

Romania: robust growth

With the invitation to join NATO in 2004 and the EU in 2007, the government has achieved its main political targets. These news together with the expected robust economic growth, improving external financial stability and decreasing inflation prompted all international rating agencies to upgrade Romania's rating. Despite all improvements, Romania has still the highest rate of inflation among the accession countries, and per capita GDP has not yet reached its pre-transition level. The EU still does not consider Romania a functioning market economy, privatization is behind schedule and financial indiscipline is acute. The question is how lasting and how high the rate of economic growth can be if the solving of the pressing structural problems is further delayed.

The 4.5% GDP growth recorded for the first nine months of 2002 can be regarded as the likely result for the year as a whole. That represents a deceleration compared to the (still provisional) 5.3% of the previous year and also to the expectation of the government.

Growth in 2002 was fed by a close to 7% increase in industry and construction value added, somewhat moderated by a 5% decline in agriculture. Industry is still growing in the traditional structure, with metallurgy, clothing and petroleum processing featuring the highest growth rates. On the demand side, household consumption, up by about 4%, sets the trend. A piece of very good news is that gross fixed capital formation grew by about 8%, increasing its share in value added to 22%. Private sector investments demonstrate the general confidence in the Romanian economy.

Budgetary policy underwent some tightening in the second half of the year, thus the annual consolidated deficit could be reduced to below 3% of GDP. Subsidies to the energy companies shrank after prices for electricity and gas had been raised. A further decrease of the consolidated budget deficit to 2.7% of GDP is envisaged for 2003. This should be achieved mainly by not increasing outlays at the rate of inflation. Substantial relief to the budget will come from falling interest payments for the public debt, while tax policy will mainly aim at harmonizing tax rates and lowering the tax burden. Corporate income tax on export earnings will be raised from 6% to 12.5%, half of the normal rate which would be reached next year, while there are plans to reduce the overall corporate income tax to 20%. Wage-related taxes were cut by 3 percentage points last year and by another 5% this year. With an overall wage-related tax burden of 50% Romania is still among the high-tax, but low-wage countries.

The external sector improved its contribution to GDP as the deficit on goods and services decreased. Merchandise exports grew by 19.7% in current USD terms and imports by 14.5% during the first 11 months. The trade deficit remained flat at USD 4.3 billion. Neither rising private consumption nor machinery investments generated an extraordinary import surge as in previous years. Romania could increase its market shares in its main market, the EU, for the most important export items: clothing, footwear, machinery and mineral products. Relying on low wages and improving product quality, Romanian companies, primarily foreign subsidiaries, attracted orders from higher-wage accession countries and EU incumbents not only in clothing and footwear but to a growing extent in machinery and electronics.¹

The current account deficit in 2002 was about USD 1.8 billion, well below that of the previous year. The main factor in the improvement was the increase in transfers of Romanians working abroad (USD 1.3 billion in the first ten months). The balance of services improved as well. The inflow of capital more than balanced the current account deficit. International bond issues as well as multilateral credits contributed to a wider availability of external funds. Both foreign debts and reserves increased by some USD 2 billion. The only item below expectation was the inflow of FDI, USD 823 million in the first ten months, less than the previous year. The unsuccessful privatization attempt of the largest commercial bank, BCR, can be blamed for this.

Both the government and the central bank have done their job to reduce inflation. The achieved 22.5% on annual average is a good deal lower than in previous years but still higher than in most other transition countries. The gradualistic approach to disinflation helped to maintain international competitiveness. The central bank did not allow much appreciation of the Romanian leu (ROL) against the euro and decreased the local currency interest rates all through the year. The reference rate was brought down from 35% to 20%. The easing of the interest burden stimulated non-government borrowing, which increased by 40% in the first ten months and even more lately. More than 62% of it was taken in foreign currency, thus dollarization remained a characteristic feature. The central bank started to counteract by decreasing the compulsory reserve rate for ROL deposits and increasing it for USD loans. Monetary expansion and wage rises also fuelled inflation in the last quarter of 2002. Increasing liquidity in the economy in 2003 will support growth but may slow down disinflation.

¹ For details see G. Hunya, 'Restructuring Through FDI in Romanian Manufacturing', *wiiw Research Reports*, no. 287, August 2002.

Privatization proceeded at the usual sluggish pace. Law amendments in 2002 allowed for the rescheduling of tax and payment arrears for companies undergoing privatization. In January 2003 the generosity was further extended to unpaid utility bills. Utility companies, in turn, are exempted from various tax payments to balance their losses. This indicates that there is no fair competition between the private and the public sector, and the government aims to support the functioning of public sector companies with discretionary measures. Another privatization-related problem is the set of obligations the new owners have to pledge. These concern the number of workforce kept and future investment outlays. Checking commitments and suing non-performing firms has become one of the main activities of the privatization agency, while this attitude discourages potential investors.

The IMF considers that there will be no problem closing the current stand-by agreement by the extended deadline, August 2003. This would be the first of six such credit lines totally disbursed. It is likely that no new agreement will be put in place, which would relieve the Romanian authorities of the IMF straightjacket. More autonomy on the one hand, more freedom to stall reforms, on the other.

While the Romanian government maintains 5-5.5% as the feasible medium-term growth target, we consider 4% to be more in line with the international environment and the pace of structural reforms. This forecast is in fact higher than expected earlier and takes into account that catching-up to pre-transformation GDP can be faster than the normal growth rate and that EU pre-accession aid provides for more external financing than earlier assumed. We also think that disinflation will be slower than expected and year-end inflation will not come down to single digit by the end of 2004.

Table RO

Romania: Selected economic indicators

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 ¹⁾ | 2003 | 2004 forecast |
|---|---------|---------|---------|---------|----------|----------|-------------------------|---------|------------------|
| Population, th pers., mid-year | 22607.6 | 22545.9 | 22502.8 | 22458.0 | 22435.2 | 22409.0 | . | . | . |
| Gross domestic product, ROL bn, nom. | 108920 | 252926 | 371194 | 545730 | 800308 | 1154126 | 1483500 | 1820000 | 2180000 |
| annual change in % (real) | 3.9 | -6.1 | -4.8 | -1.2 | 1.8 | 5.3 | 4.5 | 4 | 4 |
| GDP/capita (USD at exchange rate) | 1563 | 1565 | 1872 | 1585 | 1644 | 1772 | 2000 | . | . |
| GDP/capita (USD at PPP - wiiw) | 6630 | 5640 | 5450 | 5510 | 5740 | 6180 | 6460 | . | . |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 6.3 | -7.2 | -13.8 | -2.4 | 7.1 | 8.2 | 6.0 | 4 | 4 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 1.3 | 3.4 | -7.5 | 5.2 | -14.2 | 21.7 | . | . | . |
| Goods transport, mn t-kms ²⁾ | 106758 | 87590 | 62364 | 45988 | 42131 | 40648 | . | . | . |
| annual change in % | -15.8 | -18.0 | . | -26.3 | -8.4 | -3.5 | . | . | . |
| Gross fixed capital formation, ROL bn, nom. | 24998.5 | 53540.1 | 68111.6 | 96630.4 | 151486.2 | 219289.3 | . | . | . |
| annual change in % (real) | 5.7 | 1.7 | -5.7 | -4.8 | 4.6 | 6.6 | 8 | 5 | 5 |
| Construction output total | | | | | | | | | |
| annual change in % (real) | 3.7 | -24.4 | -0.5 | -0.2 | 2.8 | 4.1 | 4.9 ^{I-X} | . | . |
| Dwellings completed, units | 29460 | 29921 | 29692 | 29517 | 26376 | 27041 | 15610 ^{I-X} | . | . |
| annual change in % | -17.8 | 1.6 | -0.8 | -0.6 | -10.6 | 2.5 | 7.4 | . | . |
| Employment total, th pers., end of period | 9379.0 | 9022.7 | 8812.6 | 8420.0 | 8629.0 | . | . | . | . |
| annual change in % | -1.2 | -3.8 | -2.3 | -4.5 | 2.5 | . | . | . | . |
| Employees in industry, th pers., average | 2586.0 | 2443.0 | 2272.0 | 1991.0 | 1873.0 | 1817.0 | 1817.8 ^{I-X} | . | . |
| annual change in % | -1.1 | -5.5 | -7.0 | -12.4 | -5.9 | -3.0 | -0.8 | . | . |
| Reg. unemployed, th pers., end of period | 657.6 | 881.4 | 1025.1 | 1130.3 | 1007.1 | 826.9 | 760.6 | . | . |
| Reg. unemployment rate in %, end of period | 6.6 | 8.9 | 10.4 | 11.8 | 10.5 | 8.4 | 8.1 | 8 | 8 |
| LFS - unemployment rate in %, average ³⁾ | 6.7 | 6.0 | 6.3 | 6.8 | 7.1 | 6.6 | 9.0 ^{I-VI} | 9 | 9 |
| Average gross monthly wages, ROL | 426610 | 846450 | 1357132 | 1957731 | 2876645 | 4282622 | 5354872 ^{I-XI} | . | . |
| annual change in % (real, net) | 9.3 | -22.6 | 3.4 | -3.8 | 4.6 | 4.5 | 3.7 | . | . |
| Retail trade turnover, ROL bn ⁴⁾ | 35316 | 83035 | 125513 | 160137 | 213569 | . | . | . | . |
| annual change in % (real) ⁴⁾ | 15.3 | -12.1 | 20.6 | -6.4 | -7.0 | 0.4 | 0.5 ^{I-XI} | . | . |
| Consumer prices, % p.a. | 38.8 | 154.8 | 59.1 | 45.8 | 45.7 | 34.5 | 22.5 | 18 | 15 |
| Producer prices in industry, % p.a. | 49.9 | 152.7 | 33.2 | 44.5 | 53.4 | 41.0 | 24.9 ^{I-XI} | . | . |
| Central government budget, ROL bn | | | | | | | | | |
| Revenues | 18373 | 43835 | 67216 | 93240 | 120342 | 148203 | 163194 ^{I-XI} | . | . |
| Expenditures | 23732 | 52897 | 77617 | 106887 | 149168 | 184012 | 202620 ^{I-XI} | . | . |
| Deficit (-) / surplus (+) | -5359 | -9062 | -10401 | -13647 | -28826 | -35809 | -39426 ^{I-XI} | . | . |
| Deficit (-) / surplus (+), % GDP | -4.9 | -3.6 | -2.8 | -2.5 | -3.6 | -3.1 | . | . | . |
| Money supply, ROL bn, end of period | | | | | | | | | |
| M1, Money | 11173 | 18731 | 22110 | 29669 | 46331 | 64309 | 72822 ^{Nov} | . | . |
| M2, money + quasi money | 30335 | 62150 | 92530 | 134123 | 185060 | 270512 | 334584 ^{Nov} | . | . |
| Discount rate, % p.a., end of period ⁵⁾ | 35.0 | 40.0 | 35.0 | 35.0 | 35.0 | 35.0 | 20.4 | . | . |
| Current account, USD mn | -2571 | -2137 | -2968 | -1469 | -1363 | -2317 | -1800 | -2500 | -2500 |
| Current account in % of GDP | -7.3 | -6.1 | -7.1 | -4.1 | -3.7 | -5.8 | -4.0 | -4.7 | -4.6 |
| Gross reserves of NB excl. gold, USD mn | 550.7 | 2193.5 | 1374.8 | 1526.3 | 2469.7 | 3922.5 | 6145 | . | . |
| Gross external debt, USD mn ⁶⁾ | 7208.9 | 8584.3 | 9322.6 | 8770.7 | 10273.4 | 11950.0 | 14292 ^{Nov} | . | . |
| Exports total, fob, EUR mn ⁷⁾ | 6375.9 | 7434.4 | 7412.4 | 7955.6 | 11219.2 | 12710.7 | 14500 | 15400 | 16300 |
| annual growth rate in % | 5.4 | 16.6 | -0.3 | 7.3 | 41.0 | 13.3 | 14 | 6 | 6 |
| Imports total, cif, EUR mn ⁷⁾ | 9018.6 | 9946.3 | 10569.3 | 9896.0 | 14128.2 | 17362.5 | 19100 | 20400 | 21800 |
| annual growth rate in % | 14.8 | 10.3 | 6.3 | -6.4 | 42.8 | 22.9 | 10 | 7 | 7 |
| Average exchange rate ROL/USD | 3082.6 | 7167.9 | 8875.6 | 15332.9 | 21692.7 | 29060.9 | 33055.5 | . | . |
| Average exchange rate ROL/EUR (ECU) | 3862.9 | 8090.9 | 9989.3 | 16295.6 | 19955.8 | 26026.9 | 31255.3 | 36000 | 40000 |
| Purchasing power parity ROL/USD, wiiw | 726.9 | 1988.5 | 3028.9 | 4414.0 | 6215.9 | 8329.1 | 10257.6 | . | . |
| Purchasing power parity ROL/EUR, wiiw | 788.2 | 2181.1 | 3319.0 | 4808.2 | 6744.7 | 9037.7 | 11075.6 | . | . |

Notes: 1) Preliminary. - 2) From 1998 new methodology in road transport. - 3) From 2002 new methodology in accordance to EU definitions. - 4) From 1998 new methodology. - 5) Reference rate of NB from February 2002. - 6) Medium- and long-term. - 7) Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.