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Romania:
Slowly emerging from the dark

The economy is emerging from a protracted period of depression. Recovery is driven by net exports and the accumulation of stocks, while domestic consumption and gross fixed capital formation continue to contract still further. Implementation of the 2011 budget execution is on track and should meet the deficit target for the current year. The forecast for the election year 2012 points to an acceleration of economic growth and no increase in fiscal austerity. This will be followed by renewed stabilization measures and slower economic growth in 2013.

The Romanian economy is emerging from a long depression: GDP grew by 1.7% year on year in the first quarter of 2011. Growth was driven by net exports and stocks accumulation while both private and public consumption, as well as gross fixed capital formation, were further contracting. Private consumption was depressed due to the lasting effects of the wage cuts and VAT hikes as of mid-2010. It is no good news for future development that the investment activity in the economy has not rebounded either. Not only does the construction activity remain depressed, but investments in machinery declined as well. Nevertheless, both consumption and investment may pick up in the second half of the year at least due to the vanishing effect of last year’s austerity measures.

Industry, driven largely by export demand, has been the only production sector supporting economic growth. Manufacturing production soared both in the basic industries producing chemicals and metals, and in the more sophisticated branches of electrical machinery and transport equipment. The French-owned car manufacturer Automobile Dacia was the main exporter, along with the Nokia mobile phone assembly plant. Wage growth in industry lagged behind inflation and labour productivity soared, giving another boost to competitiveness. In the coming months agricultural production and the food industry are expected to recover as this year – unlike in the two previous ones – there have been no major natural calamities.

The domestic corporate sector is still under severe financial and market constraints. As of end-April 2011, non-government loans increased by 2.1% year on year (down 5.7% in real terms), composed of a 3.6% expansion in foreign currency-denominated loans (in RON terms) and a 0.1% decline in RON-denominated loans (down 7.8% in real terms). Contracting real credit shows that companies and banks are still very risk-averse concerning future financing. The ratio of non-performing loans to the total credit portfolio rose from 10% in April 2010 to 15% a year later. But recently both deposit and lending interest rates to new customers, on a slim market, have declined. Although bankruptcy procedures have become less frequent compared to the soaring numbers over the previous year and a half, the financial situation of SMEs is still precarious.

Unemployment has declined further and has been traditionally one of the lowest among the NMS despite still modest economic recovery and ongoing labour shedding in the public services sector. Migration, temporary work abroad and the subsistence survival on farms may be underlying reasons. Recent government measures have increased labour market flexibility with no immediate effect however on the labour market. The expiration of unemployment benefit periods reduced the number of registered unemployed who switched to inactivity, the grey economy or foreign employment; the employment rate remains rather low (about 50%).

Net exports were the main demand-side driver of GDP growth (beyond the accumulation of stocks) in the first quarter of 2011, backed by a strong expansion of goods exports (+39.4% in nominal EUR terms) and more moderated growth of goods imports (+24.8%). The services balance and the incomes balance worsened moderately while current transfers recovered. Migrants are apparently again in a position to increase their remittances after two years of contraction. The reserves of the National Bank grew somewhat more than the inflow of IMF credits and reached 5% of GDP while the external debt to GDP ratio declined. Under improving international financial circumstances the country has no financing problems even with slightly expanding current account deficits in the future.

The policy rate of the National Bank has remained unchanged for a year now. The recent nominal currency appreciation coincided with a rising inflation rate thus giving no guidance concerning a policy change. Energy and food price rises have mostly been imported while effects of last year’s VAT hikes are also present. In view of contradicting market signals the National Bank could do nothing but to raise the yearend inflation target. We increased the forecast for the average annual inflation to 6.5% which is the highest among the NMS. In April 2011 the RON/EUR exchange rate was back to where it had been a year before; in real terms the local currency became considerably stronger – so far with no effect on eroding competitiveness.

Austerity has been in the focus of fiscal policy. The deficit for the first five months of 2011, just 1.2% of GDP, indicates that budget execution is on track to meet the deficit target for the current year (4.4% of GDP on a cash basis; 5% on accrual, ESA basis). Due to the public sector wage cuts of last year and the ongoing reduction of public employment, wage expenditures declined. Further savings are expected by the healthcare sector reform but its implementation may suffer delays. Overall real wages continued to decline rapidly, due partly to public sector wage restraint and partly to soaring inflation.

Economic policy will continue to be under the surveillance of the IMF and the European Union, which have extended Romania a combined almost EUR 5 billion precautionary stand-by facility for two years starting in May. Under this deal, the IMF will disburse EUR 3.5 billion, while the EU and the World Bank contribute with another EUR 1.4 billion and EUR 400 million, respectively. The target laid down in the loan conditions is to reduce the budget deficit to 3% of GDP in 2012. We find this goal over-ambitious – especially in an election year. The wording of the agreement suggests that the condition is a soft recommendation. Funds were made available but the government does not intend to draw them except in case of emergency.

There is a pressing task however, not only due to the multilateral loan conditions, to improve the way state-owned companies are managed. Many of them make losses and do not pay their suppliers, causing a widespread deadlock in the economy. Both the fiscal revenue target and the management improvement target in state-owned enterprises could be served by privatization. The sale of public stakes in large energy companies may boost revenues but go against the government's desire to build national champions in the energy sector. The issue of privatization may stir further controversy and suffer delays. Further in 2012, the government intends to boost investments, lower social security contributions and raise wages for civil servants to compensate them for the salary cuts of 2010, at least in nominal terms.

The recently recovering capital inflows and diminishing financing costs for public debt, if lasting, may support the government in increasing spending in the election year 2012. In the wiiw forecast we reckon with a clear election cycle with accelerating growth and no further fiscal austerity. This would be followed by renewed stabilization measures and slower economic growth in 2013. Historical experience supports this boom-bust scenario as it had been the case in the previous three election years. The expected difference to past experience is that the amplitude of the current election cycle will be smaller than in the past.

Table RO

Romania: Selected Economic Indicators

	2007	2008	2009	2010 1)	2010	2011	2011	2012	2013
					1st quarter			Forecast	
Population, th pers., average	21547	21514	21480	21460	.	.	21440	21410	21400
Gross domestic product, RON mn, nom.	416007	514700	498008	513641	97263	106724	549100	604800	656000
annual change in % (real)	6.3	7.3	-7.1	-1.3	-2.2	1.7	2	4	3
GDP/capita (EUR at exchange rate)	5800	6500	5500	5700	.	.	.	.	.
GDP/capita (EUR at PPP)	10400	11700	10900	11000	.	.	.	.	.
Consumption of households, RON mn, nom.	273418	327928	304699	314564	65097	68846	.	.	.
annual change in % (real)	12.0	9.0	-10.5	-1.6	-4.5	-0.6	0	4	2.5
Gross fixed capital formation, RON mn, nom.	125645	164279	130603	116793	17407	18102	.	.	.
annual change in % (real)	30.3	15.6	-25.3	-13.1	-28.3	-2.2	1	5	6
Gross industrial production 2)									
annual change in % (real)	10.3	2.6	-5.5	5.5	4.3	11.4	8	6	5
Gross agricultural production									
annual change in % (real)	-17.7	21.2	-2.2	1.6	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	33.2	26.7	-15.0	-13.2	-21.3	-4.4	.	.	.
Employed persons - LFS, th, average	9353.3	9369.1	9243.5	9239.4	8934.3	.	9190	9240	9240
annual change in %	0.7	0.2	-1.3	0.0	-1.2	.	-0.5	0.5	0
Unemployed persons - LFS, th, average	640.9	575.5	680.7	725.1	787.2	.	.	.	.
Unemployment rate - LFS, in %, average	6.4	5.8	6.9	7.3	8.1	.	7.6	7	7
Reg. unemployment rate, in %, end of period	4.0	4.4	7.8	6.9	8.4	5.9	.	.	.
Average gross monthly wages, RON	1396	1761	1845	1891	1994	1988	.	.	.
annual change in % (real, net)	14.7	16.5	-1.5	-4.1	0.9	-7.3	.	.	.
Consumer prices (HICP), % p.a.	4.9	7.9	5.6	6.1	4.6	7.5	6.5	4	4
Producer prices in industry, % p.a.	7.5	15.3	1.8	6.3	3.5	10.7	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	33.7	32.6	32.1	34.3	.	.	.	.	.
Expenditures	36.3	38.3	40.6	40.8	.	.	.	.	.
Net lending (+) / net borrowing (-)	-2.6	-5.7	-8.5	-6.4	.	.	-5	-5	-4
Public debt, EU-def., in % of GDP	12.6	13.4	23.6	30.8	.	.	33	34	35
Central bank policy rate, % p.a., end of period 3)	7.50	10.25	8.00	6.25	6.50	6.25	.	.	.
Current account, EUR mn	-16758	-16178	-4938	-4952	-1544	-634	-4000	-6000	-6500
Current account in % of GDP	-13.4	-11.6	-4.2	-4.1	-6.5	-2.5	-3.1	-4.3	-4.3
Exports of goods, BOP, EUR mn	29542	33656	29091	37266	7902	11017	46200	51700	57900
annual growth rate in %	13.8	13.9	-13.6	28.1	20.0	39.4	24	12	12
Imports of goods, BOP, EUR mn	47365	52729	35959	43164	9189	11471	50100	57600	64500
annual growth rate in %	25.4	11.3	-31.8	20.0	13.1	24.8	16	15	12
Exports of services, BOP, EUR mn	6885	8751	7061	6474	1370	1467	6900	7600	8400
annual growth rate in %	23.3	27.1	-19.3	-8.3	-21.1	7.1	7	10	10
Imports of services, BOP, EUR mn	6475	8091	7352	7111	1650	1771	7600	8400	9200
annual growth rate in %	16.0	25.0	-9.1	-3.3	-4.8	7.3	7	10	10
FDI inflow, EUR mn	7280	9501	3490	2687	486	379	2500	.	.
FDI outflow, EUR mn	206	186	-61	147	32	-9	.	.	.
Gross reserves of NB excl. gold, EUR mn	25325	25977	28249	32606	32027	32767	.	.	.
Gross external debt, EUR mn	58628	72354	81163	90908	86528	93404	.	.	.
Gross external debt in % of GDP	47.0	51.8	69.1	74.6	71.0	71.4	.	.	.
Average exchange rate RON/EUR	3.3353	3.6826	4.2399	4.2122	4.1148	4.2234	4.2	4.3	4.3
Purchasing power parity RON/EUR	1.8625	2.0484	2.1354	2.1738	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2.
1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) One-week repo rate.

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