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Romania:
Slowdown after boom

In Romania, a bumper harvest boosted GDP by 2.5% in 2011, a one-time effect that is due to vanish in 2012. At best 1% growth can be expected, driven by private consumption. A major factor of the economic slowdown is the expected stop in credit expansion. The fiscal situation is not expected to deteriorate under the close control of the IMF. The elections in November may lead to a cohabitation of president and government from opposing political groupings, which may increase political uncertainty.

The Romanian economy grew ahead of expectation in 2011, only to steer into a slowdown in 2012. The fourth quarter of 2011 already turned negative compared to the previous one and this is likely to be also the case for the first quarter of 2012, to be followed by a modest upswing towards the end of the year. In 2011 the Romanian GDP grew by 2.5% due to an exceptional 10% growth in agriculture and related processing activities in the wake of a bumper harvest. This has positively affected household consumption in the countryside while real wages were lower than in the previous year. Investments picked up after two years of decline while net exports deteriorated slightly. Prudent monetary and fiscal policies including the effects of the severe austerity measures introduced in mid-2010 were directed to preserving stability. Romania has built up some confidence but is still considered as one of the most vulnerable countries mainly due to its high private external debt and perceived political instability. As a major source of confidence, Romania has a two-year precautionary agreement with the international financial organizations and the government formulates its fiscal plans and reform agenda in accordance with the IMF.

Industrial production showed robust growth of about 6% during 2011 surpassing the pre-crisis level of 2008. Manufacturing of motor vehicles, electrical and other machinery boosted production by more than 10%. These are industries dominated by foreign affiliates which sell most of their products abroad. The production of chemicals and non-metallic minerals recovered as well while the output of light industry branches in consumer goods production was declining. The electronics industry, a previously booming activity, shrank in the last few months of 2011 when Nokia, suffering a loss of global competitiveness, started running down its production facility near Cluj. The mobile phone producer has closed down its just three-year-old plant, causing a major blow to industrial production and exports that will be felt in the first half of 2012. However, the Italian home appliance manufacturer De'Longhi will settle in the buildings and Bosch will locate an automotive part production facility in the adjacent industrial park. This means that employment and exports will be restored in the second half of 2012. By that time, also Ford's car assembly plant in Craiova will be in operation producing and exporting the B-Max model. Transport equipment has reached a share of 41% in Romania's exports, and the dependence on this branch is bound to increase. The SME sector is still subject to the impact of sluggish domestic demand, although construction activity has somewhat recovered from a severe slump. The number of private sector bankruptcies declined by 10% in 2011 but was still much higher than before 2009.

The labour market indicators have hardly reacted to changes in output in recent years. The employment rate was flat at 63-65% throughout 2005-2011 and the unemployment rate climbed only 1.5 percentage points to 7.3% in 2009-2010 where it remained in 2011. As a result of the new labour code, temporary work contracts have become more widespread and registered unemployment declined. Some items of the labour market statistics will have to be adjusted to the lower than previously assumed population figures. Official statistics recorded a living population of the country of 21.4 million in 2011 but the census found only 19.0 million present – migrants comprise the difference – which causes a jump in per capita GDP.

The inflation rate rose until June 2011 when the impact of the previous year's VAT hike vanished. Monthly inflation declined thereafter leading to a year-end rate of 3.1%. This gives room for the government to adjust administered prices in the energy sector and still reach an average inflation rate of about 4% for 2012, the lowest since transition started. The decline in inflation allowed the National Bank to lower the policy interest rate in several steps, from 6.25% in October 2011 to 5.5% in February 2012. The annual interest rate on the deposit facility has been cut to 1.75% from 2.00%, while the overnight (Lombard) rate became 9.75% a year versus 10.00% previously. Further policy rate cuts may be necessary to follow the decline in inflation and stimulate economic growth. At the same time the country must stay attractive for financial investors to refinance old debt and finance the current account deficit. There was no credit squeeze in 2011. New loans to the private sector rose by 6.6% year on year in December (3.3% in real terms), of which RON-denominated loans rose by 5.6% and foreign currency-denominated loans expressed in RON by 7.2%. The banking sector booked a loss of RON 430 million (EUR 100 million) in 2011 compared to RON 516 million in 2010. Meanwhile the government implemented the facilities to put a 'troubled bank' under special administration, allowing a bankrupt bank's assets and liabilities to be taken over by another bank in an orderly manner if necessary. Last year, the banks continued their restructuring activities by closing 2% of the network and laying off 1.5% of the workforce.

The fiscal situation as of end-2011 is relatively good as revenues surpassed expectations due to economic growth and expenditures were kept at the scheduled level. The severe public sector wage cuts of mid-2010 were still felt in the wage bill decline in 2011. There have been some nominal wage increases while the number of employees was reduced. Nominal wages are bound to rise in 2012 in the wake of the statutory minimum salary hike to RON 700. The IMF is not pressing for more austerity in view of the current growth deceleration and even pleads for some public sector salary increases in order to boost domestic demand. The government is more concerned that revenues may fall short of plans, which is quite likely. Given the slowdown in economic growth, the government will have to make a difficult choice. It may abandon the plan to restrict the cash deficit to 1.9% of GDP (IMF target 2.1%, about 3% in ESA terms) or relax it in order to avoid additional austerity measures and even satisfy some of the wage demands. But if it finds external financing too costly, it may stick to the deficit target and keep down expenditures. The intentions of the new government inaugurated in February 2012 are not clear in this respect. According to the priorities laid down in the budget law, the government would prefer spending on investments rather than on wages. Public investments would first of all aim at absorbing EU funds. This is on the top of the political agenda with its co-financing needs, and administrative challenges. Support to this goal has been provided by the EU Commission by reducing the statutory co-financing rate.

Structural reforms agreed with the IMF include the identification of loss-making public sector companies and the reduction of their losses. The envisaged healthcare reform which aimed at controlling expenditures failed partly due to pressure from the street in January 2012 and will not be implemented at least before the elections later this year. State-owned enterprises are set under special surveillance and many of them are put on the privatization list. It remains to be seen whether there will be sufficient demand for these and at what price. Public sector arrears have been reduced by the end of last year but they may re-emerge if revenues fall short of expectations. All these policies, if implemented, will reduce the gap between cash and ESA deficit of the general government.

A financial crisis may emerge due to the high level of non-performing loans and the expected credit squeeze due to further deleveraging of foreign banks. Default on private debt on a massive scale is becoming quite likely in view of the high level of non-performing loans. The share of these increased from 11.9% in December 2010 to 14.1% in December

2011. The National Bank of Romania started to take action to smooth the process of debt restructuring and lower the risk of default. Depending on the behaviour of individual foreign banks, the level of risk may differ from bank to bank. Fitch downgraded Romanian banks to the second worst mark 'D' in December 2011 as the assets of the Romanian banking sector were rated as of poor quality which could worsen as a result of the impact of the eurozone crisis. Still, capitalization is in good order.

The external sector has maintained a relatively high current account deficit, above 4% of GDP over the past couple of years, and no change in this respect is expected under normal circumstances. The decisive item in the current account balance is the balance of trade in goods and services, which has slightly improved in 2011. The net income flows were increasingly negative while the flows of net current transfers (mostly remittances from Romanians working abroad) were higher than in the previous year. The rebound of private transfers goes against the expected impact of the economic calamities in the migrants' main target countries Italy and Spain, but this might change in the coming year with a gloomy growth prospect in these countries. Capital inflows of various forms outpaced the current account deficit, leading to further accumulation of National Bank reserves that are now covering 7 months of goods and services imports.

Forecasting key indicators is most uncertain as it depends to a large extent on external developments. GDP growth forecasts for 2012 have been scaled back in recent months due to forecasted stagnation in the eurozone. Our forecast is that in 2012 Romania's growth will slow down to 1% because of slow growth of export markets and a credit squeeze. Growth will be driven by private consumption and recovering investments generated by EU projects. The wiiw forecast reckons with some fiscal relaxation, to a deficit of 3.5% of GDP. The government will most probably give in to political pressure before the upcoming elections and allow for some public sector wage rises. While agriculture will not repeat its previous year results, the countryside population may have ample reserves to keep up their consumption levels.

A major factor of the economic slowdown is the expected stop in credit expansion due to the restructuring of the balance sheets of Greek and Austrian banks and provisioning requirements. In case of turmoil on the financial markets, Romania might be affected through the foreign banks whose subsidiaries control the banking sector of the country. Romania may rely on the EUR 5 billion preventive loan agreement with the IMF, WB and EU if private sources dry up. Public debt is not expected to rise above 35% of GDP and the fiscal deficit will stay below 3.5% of GDP while total external debt may not increase above 75% of GDP. The forecast for 2013 and 2014 is based on external and internal conditions without any unexpected shocks. In view of a protracted shortage of external financing, the expected medium-term growth is only around 3% annually, down from 4% previously forecasted.

There is also a major political risk looming. The present coalition led by the National Liberal Party will likely serve its mandate until the parliamentary elections in November 2012 – but it may also break up at any point if one of the partners thinks that it has better chances in the elections without the other. The government reshuffle of February 2012 has brought in some brighter faces without any new agenda. The opposition managed to form a social-liberal-conservative electoral coalition which has good chances to replace the current one. Recently they decided to abstain from parliamentary sessions to trigger early elections. Street protests in January 2012 have marked dissatisfaction with the government and especially the president who interferes in the current businesses more than legally stipulated. A more severe crisis is looming if the opposition wins the elections scheduled for November. They are likely to get into conflict with the president, who is on the side of the current coalition. Such cohabitation may lead to a stalemate and the disruption of public governance; fights between institutions can block the functioning of the state.

Table RO

Romania: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average [2]	21588	21547	21514	21480	21438	19043	19000	18950	18900
Gross domestic product, RON mn, nom.	344651	416007	514700	501139	522561	573000	613500	670000	725000
annual change in % (real)	7.9	6.3	7.4	-6.6	-1.6	2.5	1	3	3
GDP/capita (EUR at exchange rate)	4500	5800	6500	5500	5800	7100	.	.	.
GDP/capita (EUR at PPP)	9100	10400	11700	11000	11400	13300	.	.	.
Consumption of households, RON mn, nom.	233135	273418	327928	304667	327562	354000	.	.	.
annual change in % (real)	12.9	12.0	9.0	-10.4	-0.4	1	1	2	3
Gross fixed capital formation, RON mn, nom.	88272	125645	164279	122442	125227	138000	.	.	.
annual change in % (real)	19.9	30.3	15.6	-28.1	-2.1	3	3	5	6
Gross industrial production [3]									
annual change in % (real)	9.3	10.3	2.6	-5.5	5.5	5.6	3	5	5
Gross agricultural production (EAA)									
annual change in % (real)	2.4	-17.7	21.2	-2.2	1.0	9.9	.	.	.
Construction industry [3]									
annual change in % (real)	15.4	33.2	26.7	-15.0	-13.2	2.8	.	.	.
Employed persons - LFS, th, average	9291.2	9353.3	9369.1	9243.5	9239.4	9200	9150	9150	9200
annual change in %	1.9	0.7	0.2	-1.3	0.0	-0.4	-0.5	0	0.5
Unemployed persons - LFS, th, average	728.4	640.9	575.5	680.7	725.1	723	.	.	.
Unemployment rate - LFS, in %, average	7.3	6.4	5.8	6.9	7.3	7.3	7.5	7	7
Reg. unemployment rate, in %, end of period	5.2	4.0	4.4	7.8	7.0	5.1	.	.	.
Average gross monthly wages, RON	1146	1396	1761	1845	1902	1995	.	.	.
annual change in % (real, net)	9.0	14.7	16.5	-1.5	-3.7	-0.9	.	.	.
Consumer prices (HICP), % p.a.	6.6	4.9	7.9	5.6	6.1	5.8	4	4	4
Producer prices in industry, % p.a.	9.5	7.5	15.3	1.8	6.3	8.9	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	33.3	35.3	33.6	32.1	33.4	34.0	.	.	.
Expenditures	35.5	38.2	39.3	41.1	40.2	38.5	.	.	.
Net lending (+) / net borrowing (-)	-2.2	-2.9	-5.7	-9.0	-6.8	-4.5	-3.5	-3	-3
Public debt, EU-def., in % of GDP	12.4	12.8	13.4	23.6	31.0	32	34	34	34
Central bank policy rate, % p.a., end of period [4]	8.75	7.50	10.25	8.00	6.25	6.00	.	.	.
Current account, EUR mn	-10220	-16758	-16178	-4938	-5518	-5679	-6500	-7000	-8500
Current account in % of GDP	-10.5	-13.4	-11.6	-4.2	-4.4	-4.2	-4.6	-4.5	-4.9
Exports of goods, BOP, EUR mn	25953	29542	33656	29091	37368	45018	48200	54000	60500
annual growth rate in %	16.6	13.8	13.9	-13.6	28.5	20.5	7	12	12
Imports of goods, BOP, EUR mn	37765	47365	52729	35959	44970	52482	56200	61800	69800
annual growth rate in %	25.6	25.4	11.3	-31.8	25.1	16.7	7	10	13
Exports of services, BOP, EUR mn	5585	6885	8751	7061	6622	7275	7800	8600	9300
annual growth rate in %	36.2	23.3	27.1	-19.3	-6.2	9.9	7	10	8
Imports of services, BOP, EUR mn	5581	6475	8091	7352	6220	6893	7400	8100	8900
annual growth rate in %	25.4	16.0	25.0	-9.1	-15.4	10.8	7	10	10
FDI inflow, EUR mn	9060	7280	9501	3490	2219	1917	.	.	.
FDI outflow, EUR mn	338	206	186	-61	-16	-3	.	.	.
Gross reserves of NB excl. gold, EUR mn	21299	25325	25977	28249	32606	33200	.	.	.
Gross external debt, EUR mn	41196	58628	72354	81206	92458	98606	.	.	.
Gross external debt in % of GDP	42.1	47.0	51.8	68.7	74.5	72.9	.	.	.
Average exchange rate RON/EUR	3.5258	3.3353	3.6826	4.2399	4.2122	4.2391	4.3	4.3	4.2
Purchasing power parity RON/EUR	1.7604	1.8627	2.0425	2.1125	2.1445	2.2574	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) Enterprises with 4 and more employees. - 4) One-week repo rate.

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