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Romania:
Sobered optimism

In Romania, economic growth came almost to a halt in 2012. The recovery of agricultural production under normal weather conditions can in itself generate the forecasted 1.5% GDP growth in 2013. Bank deleveraging, bad debts and corporate insolvency will remain a drag on the economy. Fiscal expansion plans have been halted by the IMF. New taxes and tariffs will prolong the period of relatively strong inflation.

The performance of the Romanian economy deteriorated significantly in the second half of 2012. Economic growth came to a standstill (GDP up by 0.2%) for the whole year. The underperformance was due to devastating results in agriculture and on the farm consumption; lately also to falling exports and general consumer demand. The only bright spot, at least on paper, was gross fixed capital formation which grew by 13% in the first three quarters of the year. The investment miracle is mainly explained by public infrastructure projects finalized and transferred from inventories to fixed capital investments while gross capital formation rose only by 2.9%. Recovering investments and construction had positive if modest growth effects.

The restructuring of industrial production and exports continued in 2012 by declining shares of light industries, chemicals and metals and increasing shares of machinery and transport equipment. Romania has for some time become a country with processing industries integrated into European corporate networks and an export performance far above the pre-crisis level. The closure of the Nokia factory, however, triggered a decline in the production and exports of telecommunication equipment. At the same time, the production and exports of electronic products and other transport equipment got a significant boost. Also the car industry could uphold production despite falling domestic demand. Next to sluggish foreign demand, increasing production costs undermined the competitiveness of some chemical plants while numerous SMEs and state-owned enterprises suffered from high debts and mismanagement.

In the 2013 budget that has been agreed upon with the IMF, the government sets modest targets: the budget is based on GDP growth of 1.6%, a fiscal deficit of 2.4% and an average exchange rate of 4.5 RON/EUR. The wiiw forecast reckons with marginally lower growth and higher deficits but finds the government targets grossly in line with reality.

Expenditures of the 2013 budget have been set lower than proclaimed in the election campaign last year. The increase of the minimum monthly wage does not go up immediately to RON 800 but in two instalments as of February and July. Outlays are to increase for SME support and the finalization of EU projects which is especially necessary as the actual rate of structural and cohesion funds absorption was 14.92% of the disposable funds at the end of 2012. At the same time, investment projects financed from the government budget receive much lower funding than before bringing, among other things, the construction of the North-Transylvanian motorway, infamous for its exploding costs, to a standstill.

The revenue side of the government budget has been strengthened by several new measures. Micro enterprises are taxed according to their turnover and not their incomes. Agricultural producers and owners of herds are subject to new taxes. Additional taxes have been introduced on gas producers which are enjoying higher profits as a result of energy price rises: gas producers (Romgas and OMV-Petrom) will pay a tax of up to 60% on the additional income resulting from price hikes. As royalties on mining activities cannot increase under the present contracts until 2015, the government introduced an additional temporary tax of 0.5% of turnover on firms exploiting natural resources. Additional taxes have also been introduced on electricity and gas transporters.

The government has expressed its wish to sign a new stand-by agreement with the IMF, World Bank and the EU Commission similar to the one expiring in spring 2013. Such a treaty would provide emergency support in case of unforeseen financial difficulty, provided conditionalities are met. The most important of the targets, the fiscal stance, stayed prudent in the 2012 election year (unlike in earlier instances) and the government is committed to maintain fiscal prudence, thus the country is bound to leave the excessive deficit procedure in 2013. Further IMF conditions include measures to reduce public subsidies to the economy by restructuring and privatizing lossmaking public companies, stipulate reforms in the pension and the healthcare system, and set measures aiming at better targeting of social support. The government has grossly underperformed in terms of these structural reforms by delaying measures and their implementation. The prime minister spelled out hopes to obtain an extension by 3-5 months of the deadlines provided by the accord with the IMF on structural reforms. During this time, several state-owned companies will have to receive private management, undergo restructuring and minority shares should be floated on the stock exchange. Further companies that need a capital injection unavailable from the state budget are envisaged for privatization by auction, such as the freight transport company of the state railways, an act imposed against the government's wish.

As to monetary policy, the liquidity steering of the National Bank of Romania (BNR) has become an issue of dispute in early 2013. The interest rate and amount of weekly REPO operations by which the BNR offers cash to commercial banks in exchange for state bonds constitute the main tools to steer the liquidity of commercial banks.[1] The policy rate was cut in several steps from 6% in December 2011 to 5.25% in April 2012 and has been kept at the same level in view of exchange rate deteriorations following political uncertainties before the December elections. The BNR considers limiting the amounts at REPO auctions, a faster and more effective method of action than modifying the policy interest rate, expecting also a stronger impact on the exchange rate. Domestic currency liquidity and the exchange rate are connected. Therefore, when the RON/EUR rate climbed above 4.5 in the last quarter of 2012, the BNR squeezed liquidity by curtailing the weekly REPO sales to RON 4 billion, leaving banks' demand grossly unsatisfied. This policy continued also in the first weeks of January 2013 despite a remarkable firming of the domestic currency. A minority opinion emerged in the Board of the BNR advocating a relaxation of the liquidity squeeze with the aim of supporting economic growth. This opinion may get the upper hand in subsequent months if currency stability is maintained and inflation does not speed up.

The exchange rate and inflation are closely connected not only through market operations but also by influencing administered prices of energy, gas and excise duties. Starting 1 January 2013, the electricity price rose by 10% incorporating higher production and import costs as well as higher aid granted to producers of renewable energy. The excise duties paid for liquor, cigarettes, energy products and coffee increased mainly because of the higher exchange rate used in calculating them. Gas prices for the population will rise by 8% on 1 July and by an additional 2% from October and again by 10% in 2014 in accordance with the calendar for reducing price subsidies. In the case of companies the increase will be much harsher, putting an end to the competitive edge of energy-intensive industries. Cheap gas and electricity to major consumers had been one of the primary industrial policy tools of previous Romanian governments by which they breached EU norms stipulated by the accession agreement. The increase in energy prices to

[1] The one-week REPO rate has been the 'monetary policy interest rate' since March 2011 which is fixed every month at the BNR Board meeting. The interest rates on the NBR's standing facilities, i.e. the deposit facility and the lending facility, have been set at +/- 4 percentage points around the monetary policy rate.

international level will put an end to the competitiveness of energy-wasting industries; the bankruptcy of the Oltchim chemical company may just have been the first victim.

The current account deficit shrank in 2012 on account of vanished FDI income and improved services balances while the trade balance (also exports and imports in euro terms) remained at the level of the previous year. The first instalments of the outstanding debt to the IMF were paid by depleting the National Bank's reserves.

2013 will be a peak year in the public debt repayment calendar with EUR 15.2 billion falling due. The government will have to demonstrate prudence in view of the necessary bond issue activity and/or depleting official reserves. Thus, however solid the current fiscal and monetary situation may look, risks are high unless the impact of the euro area monetary easing – which brought down public bond refinancing costs in January – proves lasting. A modest increase in household demand and investments is expected to give some boost to the economy while net exports may not have a positive contribution again due to sluggish external demand. The GDP growth in the wiiw forecast of 1.5% in 2013 may materialize already in case of recovering agriculture. The more optimistic forecast for subsequent years is based on the recovery of main foreign markets.

After a year of political uncertainty a new government was formed in December 2012 which enjoys the support of two-thirds of the MPs. In the election campaign the Social-Liberal coalition promised an end to fiscal austerity and to introduce wage increases and tax reliefs during the four-year legislative period. The coalition also committed to reduce VAT from 24% to 19% by the end of its term in 2016 and a lower value-added tax on foodstuffs. Another promise is to keep the current flat personal income tax of 16%, but later the proposed rates would be 8%, 12% and 16%. They also envisage a stepwise increase of the minimum wage to RON 1200 by 2016. However, in January 2013 the government agreed with the IMF to further reduce fiscal deficits towards 2% of GDP. It is quite likely that the outlined stimulus to consumption will suffer delay and the 3% average annual GDP growth anticipated by the government will not materialize, at least not in the first three years of the legislative period.

Table RO

Romania: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	21514	21480	21438	19070	19000	18950	18900	18900
Gross domestic product, RON mn, nom.	514700	501139	523693	556708	589500	634200	679200	729600
annual change in % (real)	7.3	-6.6	-1.1	2.2	0.2	1.5	2.0	2.3
GDP/capita (EUR at exchange rate)	6500	5500	5800	6900	7000	.	.	.
GDP/capita (EUR at PPP)	11700	11100	11400	13300	13500	.	.	.
Consumption of households, RON mn, nom.	327928	304667	327242	345047	364400	.	.	.
annual change in % (real)	9.0	-10.4	-0.3	1.2	0.0	1.0	1.5	1.5
Gross fixed capital form., RON mn, nom.	164279	122442	129422	144558	167900	.	.	.
annual change in % (real)	15.6	-28.1	-1.8	7.3	10.0	1.0	4.0	5.0
Gross industrial production 3)								
annual change in % (real)	2.6	-5.5	5.5	5.6	0.0	3.0	5.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	21.2	-2.2	1.0	8.9	-22.7	.	.	.
Construction industry 3)								
annual change in % (real)	26.7	-15.0	-13.2	2.8	-0.4	.	.	.
Employed persons, LFS, th, average	9369.1	9243.5	9239.4	9137.7	9280.0	9300	9300	9400
annual change in %	0.2	-1.3	0.0	-1.1	1.6	0.2	0.0	1.1
Unemployed persons, LFS, th, average	575.5	680.7	725.1	730.2	710.0	.	.	.
Unemployment rate, LFS, in %, average	5.8	6.9	7.3	7.4	7.1	7.0	7.0	6.5
Reg. unemployment rate, in %, end of period	4.4	7.8	7.0	5.2	5.6	.	.	.
Average gross monthly wages, RON	1761	1845	1902	1980	2079	.	.	.
annual change in % (real, net)	16.5	-1.5	-3.7	-1.9	1.7	.	.	.
Consumer prices (HICP), % p.a.	7.9	5.6	6.1	5.8	3.4	4.2	3.5	3.5
Producer prices in industry, % p.a.	15.3	1.8	6.3	8.9	6.0	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	33.6	32.1	33.3	33.6	33.3	.	.	.
Expenditures	39.3	41.1	40.1	39.4	36.1	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-9.0	-6.8	-5.7	-2.8	-2.8	-2.8	-2.8
Public debt, EU-def., % of GDP	13.4	23.6	30.5	33.4	36.0	36.0	37.0	37.0
Central bank policy rate, % p.a., end of period 4)	10.25	8.00	6.25	6.00	5.25	.	.	.
Current account, EUR mn	-16178	-4938	-5476	-5937	-5039	-6000	-7000	-8000
Current account, % of GDP	-11.6	-4.2	-4.4	-4.5	-3.8	-4.2	-4.6	-4.9
Exports of goods, BOP, EUR mn	33656	29091	37333	45274	45043	46400	50100	54100
annual growth rate in %	13.9	-13.6	28.3	21.3	-0.5	3.0	8.0	8.0
Imports of goods, BOP, EUR mn	52729	35959	44901	52683	52356	53900	58200	62900
annual growth rate in %	11.3	-31.8	24.9	17.3	-0.6	3.0	8.0	8.0
Exports of services, BOP, EUR mn	8751	7061	6622	7253	7517	7900	8500	9200
annual growth rate in %	27.1	-19.3	-6.2	9.5	3.6	5.0	8.0	8.0
Imports of services, BOP, EUR mn	8091	7352	6216	6913	6939	7300	8000	8800
annual growth rate in %	25.0	-9.1	-15.5	11.2	0.4	5.0	10.0	10.0
FDI inflow, EUR mn	9501	3490	2227	1814	1613	1800	.	.
FDI outflow, EUR mn	186	-61	-12	-24	57	0	.	.
Gross reserves of NB excl. gold, EUR mn	25977	28249	32606	33166	31206	.	.	.
Gross external debt, EUR mn	72354	81206	92458	98724	99209	.	.	.
Gross external debt, % of GDP	51.8	68.7	74.4	75.2	75.0	.	.	.
Average exchange rate RON/EUR	3.6826	4.2399	4.2122	4.2391	4.4593	4.42	4.45	4.50
Purchasing power parity RON/EUR	2.0425	2.1047	2.1414	2.2031	2.2916	.	.	.

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.