



## ROMANIA: Investment slump

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**In Romania, the growth setback following last year's bumper harvest and export boom seems to be more severe than expected. The decline in investments, both private and public, has accelerated. Alongside exports, the recovery of private consumption, benefiting from fiscal support, has become the new driver of economic growth. The government intends to continue down this track in defiance of IMF recommendations. Improved political stability under a new president to be elected in November may improve the efficiency of the country's administration. Being one of the countries least dependent on trade with Russia, Romania lends full support to EU sanctions.**

Economic growth decelerated in the first half of 2014; quarter-to-quarter rates were negative, pointing to a technical recession. The 2.4% GDP growth in the first half of 2014 is sobering after last year's boom. The base effect of strong growth in the second half of 2013 will render even weaker results for the rest of 2014. Beyond net exports, private consumption has become the main driving force of growth this year. The latter contributed 3.3 percentage points to GDP growth and net exports added another 1pp. Gross fixed capital formation plummeted by as much as 11% in the first half of 2014 and had a negative contribution to GDP growth (-2.2pp).

Investments have remained the sour point of the Romanian economy. They have been on the decline for the fifth quarter in a row. Corporate investments shrank while the construction of dwellings started to recover. Public investments, which account for close to 20% of the total investments, plummeted. There are two main reasons for the detrimental development of investments: one is the continuing deleveraging process in the banking sector; credit to the private sector declined further and the share of non-performing loans dwelt around 20%. The other factor is the inability of the government to manage investment programmes and properly utilise EU funds.

It was not fiscal austerity that suppressed public investment outlays. The level of the central government deficit (2.2% of GDP) is well on target but both revenues and expenditures were below the half-year schedule by a wide margin. Revenues were 4.3% lower due to shortfalls in the collection of personal income tax and VAT. This is all the more alarming as both private income and retail sales expanded quite rapidly. Less than half of the scheduled EU funds and co-financing could be disbursed, mirrored by a similar shortfall in expenditures on EU-funded projects. Also the other public capital expenditures declined and fell short of programme by 30%. Government decision-making has become all the more cumbersome as more and more former office-holders have been accused of corruption, making current ministers over-cautious.

Inflation has subsided but remained positive all through the first half of 2014 and is expected to rise somewhat in the second half of the year. One of the components adding to inflation has been the adjustment of gas prices, and another resulted from the fuel tax increase. The government is, however, trying to postpone the next gas price rise for private consumers, scheduled in the IMF-EU agreement, for social reasons. Cheap domestic production is used as a justification against EU recommendations to introduce a unitary gas market for all consumers.

The current account deteriorated due to a jump in foreign investors' income while the goods trade deficit and the services surplus increased. Services exports, especially transport, revenues continued to increase as Romania attracted the headquarters of some large foreign truck fleets. The average exchange rate for the first half of 2014 (RON 4.46/EUR) was higher than in the pre-year period but firmed in the third quarter. Vehicles, electronic products as well as food products contributed most to the boost in exports. FDI inflow and the number of new greenfield projects were somewhat lower in the first half of 2014 than a year before, still the country maintains a strong position among the NMS in terms of attracting FDI and outsourcing projects.

The impact of the Ukraine-Russia conflict and related sanctions on Romania is limited as economic cooperation with the countries involved is modest. The Ukrainian market accounts for only 1.9% of total Romanian exports and 0.8% of imports (2013). The significance of Russia has been somewhat higher, 2.8% in the case of exports and 4.3% in the case of imports. Close to 90% of Romanian imports from Russia is constituted by mineral products. It is worth noting that Romania has the smallest dependence on trade with Russia among the NMS next to Slovenia. An important reason is the high rate of self-sufficiency of the country in terms of oil and gas. Although Romania is a large exporter of food products, its exposure to Russia (2%) is one of the smallest in the EU. Not unrelated, the Romanian government firmly supports the EU and NATO policy in the conflict and even tries to benefit from its strategic position in the Black Sea region.

In view of the still good growth performance at the beginning of the year, the government delayed structural reforms required under the precautionary IMF stand-by agreement of September 2013. They have even taken action against IMF recommendations by deciding to reduce the social security contribution in accordance with the request of the business community. In turn, the IMF did not conclude its programme review in June and stays in a wait-and-see position until the next supervision due in November this year. If the fiscal target is observed and the external balance is maintained, the government may further extend its freedom of action in relation to the European Commission and the IMF. Shifting the main growth driver from net exports to private consumption will not be drastic and may not require larger amounts of external financing in the coming years. Incumbent socialist Prime Minister Victor Ponta is likely to win the presidential elections in November putting an end to cohabitation with Traian Basescu, who has repeatedly blocked government action and used the anti-corruption agency for political purposes. Regained confidence under a new president and, possibly, prime minister may improve the efficiency of administration and speed up the access to EU funds but it may also result in some loss of checks and balances and in the return of fiscal expansion. The success of investment programmes is in the interest of the EU Commission too and institutional support may increase once the new Commission starts working. Only in this case can one expect a rebound of investments which is badly needed to accelerate GDP growth to 3% in the coming years.

**Table 1 / Romania: Selected Economic Indicators**

	2010	2011	2012	2013 <sup>1)</sup>	2013 January-June	2014	2014	2015	2016
							Forecast		
Population, th pers., average <sup>2)</sup>	20,247	20,148	20,058	19,981	.	.	20,000	20,000	20,000
Gross domestic product, RON bn, nom.	523.7	557.3	586.7	628.6	264.7	279.4	660	700	740
annual change in % (real)	-1.1	2.3	0.6	3.5	1.8	2.4	2.2	2.7	3.0
GDP/capita (EUR at exchange rate)	6,100	6,500	6,600	7,100	.	.	.	.	.
GDP/capita (EUR at PPP)	12,400	12,900	13,500	14,400	.	.	.	.	.
Consumption of households, RON bn, nom.	327.2	345.8	363.1	384.3	172.7	183.3	.	.	.
annual change in % (real)	-0.3	1.6	1.1	1.4	0.1	5.1	3.0	2.0	2.5
Gross fixed capital formation, RON bn, nom.	129.4	145.2	154.3	148.2	53.2	47.0	.	.	.
annual change in % (real)	-1.8	7.7	3.8	-3.3	-5.2	-11.0	-2.0	4.0	5.0
Gross industrial production <sup>3)</sup>									
annual change in % (real)	5.5	7.4	2.4	7.8	6.1	9.1	7.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	1.0	8.9	-21.9	27.3	.	.	.	.	.
Construction industry <sup>3)</sup>									
annual change in % (real)	-13.2	2.8	1.2	-0.4	-5.8	-10.2	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	9,239	9,138	9,263	9,247	.	8,540	8,600	8,690	8,780
annual change in %	0.0	-1.1	1.4	-0.2	.	.	0.6	1.0	1.0
Unemployed persons, LFS, th, average <sup>4)</sup>	725	730	701	730	.	640	.	.	.
Unemployment rate, LFS, in %, average <sup>4)</sup>	7.3	7.4	7.0	7.3	.	7.0	7.0	7.0	6.8
Reg. unemployment rate, in %, end of period	7.0	5.2	5.5	5.7	4.8	4.9	.	.	.
Average monthly gross wages, RON <sup>5)</sup>	1,902	1,980	2,063	2,166	2,208	2,320	.	.	.
annual change in % (real, gross)	-2.8	-1.6	0.8	1.0	0.0	4.0	.	.	.
Average monthly net wages, RON <sup>5)</sup>	1,391	1,444	1,507	1,580	1,599	1,677	.	.	.
annual change in % (real, net)	-3.7	-1.9	1.0	0.8	-0.2	3.8	.	.	.
Consumer prices (HICP), % p.a.	6.1	5.8	3.4	3.2	4.6	1.3	2.0	3.0	3.5
Producer prices in industry, % p.a.	4.4	7.1	5.3	2.0	0.0	-0.3	.	.	.
General government budget, EU-def., % of GDP									
Revenues	33.3	33.9	33.7	32.7	.	.	.	.	.
Expenditures	40.1	39.4	36.7	35.0	.	.	.	.	.
Net lending (+) / net borrowing (-)	-6.8	-5.5	-3.0	-2.3	.	.	-2.4	-2.5	-2.7
Public debt, EU-def., % of GDP	30.5	34.7	38.0	38.4	.	.	38.0	39.0	40.0
Central bank policy rate, % p.a., end of period <sup>6)</sup>	6.25	6.00	5.25	4.00	5.25	3.50	.	.	.
Current account, EUR mn	-5,476	-5,921	-5,851	-1,529	123	-877	-3,000	-3,500	-4,000
Current account, % of GDP	-4.4	-4.5	-4.4	-1.1	0.2	-1.4	-2.0	-2.2	-2.4
Exports of goods, BOP, EUR mn	37,333	45,281	45,022	49,579	23,716	25,522	53,000	56,700	60,700
annual change in %	28.3	21.3	-0.6	10.1	5.9	7.6	7.0	7.0	7.0
Imports of goods, BOP, EUR mn	44,901	52,664	52,393	53,005	25,168	27,187	56,700	60,700	64,900
annual change in %	24.9	17.3	-0.5	1.2	-2.8	8.0	7.0	7.0	7.0
Exports of services, BOP, EUR mn	6,622	7,253	8,395	10,792	5,003	5,755	11,900	12,600	13,400
annual change in %	-6.2	9.5	15.7	28.6	30.1	15.0	10.0	6.0	6.0
Imports of services, BOP, EUR mn	6,216	6,911	7,264	8,053	3,766	3,897	8,300	8,800	9,300
annual change in %	-15.5	11.2	5.1	10.9	6.0	3.5	3.0	6.0	6.0
FDI inflow (liabilities), EUR mn	2,227	1,798	2,127	2,730	1,329	1,192	2,500	3,000	3,000
FDI outflow (assets), EUR mn	-12	-25	-88	87	-52	-64	.	.	.
Gross reserves of NB excl. gold, EUR mn	32,606	33,166	31,206	32,525	32,307	30,681	.	.	.
Gross external debt, EUR mn	92,458	98,724	99,681	96,060	99,074	92,958	.	.	.
Gross external debt, % of GDP	74.4	75.1	75.8	67.5	69.7	62.5	.	.	.
Average exchange rate RON/EUR	4.2122	4.2391	4.4593	4.4190	4.3923	4.4641	4.44	4.45	4.50
Purchasing power parity RON/EUR	2.0873	2.1469	2.1575	2.2590	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) Enterprises with 4 and more employees. - 4) From 2014 according to census October 2011. - 5) Half-year data refer to enterprises with 4 and more employees. - 6) One-week repo rate.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.