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# Romania:
## contraction in all fields

In the first quarter of 2009 the GDP contracted by 6.2% compared to the same period a year earlier, first of all due the strong fall in private consumption (-12.3%) and an even more serious decline in inventories. Gross fixed capital formation was maintained at almost the same level as in the previous year, while public consumption increased and the trade balance improved. The first-quarter GDP downturn was more severe than expected and the decline is not going to bottom out before the last quarter of the year when the base from the previous year will become lower.

In April, the government revised its February estimation of the GDP decline for 2009 from 2% to 4.1%. Also wiiw has followed this course in view of the shrinking industrial production: currently we expect a decline of about 6%. This forecast is based not only on the performance in the first quarter of the year, but also takes into account the expected output decline in agriculture. The extreme drought in several parts of the country will cause agricultural production to drop, triggering a fall in the food industry and on-the-farm consumption as well. Weather conditions may have a plus-minus 2 percentage point impact on the Romanian GDP and 2008 was an extremely good year, thus the decline in 2009 can be all the more severe. Further hardship is looming in the corporate sector. Currently SMEs credit each other involuntarily in the absence of affordable loans on a massive scale, but this may not last for long and a wave of bankruptcies may set in. In the first five months of the year the number of filed insolvency cases was already up by 60% compared with the previous year.

Industrial production fell due to shrinking demand both within the country and abroad. In the first quarter of 2009 it was 13% lower than in the same period a year earlier, in the first four months by 12% – a negligible improvement. Nevertheless, compared with other NMS, industrial production has suffered a less severe setback as it is less dependent on foreign demand. Declines were registered for all main categories of products, more strongly so in manufacturing than in mining and the energy sector. The output of the construction sector and investments as a whole almost reached the level of the previous year in the first quarter of 2009. Projects launched earlier were finished but very few building permits were issued and in April there was already a marked decline in housing construction.

In April 2009, Romania posted the highest annual inflation rate within the EU, 6.5%. Due to the depreciation of the local currency after December 2008 import prices rose and compensated for the deflationary effect of the recession. As the exchange rate broadly stabilized from April onwards and the deflationary effects of the recession became stronger, prices remained stable in May compared to the previous month. A return of depreciation is still likely, thus a resumption of inflation cannot be ruled out.

The population has been confronted with small or no wage increases at all this year as the new government invalidated the generous promises made by the former one which lost power in December. Still, in March 2009, the nominal average net salary was 17.6% and the real salary 10.2% higher than a year earlier. But this strong increase was the result of last year's hikes; the restrictive wage policies of the current year will show their effects with some delay. The increase in unemployment was modest in the first quarter of the year, companies introduced short working weeks rather than laying off people, at least for the time being.

In view of the rapid currency depreciation and the increasing possibility of a sudden stop of external financing, Romania asked for a loan agreement from the IMF, World Bank and the EU in February. The accord with the IMF approved in May 2009 puts a cap on the fiscal deficit but does not recommend it to be cut from the 5.1% attained last year. The target has to be kept no matter how strongly GDP is going to contract in addition to the 4.1% decline calculated in the stand-by agreement – which in fact means a curtailment of the deficit. In expenditures there is shift from public wages to investments. According to the accord with the IMF, fiscal reforms include measures to improve budgeting, streamline public wages and pensions, and make public enterprises more efficient to ensure that the deficit will remain low in the future. These reforms should help produce a leaner, more efficient, and more transparent public sector. To make sure that weak social groups are not hit overly hard, the government promised to make arrangements to protect the lowest paid public employees, the poorest pensioners, and others exposed to the economic downturn by boosting social safety net spending.

The current account posted a deficit of only EUR 709 million for the first quarter of 2009, improving by 82.1% compared to the first quarter of 2008. This improvement, from an excessive 16% of GDP to a mere 3% of GDP, came abruptly and reflects the sharp decline in domestic demand. The trade balance accounted for the main impact: it amounted to EUR 1.337 billion, down 67.2% as against the first three months of 2008. (In April, exports and even more so imports kept falling, thus the trade deficit contracted further.) The income of foreign investors declined sharply in the first quarter while the transfers of emigrants remained at the previous year's level. The latter is quite surprising in view of the rising unemployment in the host countries and Spain even offering a return-subsidy for migrants. It seems that migrants are still hoping for a better future abroad and do not expect any better opportunities at home. The current account deficit in the first quarter of 2009 was fully financed by direct investments (as against 42.8% in the first quarter of 2008): these amounted to EUR 1.456 billion, compared to EUR 1.691 billion a year earlier. It is expected that the current account deficit may climb to about 5% of GDP; FDI will finance about three quarters of it, the rest will be covered by EU and IMF funds.

In May Romania received a first instalment of the stand-by credit worth EUR 4.9 billion which was added to the central bank's foreign currency reserves. Reserves thus stocked up, and the BNR could reduce its own reserve collection activity. As of May the monetary policy interest rate was cut by 0.5 percentage points, to 9.5% per year. The mandatory minimum reserves rates applicable for RON and foreign currency liabilities were maintained at 18% and 40% respectively, but it was abolished for foreign-denominated liabilities with residual maturities of over two years, starting with 24 May. This has effectively reduced the reserve building obligations of commercial banks and allowed to pump new liquidity into the system.

On 26 March, in Vienna, the parent banks of the nine largest foreign banks incorporated in Romania (Erste Group Bank, Raiffeisen International, Eurobank EFG, National Bank of Greece, Unicredit Group, Société Generale, Alpha Bank, Volksbank, Piraeus Bank) gave a general declaration on maintaining their overall exposure to the country and on increasing the capital of their subsidiaries. As a result of the discussions held in Brussels on 19 May, the nine parent banks agreed to submit specific bilateral commitment letters in the coming weeks to fulfil the objectives agreed upon in Vienna. These commitments include a precautionary increase in the minimum capital adequacy ratio for each subsidiary from 8% to 10% for the duration of the IMF programme. The banks will have to provide recapitalization of altogether EUR 1 billion until September 2009 and undergo another stress test in March next year.

As of mid-2009 the Romanian economy's contraction has not reached its bottom yet, but its stability has improved as a result of fiscal and current account adjustments. The IMF support protects the country in case of a sudden stop imposed by market sentiment. The recovery of the economy is dependent on the demand in its main export markets and on international financial flows to the country. Even if a recovery takes place in the main foreign markets, the inflow of financing may stay restricted compared with earlier years. Under such conditions, we expect a stagnation of the economic performance in 2010 and only a modest upswing in the following years. The introduction of the euro is approached cautiously with the target date 2014.

Table RO

## Romania: Selected Economic Indicators

| | 2005 | 2006 | 2007 | 2008 1) | 2008 | 2009 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 1st quarter | | | Forecast | |
| Population, th pers., average | 21634 | 21588 | 21547 | 21513 | . | . | . | . | . |
| Gross domestic product, RON mn, nom. 2) | 288955 | 344651 | 412762 | 503959 | 91130 | 96521 | 521100 | 559100 | 607300 |
| annual change in % (real) 2) | 4.2 | 7.9 | 6.2 | 7.1 | 8.2 | -6.2 | -6 | 0 | 3 |
| GDP/capita (EUR at exchange rate) | 3700 | 4500 | 5700 | 6400 | . | . | . | . | . |
| GDP/capita (EUR at PPP) | 7900 | 9100 | 10500 | 11300 | . | . | . | . | . |
| Consumption of households, RON mn, nom. 2) | 197069 | 233135 | 273063 | 325041 | 69073 | 64812 | . | . | . |
| annual change in % (real) 2) | 10.1 | 12.9 | 11.7 | 9.2 | 15.6 | -12.3 | -8 | 0 | 3 |
| Gross fixed capital formation, RON mn, nom. 2) | 68527 | 88272 | 125645 | 167942 | 21484 | 23287 | . | . | . |
| annual change in % (real) 2) | 15.3 | 19.9 | 29.0 | 19.3 | 33.2 | -0.3 | -5 | 3 | 10 |
| Gross industrial production 3)4) | | | | | | | | | |
| annual change in % (real) | 2.0 | 7.1 | 5.4 | 0.9 | 6.4 | -13.0 | -10 | 3 | 5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -13.1 | 2.4 | -17.7 | 19.4 | . | . | . | . | . |
| Construction industry (build.& civil engin.) 3)4) | | | | | | | | | |
| annual change in % (real) | 8.6 | 20.5 | 34.0 | 26.0 | 35.1 | 4.4 | . | . | . |
| Employed persons - LFS, th, avgerage | 9114.6 | 9291.2 | 9353.3 | 9369.1 | 9118.6 | . | . | . | . |
| annual change in % | -0.5 | 1.9 | 0.7 | 0.2 | 0.1 | . | . | . | . |
| Unemployed persons - LFS, th, average | 704.5 | 728.4 | 640.9 | 575.5 | 616.7 | . | . | . | . |
| Unemployment rate - LFS, in %, average | 7.2 | 7.3 | 6.4 | 5.8 | 6.3 | . | 9 | 9 | 8 |
| Reg. unemployment rate, in %, end of period | 5.9 | 5.2 | 4.0 | 4.4 | 4.1 | 5.6 | . | . | . |
| Average gross monthly wages, RON | 968.0 | 1146.0 | 1396.0 | 1742.2 | 1601.0 | 1865.7 | . | . | . |
| annual change in % (real, net) | 14.3 | 9.0 | 14.7 | 14.2 | 13.7 | 9.3 | . | . | . |
| Consumer prices (HICP), % p.a. | 9.1 | 6.6 | 4.9 | 7.9 | 8.0 | 6.8 | 6 | 4 | 3 |
| Producer prices in industry, % p.a. 4) | 10.5 | 11.6 | 8.1 | 15.8 | 14.2 | 5.7 | . | . | . |
| General governm.budget, EU-def., % GDP 5) | | | | | | | | | |
| Revenues | 32.3 | 33.1 | 34.0 | 33.1 | . | . | . | . | . |
| Expenditures | 33.5 | 35.3 | 36.6 | 38.5 | . | . | . | . | . |
| Net lending (+) / net borrowing (-) | -1.2 | -2.2 | -2.5 | -5.4 | . | . | -5.5 | -4 | -4 |
| Public debt, EU-def., % of GDP 5) | 15.8 | 12.4 | 12.7 | 13.6 | . | . | . | . | . |
| Discount rate of NB, % p.a., end of period 6) | 7.50 | 8.75 | 7.50 | 10.25 | 9.00 | 10.14 | . | . | . |
| Current account, EUR mn | -6888 | -10220 | -16715 | -16744 | -3955 | -709 | -6000 | -7000 | -9000 |
| Current account in % of GDP | -8.6 | -10.5 | -13.5 | -12.2 | -16.0 | -3.1 | -5.0 | -5.3 | -5.9 |
| Exports of goods, BOP, EUR mn | 22255 | 25953 | 29542 | 33560 | 8143 | 6561 | 26800 | 27600 | 29500 |
| annual growth rate in % | 17.5 | 16.6 | 13.8 | 13.6 | 15.8 | -19.4 | -20 | 3 | 7 |
| Imports of goods, BOP, EUR mn | 30061 | 37765 | 47365 | 51895 | 12221 | 7898 | 36300 | 36700 | 38900 |
| annual growth rate in % | 23.9 | 25.6 | 25.4 | 9.6 | 15.9 | -35.4 | -30 | 1 | 6 |
| Exports of services, BOP, EUR mn | 4102 | 5585 | 6931 | 8766 | 1877 | 1789 | 8300 | 9100 | 10000 |
| annual growth rate in % | 41.3 | 36.2 | 24.1 | 26.5 | 12.5 | -4.7 | -5 | 10 | 10 |
| Imports of services, BOP, EUR mn | 4451 | 5581 | 6450 | 7921 | 1732 | 1732 | 7500 | 8300 | 9100 |
| annual growth rate in % | 42.8 | 25.4 | 15.6 | 22.8 | 26.0 | 0.0 | -5 | 10 | 10 |
| FDI inflow, EUR mn | 5213 | 9060 | 7271 | 8902 | 1690 | 1457 | 4000 | . | . |
| FDI outflow, EUR mn | -24 | 338 | 206 | -188 | -98 | -22 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 16785 | 21299 | 25325 | 25978 | 25158 | 25121 | . | . | . |
| Gross external debt, EUR mn | 30914 | 41196 | 58537 | 73004 | 61027 | 71632 | . | . | . |
| Gross external debt in % of GDP | 39.4 | 40.4 | 51.2 | 58.3 | 48.7 | 59.1 | . | . | . |
| Average exchange rate RON/EUR | 3.6209 | 3.5258 | 3.3328 | 3.6776 | 3.6892 | 4.2662 | 4.3 | 4.2 | 4.0 |
| Purchasing power parity RON/EUR | 1.6990 | 1.7618 | 1.8273 | 2.0813 | . | . | . | . | . |

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 3 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) According to ESA'95, excessive deficit procedure. - 6) Reference rate of NB.

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