributed across the population. Real wages rose by some 9% and fuelled the increase in retail sales. The number of dwellings completed rose by 12%, that of cars sold by 25%. Fortunately, investments went also into infrastructure and the modernization of manufacturing companies. Consumer credits expanded significantly for the first time in Romanian history. Private demand pulled growth, generating at the same time increasing imports that were not matched by exports.

Imports rose by 11.6% and exports by 6.2%, based on customs statistics. Particularly high rates of import growth were registered for durable consumer goods, cars and building materials. Among the export commodities, the share of textiles and clothing was still high (at more than 20%) but decreasing, while the share of machinery and transport equipment exceeded 22%. The upgrading process of the export structure was to a great extent due to the increase in FDI. The inflow of direct investment has probably reached EUR 1.4 billion, 20% more than the year before. This sum does not even include the EUR 200 million to be received from EBRD and IFC for shares in the BCR bank.

The current account deficit of 6-7% of GDP causes no problem for the country, as the economy is growing and investors' confidence is good. The credit risk is expected to improve further, interest margins are shrinking and external financing is becoming cheaper. Gross external debt increased to about EUR 16 billion, still only 33% of GDP. International reserves reached EUR 6.4 billion by the end of the year, equalling 3.6 months of imports. The exposure to short-term capital flows is low.

In 2003 the Romanian leu devalued by an average 20% against the euro, while consumer price inflation was 15% and the increase in industrial producer prices in the range of 22%. This suggests a neutral exchange rate policy. The managed floating system functioned without any significant turbulences. Active participation of the National Bank on the currency market was necessary in the second half of the year to curb the pressure towards depreciation. Government-controlled prices were increased several times in the last

quarter of the year, thus also contributing to inflation in 2003. Yet the inflation target was missed by just a narrow margin.

The restructuring of state-owned firms and privatization have continued to proceed but slowly. For the largest commercial bank an interim solution with the involvement of EBRD and IFC was found, practically postponing privatization. The tenders of gas distribution companies also meet with delays. But the privatization of loss-making manufacturing companies proceeded quite rapidly. As a result, inter-enterprise payment arrears should diminish and also tax-payment discipline improve.

In the last quarter of 2003, the government started to take measures curtailing domestic demand and limiting the soaring current account deficit. The National Bank gradually increased the reference interest rate from 17.4% in April 2003 to 21.25% in January 2004. It also warned commercial banks to better assess the creditworthiness of private customers. Commercial credit rates are sluggish to follow and there is no sign of the public losing interest in further borrowing. The question is how long this course can be maintained in view of the local elections in June and the parliamentary and presidential elections in December this year.

The 2004 budget envisages cutting the deficit from 2.7% to 2.5% of GDP and attaining economic growth of 5.5% while bringing down inflation to below 10% and curtailing the current account deficit to less than 6% of GDP. It goes without saying that these plans are over-ambitious and also contradictory. The wiw forecast reflects the problems related to slow restructuring and low competitiveness. Economic growth at a similar rate as in 2003 would certainly be not a bad result. Also disinflation may continue, albeit at a slower pace. FDI – which is rather low as compared to the size of the country – will grow, and may finance the current account deficit to an even larger extent than in the previous year. To keep the economy on a healthy growth path, exports should rise more rapidly and imports benefit more from the modernization of production. To this end, some curtailment of private consumption is necessary. The export performance may improve due to increasing European demand, but the tax incentives for exporters will expire. A serious slippage in the budgetary policy is not very likely, even if the restrictive course may not be followed.

Some consumption restriction will not harm the ruling party's popularity and there is a good chance for the present Social-Democratic Party government to continue even if Adrian Nastase should resign as prime minister and run for presidency. The opposition has started forming a coalition with the aim to bring the Social Democrats to fall, but may be too late to come up with attractive alternatives.

Table RO

## Romania: Selected Economic Indicators

|  | 1997    | 1998    | 1999    | 2000     | 2001     | 2002     | 2003 <sup>1)</sup>      | 2004<br>forecast | 2005<br>forecast |
|--|---------|---------|---------|----------|----------|----------|-------------------------|------------------|------------------|
| Population, th pers., mid-year                       | 22545.9 | 22502.8 | 22458.0 | 22435.2  | 22408.4  | 21698.2  | .                       | .                | .                |
| Gross domestic product, ROL bn, nom.                 | 252926  | 371194  | 545730  | 800773   | 1167243  | 1512257  | 1820000                 | 2110000          | 2382000          |
| annual change in % (real)                            | -6.1    | -4.8    | -1.2    | 2.1      | 5.7      | 4.9      | 4.7                     | 4.5              | 4.5              |
| GDP/capita (EUR at exchange rate)                    | 1387    | 1651    | 1491    | 1789     | 2001     | 2230     | 2290                    | .                | .                |
| GDP/capita (EUR at PPP -wiiw)                        | 5070    | 4880    | 4980    | 5210     | 5700     | 6390     | 6930                    | .                | .                |
| Gross industrial production                          |         |         |         |          |          |          |                         |                  |                  |
| annual change in % (real)                            | -7.2    | -13.8   | -2.4    | 7.1      | 8.4      | 3.1      | 3                       | 4                | 4                |
| Gross agricultural production                        |         |         |         |          |          |          |                         |                  |                  |
| annual change in % (real)                            | 3.4     | -7.5    | 4.0     | -14.8    | 22.7     | -6       | .                       | .                | .                |
| Goods transport, mn t-kms <sup>2)</sup>              | 87590   | 62364   | 45988   | 42131    | 40647    | 47334    | .                       | .                | .                |
| annual change in % <sup>2)</sup>                     | -18.0   | .       | -26.3   | -8.4     | -3.5     | 16.5     | .                       | .                | .                |
| Gross fixed capital formation, ROL bn, nom.          | 53540.1 | 68111.6 | 96630.4 | 151947.2 | 238977.5 | 319645.1 | .                       | .                | .                |
| annual change in % (real)                            | 1.7     | -5.7    | -4.8    | 5.5      | 9.2      | 8.3      | 8                       | 7                | 7                |
| Construction output total                            |         |         |         |          |          |          |                         |                  |                  |
| annual change in % (real)                            | -24.4   | -0.5    | -0.2    | 2.8      | 9.0      | 5.9      | 5.7 <sup>I-X</sup>      | .                | .                |
| Dwellings completed, units                           | 29921   | 29692   | 29517   | 26376    | 27041    | 27722    | 17495 <sup>I-X</sup>    | .                | .                |
| annual change in %                                   | 1.6     | -0.8    | -0.6    | -10.6    | 2.5      | 2.5      | 12.1 <sup>I-X</sup>     | .                | .                |
| Employed persons total - LFS, th, avg. <sup>3)</sup> | 11050.0 | 10844.9 | 10775.6 | 10763.8  | 10696.9  | 9234.3   | 9119.0 <sup>I-VI</sup>  | .                | .                |
| annual change in %                                   | 1.0     | -1.9    | -0.6    | -0.1     | -0.6     | -13.7    | 0.1 <sup>I-VI</sup>     | .                | .                |
| Reg. employees in industry, th pers., avg.           | 2443.0  | 2272.0  | 1991.0  | 1873.0   | 1901.0   | 1884.0   | 1784.3 <sup>I-X</sup>   | .                | .                |
| annual change in %                                   | -5.5    | -7.0    | -12.4   | -5.9     | 1.5      | -0.9     | -1.8 <sup>I-X</sup>     | .                | .                |
| Reg. unemployed, th pers, end of period              | 881.4   | 1025.1  | 1130.3  | 1007.1   | 826.9    | 760.6    | 655.4 <sup>Nov</sup>    | .                | .                |
| Reg. unemployment rate in %, end of period           | 8.9     | 10.4    | 11.8    | 10.5     | 8.8      | 8.1      | 7.2 <sup>Nov</sup>      | 7                | 7                |
| LFS - unemployment rate in %, average <sup>3)</sup>  | 6.0     | 6.3     | 6.8     | 7.1      | 6.6      | 8.4      | 8                       | 8                | 7                |
| Average gross monthly wages, ROL                     | 846450  | 1357132 | 1957731 | 2876645  | 4282622  | 5452097  | 6620445 <sup>I-XI</sup> | .                | .                |
| annual change in % (real, net) <sup>4)</sup>         | -22.6   | 3.4     | -3.8    | 4.6      | 4.9      | 3.7      | 8.7 <sup>I-XI</sup>     | .                | .                |
| Retail trade turnover, ROL bn                        | 83035   | 125513  | 160137  | 213569   | 287278   | .        | .                       | .                | .                |
| annual change in % (real)                            | -12.1   | 20.6    | -6.4    | -7.0     | 1.9      | 0.8      | 4.7 <sup>I-X</sup>      | .                | .                |
| Consumer prices, % p.a.                              | 154.8   | 59.1    | 45.8    | 45.7     | 34.5     | 22.5     | 15.3                    | 11               | 8                |
| Producer prices in industry, % p.a.                  | 152.7   | 33.2    | 44.5    | 53.4     | 41.0     | 24.6     | 22                      | 15               | 10               |
| Central government budget, ROL bn                    |         |         |         |          |          |          |                         |                  |                  |
| Revenues   | 43835   | 67216   | 93240   | 120342   | 148203   | 179206   | 214156 <sup>Oct</sup>   | .                | .                |
| Expenditures   | 52897   | 77617   | 106887  | 149168   | 184012   | 226824   | 225285 <sup>Oct</sup>   | .                | .                |
| Deficit (-) / surplus (+)                            | -9062   | -10401  | -13647  | -28826   | -35809   | -47618   | -11129 <sup>Oct</sup>   | .                | .                |
| Deficit (-) / surplus (+), % GDP                     | -3.6    | -2.8    | -2.5    | -3.6     | -3.1     | -3.1     | .                       | -2.5             | .                |
| Money supply, ROL bn, end of period                  |         |         |         |          |          |          |                         |                  |                  |
| M1, Money  | 18731   | 22110   | 29669   | 46331    | 64309    | 88305    | 99413 <sup>Nov</sup>    | .                | .                |
| M2, money + quasi money                              | 62150   | 92530   | 134123  | 185060   | 270512   | 373713   | 425654 <sup>Nov</sup>   | .                | .                |
| Discount rate, % p.a., end of period <sup>5)</sup>   | 40.0    | 35.0    | 35.0    | 35.0     | 35.0     | 20.4     | 20.4                    | .                | .                |
| Current account, EUR mn <sup>6)</sup>                | -1864   | -2592   | -1352   | -1494    | -2488    | -1623    | -3000                   | -3500            | -3500            |
| Current account in % of GDP                          | -6.0    | -7.0    | -4.0    | -3.7     | -5.5     | -3.4     | -6.2                    | -6.8             | -6.4             |
| Gross reserves of NB excl. gold, EUR mn              | 1984.7  | 1177.3  | 1520.0  | 2654.8   | 4445.3   | 5876.8   | 6399.3                  | .                | .                |
| Gross external debt, EUR mn <sup>7)</sup>            | 7767.2  | 7983.4  | 8734.3  | 11043.5  | 13501.9  | 14622.8  | 15542.0 <sup>Oct</sup>  | .                | .                |
| Exports total, fob, EUR mn <sup>8)</sup>             | 7434.4  | 7412.4  | 7977.0  | 11273.3  | 12722.0  | 14674.9  | 15600                   | 16700            | 17900            |
| annual growth rate in %                              | 16.6    | -0.3    | 7.6     | 41.3     | 12.9     | 15.4     | 6                       | 7                | 7                |
| Imports total, cif, EUR mn <sup>8)</sup>             | 9946.3  | 10569.3 | 9927.2  | 14235.4  | 17383.3  | 18880.8  | 21100                   | 23200            | 24600            |
| annual growth rate in %                              | 10.3    | 6.3     | -6.1    | 43.4     | 22.1     | 8.6      | 12                      | 10               | 6                |
| Average exchange rate ROL/USD                        | 7167.9  | 8875.6  | 15332.9 | 21692.7  | 29060.9  | 33055.5  | 33200.1                 | .                | .                |
| Average exchange rate ROL/EUR (ECU)                  | 8090.9  | 9989.3  | 16295.6 | 19955.8  | 26026.9  | 31255.3  | 37555.9                 | 41000            | 43500            |
| Purchasing power parity ROL/USD, wiiw                | 1996.8  | 3066.4  | 4464.1  | 6349.2   | 8435.7   | 10166.6  | 11367.5                 | .                | .                |
| Purchasing power parity ROL/EUR, wiiw                | 2212.7  | 3378.2  | 4877.9  | 6845.7   | 9138.4   | 10913.8  | 12395.1                 | .                | .                |

Notes: 1) Preliminary. - 2) From 1998 new methodology in road transport. - 3) From 2002 break in methodology and according to census March 2002. - 4) From 2000 excluding various social security contributions of employees. - 5) Reference rate of NB from February 2002. - 6) Up to 1998 wiiw calculated from USD. - 7) Medium- and long-term. - 8) Up to 1998 converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.