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Romania: economic boom with growing foreign imbalance

Romania entered the European Union on 1 January 2007 after a year of impressive economic growth of about 7.5%, an appreciating currency and year-end inflation reduced to below 5%. The prospects for further economic growth are bright, at least in the short run. But the widening current account deficit and the wage drift pose problems which increase currency risk and inflationary pressure. These may call for austerity measures in the future.

Private consumption has been the main driving force of economic growth while also investments have been buoyant. The former contributed 9.4% to the GDP growth rate of 7.8% in the first three quarters of 2006 while gross fixed capital formation added 3.1%. Net exports contributed 4.6% on the negative side. The expansion of construction surpassed that of all other economic sectors, reflecting stepped-up spending on roads, shopping centres and office buildings. Also industrial output grew faster than the year before, in particular in the export sectors of car manufacturing and the furniture industry. Agriculture recovered from the previous year's slump which supported the food industry and tempered inflation.

The budget deficit in 2006 exceeded 1% of GDP, according to provisional data (national methodology). The budget deficit ceiling was set to 2.5% of GDP after the government had increased the deficit target twice during the year to support infrastructure investment expenditure. Lack of administrative and construction capacities prohibited the realization of this plan.

Wage increases continued to outpace productivity growth in the economy as a whole and also in manufacturing. The wage drift fuelled private consumption and imports but not inflation. The consumer price index declined significantly, to below 7%, and the year-end pace of 4.9% hit the National Bank target.

The current account and foreign trade deficits continued to be of concern. There was a remarkable expansion of exports by some 20%, but imports grew even faster, by about 25%. The trade deficit has hardly been mitigated by other items in the current account, as trade in services was nearly balanced and the deficit on incomes was balanced by the surpluses in current transfers. The current account deficit was close to 11% of GDP; 90% of it could be financed by FDI. The latter reached an all-time high, mainly due to privatization revenues and profit reinvestments rather than to new greenfield projects.

The progress of privatization has slowed down again. At the beginning of June 2006, the privatization agency (AVAS) had in its portfolio 441 companies, of which 64 were majority state-owned including only 22 large companies. Little progress was achieved through the

year due to cumbersome procedures and, in many cases, the unattractive situation of the companies offered for sale. The plan for 2007 includes the privatization of 62 companies including large companies in the utilities sector. The natural gas producer Romgaz is certainly the biggest remaining chunk, and in the banking sector this is the savings bank, CEC. There was a half-hearted attempt to sell CEC, but the price offered was declared unsatisfactory in December 2006 and the bank remained in public hands. The privatization of Romgaz is in stand-by; both President Basescu and the opposition leaders consider that it is not a priority. The energy sector is understood as sensitive. It is widely quoted that many EU countries maintain a national stronghold on energy companies, such as Gaz de France, which bought part of the gas distributor Distrigaz in Romania. Four energy distribution companies are in the 2007 privatization plan of AVAS, but no government decision has been passed yet. AVAS is also left with minority shares in a number of companies. According to the 2007 plans, in 95 cases the majority owner would buy them, while in 265 cases the shares will be offered on the Bucharest stock exchange. If these plans are successful, 2007 will be the year of the largest amount of stock exchange privatization.

In 2007 and 2008 Romania will be confronted with growing tensions. The current account deficit will expand further, while FDI will decline in the absence of new large privatization projects. Wages are set to expand: an 18% rise has been promised to public sector employees in 2007, and qualified labour in the private sector which is becoming short will also demand more. While foreign financing uncertainties may bring more volatility to the exchange rate, wages too may fuel inflation. In addition, the government budget will be more expansionary than in recent years. The question is when and how these tensions will trigger an appropriate stabilization policy. For 2007 our forecast is based on continuing economic expansion, but for 2008 we reckon with a soft austerity programme. A currency crisis cannot be ruled out in a worst-case scenario if stabilization needs are not responded to in time.

Table RO

Romania: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007	2008
									forecast
Population, th pers., mid-year ²⁾	22435.2	22408.4	21794.8	21733.6	21673.3	21623.8	21584	.	.
Gross domestic product, RON mn, nom. ³⁾	80377.3	116768.7	151475.1	197564.8	246371.7	287186.3	329500	372000	420000
annual change in % (real) ³⁾	2.1	5.7	5.1	5.2	8.4	4.1	7.5	6.5	6
GDP/capita (EUR at exchange rate) ³⁾	1795	2002	2224	2420	2805	3665	4331	.	.
GDP/capita (EUR at PPP - wiiw) ³⁾	5000	5460	6060	6510	7400	8010	8460	.	.
Gross industrial production									
annual change in % (real)	7.1	8.3	4.3	3.1	5.3	2.0	7.1	6	6
Gross agricultural production									
annual change in % (real)	-14.8	22.7	-3.5	7.5	18.1
Construction output total									
annual change in % (real)	2.8	9.0	10.0	9.8	9.2	9.8	19.3	.	.
Consumption of households, RON mn, nom. ³⁾	55387.4	80336.9	102671.0	128150.4	164054.1	192020.5	.	.	.
annual change in % (real) ³⁾	-0.8	6.9	5.3	8.5	14.1	9.8	12	10	8
Gross fixed capital formation, RON mn, nom. ³⁾	15194.7	24115.4	32283.6	42293.0	53291.8	66356.8	.	.	.
annual change in % (real) ³⁾	5.5	10.2	8.2	8.5	10.8	13.1	13	12	10
LFS - employed persons, th, avg. ⁴⁾	10508.0	10440.0	9234.3	9222.5	9157.6	9146.6	9150	.	.
annual change in %	-0.3	-0.6	.	-0.1	-0.7	-0.1	0.04	.	.
Reg. employees in industry, th pers., avg.	1873.0	1901.0	1891.0	1848.0	1741.0	1704.0	.	.	.
annual change in %	-5.9	1.5	-0.5	-2.3	-5.8	-2.1	-3.7	.	.
LFS - unemployed, th pers., average ⁴⁾	775.0	711.0	845.3	691.8	799.5	704.5	700	.	.
LFS - unemployment rate in %, average ⁴⁾	6.9	6.4	8.4	7.0	8.0	7.1	7	7	7
Reg. unemployment rate in %, end of period	10.5	8.8	8.4	7.4	6.3	5.9	5.2	5	5
Average gross monthly wages, RON	284.0	422.0	532.1	663.8	818.3	957.5	1150	.	.
annual change in % (real, net)	4.2	5.1	2.4	10.8	10.6	13.1	9.6	.	.
Consumer prices, % p.a.	45.7	34.5	22.5	15.3	11.9	9.0	6.6	6	6
Producer prices in industry, % p.a.	53.4	38.1	23.0	19.5	19.1	10.5	11.6	8	8
General governm. budget, EU-def., % GDP ⁵⁾									
Revenues	43.8	36.7	37.6	36.5	36.8	36.8	.	.	.
Expenditures	40.6	38.8	39.6	38.1	38.3	38.2	.	.	.
Deficit (-) / surplus (+)	3.2	-2.1	-2	-1.5	-1.5	-1.5	-1.8	-3.0	-3.0
Public debt, EU-def., % of GDP ⁵⁾	23.9	23.2	25.0	21.5	18.8	15.9	13.7	.	.
Discount rate, % p.a., end of period ⁶⁾	35.0	35.0	20.4	20.4	18.0	7.5	8.8	.	.
Current account, EUR mn	-1494	-2488	-1623	-3060	-5099	-6888	-10000	-13500	-13000
Current account in % of GDP	-3.7	-5.5	-3.3	-5.8	-8.4	-8.7	-10.7	-12.7	-11.0
Gross reserves of NB excl. gold, EUR mn	2655	4445	5877	6374	10848	16796	21310	.	.
Gross external debt, EUR mn ⁷⁾	12098	14788	16200	17835	21698	30736	30600	.	.
Gross external debt in % of GDP	30.0	33.0	33.4	33.9	35.7	38.8	33	.	.
FDI inflow, EUR mn	1147	1294	1212	1946	5183	5213	9000	6000	6000
FDI outflow, EUR mn	-14	-18	18	36	56	-24	20	.	.
Exports of goods, BOP, EUR mn	11273	12722	14675	15614	18935	22255	25850.5	30720	35330
annual growth rate in %	41.3	12.9	15.4	6.4	21.3	17.5	16.2	15	15
Imports of goods, BOP, EUR mn	13140	16045	17427	19569	24258	30061	37609.2	45100	51870
annual growth rate in %	43.4	22.1	8.6	12.3	24.0	23.9	25.1	20	15
Exports of services, BOP, EUR mn	1910	2273	2468	2671	2903	4102	5870	7630	9160
annual growth rate in %	48.4	19.0	8.6	8.2	8.7	41.3	43	30	20
Imports of services, BOP, EUR mn	2170	2402	2463	2609	3116	4451	5610	7240	8690
annual growth rate in %	31.0	10.7	2.5	5.9	19.4	42.8	26	29	20
Average exchange rate RON/USD	2.1693	2.9061	3.3055	3.3200	3.2637	2.9137	2.8090	.	.
Average exchange rate RON/EUR (ECU)	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234	3.5245	3.50	3.55
Purchasing power parity RON/USD	0.6293	0.8324	0.9893	1.1811	1.2962	1.3917	1.4960	.	.
Purchasing power parity RONEUR	0.7161	0.9548	1.1473	1.3955	1.5371	1.6590	1.8049	.	.

Notes: On 1 July 2005 the new Romanian leu was introduced (1 RON = 10000 ROL). Data in this table are presented in new leu (RON). - The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census March 2002. - 3) According to ESA'95, from 2003 FISIM-adjusted. - 4) From 2002 break in methodology. - 5) According to ESA'95, excessive deficit procedure. - 6) From February 2002 reference rate of NB. - 7) From 2000 including balance of medium- and long-term deposits of foreign banks with resident banks, short-term deposits and FDI intercompany loans.

Source: wiiw Database incorporating national statistics; Eurostat; European Commission (Autumn 2006); wiiw forecasts.