SigmaBleyzer

Romania
Macroeconomic Situation

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

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- **Real GDP growth was registered at 1.6% yoy over the first quarter.**
- **In January-April, the consolidated budget deficit shrank by 64% yoy to EUR 1 billion or 0.8% of projected full year GDP.**
- **CPI increased by 8.3% yoy in April.**
- **In January-March, the merchandise trade deficit in FOB-FOB terms narrowed by 65% yoy to EUR 0.5 billion.**
- **The current account deficit contracted by 59% yoy over the first quarter and settled at EUR 0.6 billion.**
- **The stock of medium and long-term public and private external debt has grown by 3% since the beginning of the year to EUR 74.3 billion. Thus, external debt reached EUR 93.4 billion or 70.9% of full year projected GDP.**

Executive Summary

The Romanian economy returned to growth after two years of shrinking, with real GDP growing by 1.6% yoy during the first quarter. Annual GDP growth could reach around 1.6% yoy this year and should be supported by sound export dynamics and recovery of domestic demand, which is expected in the second half of the year.

In January-April, the consolidated budget deficit contracted by 64% yoy to EUR 1 billion or 0.8% of full year projected GDP. The narrowing was supported by growing state revenues and declining government spending. The former's growth was fueled by sound proceeds from indirect taxes, notably VAT and excises, which made up more than one third of total spending revenues. Meanwhile, lower state spending reflected the decline in the state wage bill and social transfers payments as a result of fiscal austerity measures. These favorable dynamics could be preserved until the second half of the year, when the base effect of fiscal consolidation will disappear.

In April, the growth in consumer prices sped up to 8.3% yoy in April from 8.0% yoy in the previous month. The rise in CPI was primarily fueled by growing food prices, while the increase in the price of non-foods and services remained much more moderate. Given the strong upward trend of food prices, their contribution to overall CPI growth has increased to half since the beginning of the year. Concurrently, the higher price of non-foods was supported by growing international oil prices, although growth of the latter eased in May. Under these circumstances, the National Bank of Romania (NBR) tried to cope with rising consumer prices by providing a stable monetary policy, notably keeping its policy rate unchanged at 6.25% per annum.

In January-March, the merchandise trade deficit in FOB-FOB terms narrowed by 65% yoy and settled at EUR 0.5 billion, compared with EUR 1.3 billion a year ago. The improvement was achieved on the back of buoyant growth of exports in goods, which significantly outpaced the corresponding increase in imports. The stronger exports in goods were supported by favorable external demand for Romanian transport equipment and vehicles, and industrial raw materials and manufactured goods. Meanwhile, the imports' growth reflected a significant share of imported goods that were used for further exports, since domestic demand remained subdued.

During the first quarter, the current account deficit shrank by 59% yoy to EUR 0.6 billion from EUR 1.5 billion in 2010. The improvement occurred thanks to a decline in the merchandise trade deficit and the increase in the current transfers surplus. On the other hand, a higher trade in services deficit and a rising incomes deficit partially offset the overall narrowing of the current account deficit. Net FDI inflows totaling EUR 0.4 billion funded 60% of the current account gap after a contraction of 32% yoy.

	2007	2008	2009	2010	2011[f]	2012[f]
GDP growth, % change yoy	6.3	7.1	-7.2	-1.3	1.6	3.0
Industrial production, % change yoy	5.4	0.9	-5.5	5.5	5.0	5.5
Consolidated budget balance, % of GDP	-2.4	-4.8	-7.2	-6.5	-5.0	-4.0
Unemployment, end of period	4.1	4.4	7.8	6.9	7.0	6.5
Inflation, end of period	6.56	6.30	4.75	8.0	4.8	3.8
Retail sales, % change yoy	17.8	13.0	-8.5	-5.3	3.0	5.0
Gross forex reserves of the NBR, EUR billion, end of period	25.3	28.3	30.9	36	33.5	33.2
Current Account Balance, EUR billion	-16.68	-16.16	-5.05	-5.2	-6.8	-7.9
Total gross external debt, EUR billion	58.6	72.4	78.7	90.8	90.4	98.4
Exchange rate, RON/EUR, annual average	3.34	3.68	4.24	4.2	4.2	4.1

Source: INNSE, The Bleyzer Foundation

Where Opportunities Emerge.

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Editor Rina Bleyzer O'Malley

Economic Growth

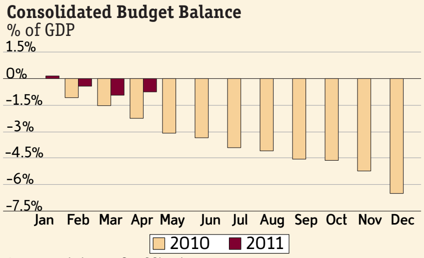
The Romanian economy resumed its economic growth after two years of contraction. Real GDP growth advanced to 1.6% yoy in January-March after a 0.6% yoy decline a quarter ago. On the supply side, the recovery was based on solid performance of its key driver – industrial production, which posted 11.4% yoy growth over the first three months. Sound dynamics of industrial output, especially manufacturing production, was underpinned by favorable external demand. Indeed, the highest growth was registered in production of vehicles (up by 18.1% yoy), machinery (up by 21.3% yoy), chemicals (up by 29.6% yoy), and basic metals (up by 18.9% yoy). At the same time, the domestic oriented industries started to contribute positively to stronger industrial output. Specifically, food production grew by 4.1% yoy, while manufacturing of wood products was up by 14.4% yoy. While industrial production continued to support economic growth, other sectors remained subdued. In particular, the construction sector still experienced a decline as the index of construction works dropped by 4.4% yoy in January-March. Likewise, the volume of domestic trade continued to fall on the back of tight budgets; the index of retail sales dropped by 5.5% yoy.

Taking into account the favorable start of the year, the Romanian economy is expected to expand with about a 1.6% yoy annual growth rate in 2011. Domestic demand should be revived in the second half of the year as the effect of fiscal consolidation will fade, which should support economic growth. However, external demand will also continue to play a crucial role in supporting economic growth. Further prospects for exports are likely to be shaped by the EU's economic growth, given the close trade relations with other EU members.

Fiscal Policy

During the first four months of the year, the Romanian government continued to contain the consolidated budget deficit. In fact, the consolidated budget deficit shrank significantly by 64% yoy to EUR 1 billion (RON 4.4 billion) or 0.8% of projected full year GDP compared with 2.4% of GDP in 2010. More importantly, the consolidated budget gap has declined in nominal terms since it was registered at 1% of full year GDP over the first quarter. These favorable dynamics are explained by growing state revenues and declining government spending. Specifically, state revenues posted sound double-digit growth of 10.3% yoy and reached EUR 13.8 billion (RON 58 billion). At the same time, state spending declined by 3.6% yoy and settled at EUR 14.9 billion (RON 62.4 billion). Under such circumstances, the expected annual consolidated budget deficit might reach 5% of projected full year GDP.

Consolidated Budget Balance



Source: Ministry of Public Finances

In January-April, the rise in government revenues was primarily fueled by brisk receipts from indirect taxes. In particular, stronger collections from VAT (up by 35.6% yoy) and excise duties (up by 24.3% yoy) were consequences of summer fiscal austerity measures (the hike in VAT rate by 5 p.p.). As a result, proceeds from the aforementioned group of taxes made up 34.3% of overall government revenues. Nevertheless, the solid growing pace of collections from indirect taxes is likely to be limited in the second half of the year since the favorable base effect will disappear. Greater transfers from the EU budget (up by 36.1% yoy to EUR 0.4 billion (EUR 1.6 billion)) also positively contributed to dynamic of state revenues. By contrast, the proceeds from major direct taxes demonstrated uneven behavior. On the one hand, receipts from wage and income tax continued to fall (down by 2.5% yoy) on the back of constrained budgets as a consequence of fiscal consolidation. On the other hand, the receipts from corporate profit tax posted mild growth, notably 0.9% yoy.

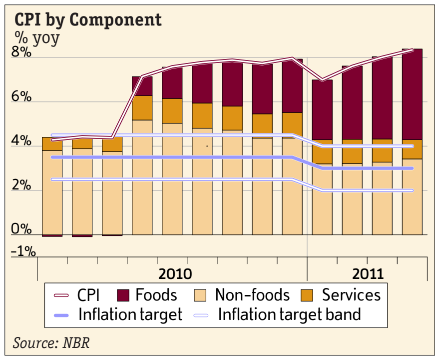
In January-April, government expenditures returned to a downward trend. Specifically, lower state spending reflected the decline in the state wage bill (down by 19.7% yoy) and the fall in social transfers payments (down by 3.3% yoy). Likewise to the state revenue dynamics, the low government spending on wage and transfers will be preserved until the second half of the year as the base effect (cut in state wages and transfers) will fade. On a negative note, the government reduced its capital expenditures – down by 15.3% yoy – which could restrict future economic growth. In contrast, the higher servicing of public and publicly guaranteed debt (up by 33.4% yoy) and purchases of goods and services (up by 8.3% yoy) were other factors driving government expenditures.

Monetary Policy

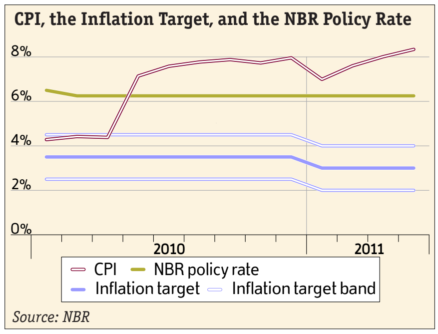
During the last three months, consumer prices were on a robust growing trend. Indeed, the CPI steadily advanced to 8.3% yoy in April from 7% yoy in January, which is significantly higher than the upper band for the inflation target – 4.0%. Moreover, consumer prices might continue their growth in the next months amid the presence of prices shocks coming from international commodities markets. By contrast, significant disinflation is anticipated in the second half of the year on the back of a favorable base, notably after the fading of the VAT hike effect. Under such circumstances, the National Bank of Romania updated its forecast for the year-end inflation to 5.1%

from 3.6% yoy, which is close to our forecast (4.8%).

In April alone, the increase in CPI was primarily driven by rising food prices, which went up by 10.9% yoy from 9.9% yoy in the previous month. The growing price of food made their contribution more pronounced – increasing to 49% of overall CPI growth in April from 37% of overall CPI growth in January. Indeed, global food prices continued to on a growing trend according to the FAO Food Price Index (FFPI). Specifically, the FFPI grew by 36% yoy in April and remained 2% lower than the historical peak in February. Meanwhile, the prices of non-foods posted a much flatter growth rate – up by 7.7% yoy in April from 7.4% yoy a month ago despite growing fuel prices. The latter reflected the rise in international oil prices amid turmoil in Libya and the Middle East. By contrast, the dynamics of oil prices changed in May (NYMEX Crude Oil fall to $99 in May 24th from $114 in April 29th) due to a slowdown in world demand caused by a sluggish recovery in advanced countries. Indeed, the International Energy Agency expects that the growth of global demand for oil will decelerate to 1.5% yoy in 2011 from 3.3% yoy in 2010. The easing of oil prices on the international markets could exert downward pressure on the price of non-foods in the coming months. Finally, the growth in prices of services slowed down and was registered at 4.8% yoy on the back of constrained budgets.



Source: NBR



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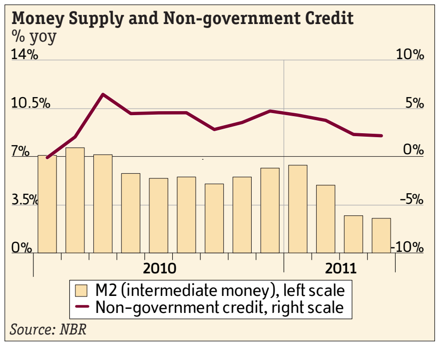


Source: NBR

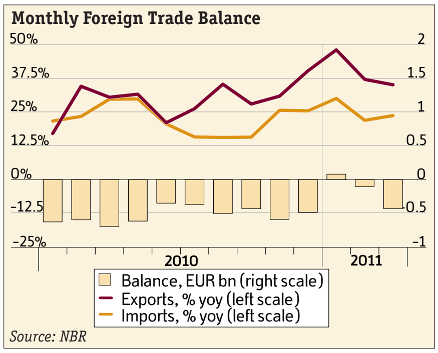
The National Bank of Romania continued to provide a stable monetary policy, aiming to revive the disinflationary trend and anchor inflationary expectations. In fact, the NBR kept its key policy rate unchanged for the thirteenth month in a row, notably at 6.25% per annum. Concurrently, the ensuring of price stability remained insufficient since the consumer inflation was the highest among other EU members, although the latter experienced similar shocks. Thus, it is unlikely that the National Bank of Romania will switch to loose monetary policy in the coming months and cut its key policy rate.

The money supply measured as intermediary money (M2) was kept on a downward trend during the first four months of the year. Indeed, M2 grew by 2.5% yoy in April and reached EUR 47.9 billion (RON 196.5 billion) compared with 6.4% yoy in January. The rise in M2 reflected increasing deposits (with maturity up to two years) and narrow money aggregate (M1) – up by 2.9% yoy and 2.0% yoy, respectively. Meanwhile, the stock of non-government loans inched up by 2.1% yoy amid stronger dynamics of forex-nominated loans. Specifically, the latter grew by 3.6% yoy and made up 62% of overall volume of non-government loans, while the stock of domestic issued loans remained almost unchanged. Nevertheless, the rate of expansion of credit activity in nominal terms was still outpaced by a higher CPI growth rate, which could translate into negative real growth of non-government loans.

International Trade and Capital

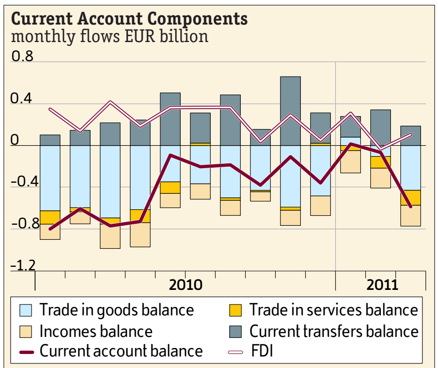
During the first quarter of 2011, the merchandise trade deficit in FOB-FOB terms contracted significantly. In fact, the deficit in trade in goods narrowed by 65% yoy and stood at EUR 0.5 billion compared with EUR 1.3 billion a year ago. Moreover, the Romanian trade in goods was almost balanced during the first two months and slipped to a deficit only after stronger imports performance in March. The narrowing of the merchandise trade deficit was achieved thanks to brisk dynamics of the exports in goods, which posted solid 39% yoy growth and reached EUR 11.0 billion. At the same time, merchandise imports rose with a flatter growth rate, notably 25% yoy and settled at EUR 11.5 billion.

In January-March, rising merchandise exports were underpinned by higher purchases of Romanian transport equipment and vehicles (up by 40% yoy), and industrial raw materials and manufactured goods (up by 30% yoy). However, the dynamics of Romanian exports significantly depends on EU economic growth, since Romania shipped 72% of overall exports to other members of the EU. Despite sound export dynamics to the EU over the first quarter (up by 35% yoy), several external risks could limit Romanian export potential. In particular, the unsustainably high debt in Greece and its probable restructuring continues to be the main factor, which might lead to spreading fears regarding sovereign debts of other Eurozone members. In fact, Standard and Poor's has started to downgrade other Eurozone country's credit ratings outlook (such as Italy). Thus, the consequences of the turmoil in the EU periphery are likely to play an important role for growth of the whole Eurozone area, and therefore should shape the dynamics of Romania's exports. At the same time, Romania's exports to the rest of the world benefitted with a steeper growth rate – 52% yoy, though it might reflect a favorable base effect.



Source: NBR

During the first quarter, the increase in imports was primarily driven by stronger purchases of foreign transport equipment and vehicles (up by 24% yoy), and industrial raw materials and manufactured goods (up by 23% yoy). Given the strong dynamics of these two commodity groups, they made up about 64% of overall imports and contributed 15 percentage points of total import growth. Thus, the solid import growth might be explained by the significant share of goods, which would be used for further exports, while domestic demand remained weak amid tight budgets. In addition, the Romanian currency's appreciation against the Euro (3% since the beginning of the year) also supported growing imports.



Source: NBR, INNSE

In January-March, the current account deficit shrank substantially. Indeed, the current account deficit narrowed by 59% yoy to EUR 0.6 billion from EUR 1.5 billion in 2010. The contraction was led by a lower merchandise trade deficit and higher surplus in current transfers. Specifically, the latter posted 67% yoy growth and reached EUR 0.7 billion amid stronger EU transfers coupled with a low statistical base. By contrast, the higher deficit in trade in services and rise in the incomes deficit partially offset the overall contraction of the current account deficit. While the trade in services deficit widened to 9% yoy (to EUR 0.3 billion), the incomes deficit expanded by 46% yoy (to EUR 0.6 billion) amid higher incomes on equity and debt earned by foreign investors. Concurrently, declining net FDI inflows (down by 32% yoy to EUR 0.4 billion) funded 60% of the current account gap compared with 30% in the previous year.

In March, the stock of medium and long term external debt had risen by 3% since the beginning of the year (ytd) and settled at EUR 74.3 billion. The increase was driven by public external debt (up by 6.9% ytd to EUR 28.4 billion), while private external debt remained almost unchanged at EUR 45.8 billion. The former's growth reflected borrowing from international financial institutions (IMF, World Bank and European Commission) under the Stand By-Arrangement program. Taking into account short term external debt totaling EUR 19.1 billion, the external debt (EUR 93.4 billion) to full year projected GDP ratio become 71%.