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Romania:
Stagnation

The year 2010 began with good news: the re-elected president and the re-installed prime minister have ended the political stalemate that halted the reforms required for receiving the December instalment of the IMF and EU loan. The budget law for the current year was passed in mid-January, stipulating austerity measures in line with the stand-by agreement, and enabled the release of multilateral funding. The announced austerity measures will suppress domestic demand. At the same time the outlook for exports is positive driven by the inception of European recovery. The question is, what will have a stronger impact, the recovery of exports or the drop in public demand? The most likely scenario is that the contradicting forces will extinguish each other and the Romanian economy will stagnate in 2010.

In 2009 GDP contracted by 7.2%, first of all due the strong fall in private consumption and investment. Public consumption expanded and the trade balance improved remarkably forestalling an even stronger GDP decline. Romania was among those few EU members where the GDP decline continued in the fourth quarter of 2009. But industrial output recovered already in the final months of the year riding on the waves of increasing external demand. Manufacturing production was 3% higher in November 2009 than a year before; the production of capital goods in particular recovered strongly. This trend is due to continue in 2010 and beyond as Romania has established itself as a relatively cheap manufacturing location. Agricultural production contracted only marginally as against the previous peak year. But it is facing major difficulties in 2010 as several domestic subsidies expire in accordance with the EU accession agreement while farmers cannot easily access support provided under the Common Agricultural Policy.

Inflation came down somewhat but was still rather high in a European comparison. Due to the depreciation of the local currency by 15% on annual average, import prices rose and compensated for the deflationary effect of the recession. The exchange rate is expected to be more or less stable in 2010 which will easy inflationary pressure. But the increase in excises and forthcoming gas price hikes will not allow much inflation decline in 2010 either.

The consolidated fiscal deficit in 2010 was more than 7% of GDP, much higher than initially envisaged but in line with the modified IMF target. Further slippage could be avoided by seriously curtailing spending in the last quarter of the year. Authorities simply did not pay their obligations and increased arrears towards the rest of the economy. The 2010 budget law foresees expenditure cuts in the public sector, a wage freeze and releasing about a hundred-thousand employees. The government faced the dilemma either to cut public sector wages or decrease employment there;

they opted for a mix of the two solutions. Labour unrest, expected for the coming months, may modify these intentions. Earlier plans of increasing one or the other taxes were abandoned except for excises.

The unemployment rate based on registration rose to 7.6% in December, from 4.4% a year earlier, and the annual average for 2009 stood at 6.3%. LFS data come usually with some delay and may still show a milder increase. Most of the unemployed had to leave the private sector, in particular construction. Net real wages rose by some 2% as the public sector continued paying bonuses up to the middle of the year. The labour market situation will worsen in 2010 due to the expected layoffs in the public sector and registered unemployment may rise to 10%. A recovery in some industries may come from productivity increases and not from re-employment. Another factor influencing employment and income is the behaviour of Romanian migrants. Return migration was weak in 2009 but may accelerate if the economic rebound in Italy and Spain turns out weak. Unemployment and the threat of it forces the population to save more and curtail consumption, depressing the main domestic source of economic growth. Bank deposits rose by 7.9% in real terms in December year-on-year and the central bank expects this trend to continue. Labour market, income and savings trends point to falling private consumption in 2010.

In 2009 the current account deficit narrowed to less than one third compared to the previous year as both the trade and services balance improved and also the income deficit shrank. Imports contracted more than twice as fast as exports. Machinery and equipment (including cars) was the major export commodity group with 43% in exports while they accounted for only one third of imports. This reflects the strong position of cheap Romanian cars on foreign markets and the sharp drop in demand for vehicles and investment goods in the country. In November 2009 exports already outpaced the level of November 2008 and more recovery can be expected for 2010. Another important current account item, transfers, declined by one third indicating that emigrant workers could send home less than before. The inflow of direct investments was EUR 4.9 billion, half the amount registered in the previous year but still covering almost the whole current account deficit. In 2010 neither remittances nor FDI are expected to recover; the trade and thus also the current account deficit will most probably start to grow in euro terms.

The IMF Executive Board allowed two disbursements worth EUR 2.3 billion from the loan package which had been frozen in October after the government's dismissal by Parliament. Also the European Commission indicated it would unlock EUR 1 billion in funding. Half of the IMF funds will go directly to the government budget, which is an exceptional measure allowed by the Fund. Thus external financing is sufficient to ensure stability, provided the agreed policy measures are implemented.

In 2010 Romania faces a year with stagnating GDP. This wiiw forecast is more pessimistic than those of the multilateral institutions and of the Romanian government, which have agreed on 1.3% recovery. The positive component is the recovery in Western Europe, which invigorates Romanian exports and will bring new orders for manufacturing, but will not necessarily have a positive impact on employment and only a modest one on investment and consumption. Meanwhile also imports will be increasing thus net exports may stagnate. Importantly, the above-mentioned restrictive fiscal measures will curtail consumption and investment. As to the latter, one may expect some increase only due to EU-financed programmes. Agriculture is another uncertain factor with an eventually strong impact on GDP. As 2009 was better than average in this field despite a slight production drop compared to the peak-year 2008, decline is more likely than recovery. For the overall economy, the balance of the positive and negative trends may be zero for the year as a whole. If exports and manufacturing recover more robustly and fiscal revenues rebound, the second half of the year may already bring some recovery which will show up more strongly in 2011. Beyond that year our forecast refers to a kind of balanced growth over the medium term. It is expected that the inflow of external financing will remain modest and growth that is primarily based on domestic savings cannot be very robust. The boom of 2006-2008 will thus not return any time soon. Still economic growth of about 4% will ensure the resumption of a modest catching-up process.

Table RO

Romania: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011	2012
								Forecast	
Population, th pers., average	21685	21634	21588	21547	21514	21482	21460	21440	21410
Gross domestic product, RON mn, nom.	247368	288955	344651	416007	514654	501500	526600	564100	616000
annual change in % (real)	8.5	4.2	7.9	6.3	7.3	-7.2	0	3	4
GDP/capita (EUR at exchange rate)	2800	3700	4500	5800	6500	5500	.	.	.
GDP/capita (EUR at PPP)	7400	7900	9100	10400	12000	11400	.	.	.
Consumption of households, RON mn, nom.	167644	197069	233135	273418	327882	303000	.	.	.
annual change in % (real)	15.8	10.1	12.9	12.0	9.5	-12	-1	1	2
Gross fixed capital formation, RON mn, nom.	53850	68527	88272	125645	164264	144900	.		
annual change in % (real)	11.0	15.3	19.9	30.3	16.2	-16	3	7	9
Gross industrial production [2]									
annual change in % (real)	2.7	-3.1	9.3	10.3	2.6	-5.5	3	5	7
Gross agricultural production									
annual change in % (real)	18.1	-13.1	2.4	-17.7	21.2	-2.7	.	.	.
Construction industry [2]									
annual change in % (real)	2.0	6.1	15.4	33.2	26.7	-15.1	.	.	.
Employed persons - LFS, th, avgerage	9157.6	9114.6	9291.2	9353.3	9369.1	9250	9150	9150	9200
annual change in %	-0.7	-0.5	1.9	0.7	0.2	-1.3	-1	0	1
Unemployed persons - LFS, th, average	799.5	704.5	728.4	640.9	575.5	700	.	.	
Unemployment rate - LFS, in %, average	8.0	7.2	7.3	6.4	5.8	7	8.5	8	6
Reg. unemployment rate, in %, end of period	6.3	5.9	5.2	4.0	4.4	7.6	.	.	.
Average gross monthly wages, RON	818.3	968.0	1146.0	1396.0	1742.2	1900	.	.	.
annual change in % (real, net)	10.5	14.3	9.0	14.7	14.1	2	.	.	.
Consumer prices (HICP), % p.a.	11.9	9.1	6.6	4.9	7.9	5.6	4	3	4
Producer prices in industry, % p.a.	19.2	8.1	9.5	7.5	15.3	1.8	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	32.3	32.3	33.1	33.5	32.1	31.0	.	.	.
Expenditures	33.5	33.5	35.3	36.0	37.6	38.2	.	.	.
Net lending (+) / net borrowing (-)	-1.2	-1.2	-2.2	-2.5	-5.4	-7.2	-6	-5	-4
Public debt, EU-def., in % of GDP	18.7	15.8	12.4	12.6	13.6	22	27	31	33
Discount rate of NB, % p.a., end of period [3]	17.96	7.50	8.75	7.50	10.25	8.00	.	.	.
Current account, EUR mn	-5099	-6888	-10220	-16758	-16178	-5054	-7000	-9000	-11000
Current account in % of GDP	-8.4	-8.6	-10.5	-13.4	-11.6	-4.3	-5.6	-6.5	-7.1
Exports of goods, BOP, EUR mn	18935	22255	25953	29542	33656	29036	30500	33600	37600
annual growth rate in %	21.3	17.5	16.6	13.8	13.9	-13.7	5	10	12
Imports of goods, BOP, EUR mn	24258	30061	37765	47365	52729	35790	37200	41700	47500
annual growth rate in %	24.0	23.9	25.6	25.4	11.3	-32.1	4	12	14
Exports of services, BOP, EUR mn	2903	4102	5585	6885	8751	7000	7700	8500	9400
annual growth rate in %	8.7	41.3	36.2	23.3	27.1	-20.0	10	10	10
Imports of services, BOP, EUR mn	3116	4451	5581	6475	8091	7267	8000	8800	9700
annual growth rate in %	19.4	42.8	25.4	16.0	25.0	-10.2	10	10	10
FDI inflow, EUR mn	5183	5213	9060	7280	9501	4899	4000	.	.
FDI outflow, EUR mn	56	-24	338	206	186	131	.	.	.
Gross reserves of NB excl. gold, EUR mn	10923	16785	21299	25325	25978	28303	.	.	.
Gross external debt, EUR mn	21504	30914	41196	58628	72354	78656	.	.	.
Gross external debt in % of GDP	34.2	39.4	40.4	50.8	56.6	66.4	.	.	.
Average exchange rate RON/EUR	4.0510	3.6209	3.5258	3.3353	3.6826	4.2399	4.2	4.1	4.0
Purchasing power parity RON/EUR	1.5442	1.6989	1.7600	1.8621	1.9869	2.0552	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) Reference rate of NB.

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