Summary

In January-September, the growth rate of industrial output remained strong and stood at 7.2% year-over-year (yoy). Over the first three quarters of the year, the consolidated budget surplus increased to RON 5.6 billion (EUR 1.6 billion) or 1.69% of projected full-year GDP. In November, the fourth rectification of the 2006 budget was passed, maintaining a year-end consolidated budget deficit at the previous level of 2.5% of GDP.

In January-September, output in the utilities sector grew by 3.4% yoy and stood at 45.6% yoy over the same period of the previous year.

In January-September, the current account deficit widened to EUR 6.7 billion. On a positive note, about 73% of the current account gap was covered with FDI inflows that amounted to EUR 4.9 billion or 32.4% higher than in the same period of 2005.

The International Bank for Reconstruction and Development agreed to lend Romania $180 million to improve the quality of transportation infrastructure in the country.

Economic Growth

In January-September, the growth rate of industrial output remained strong and stood at 7.2% year-over-year (yoy). Although the expansion of output in extracting sectors continued to slow, growing by 3.4% yoy, manufacturing remained the main driver of industrial production, posting 7.7% yoy growth. During the first nine months of this year, the growing output in food processing (by 24.8%) and the volume of market services rendered to the population increased by 8.4%.

In September, industrial production grew by 6.7% yoy, increasing slightly slower than in August due to weaker performance in the mining sector, where output contraction was registered for the first time since January. In September, output in manufacturing accelerated to 7.9% yoy from 7.1% yoy in August on the back of higher growth rates in the food processing industry (17.6% yoy), automobile industry (30.5% yoy) and furniture processing and other sectors (34.4% yoy). At the same time, the evolution of the chemical industry was somewhat disappointing as the output in this sector decelerated to 5.1% yoy from 56.4% yoy in August. However, this deceleration can be partially explained by the particularly weak performance of the chemical industry in August 2005 when output in this sector shrank by about 24% yoy. As a result, the record high growth rate of the chemical industry in August 2006 can be largely explained by the low statistical base. In September, production in fuel processing and machine building continued to decline by 12.3% yoy and 5.8% yoy respectively, though at a slower rate than in the previous month. The growth rate of the metallurgical industry was on a downtrend as well and output in this sector fell by 2% yoy in September after a modest 0.7% yoy recovery in August. Finally, output in utilities noticeably decelerated from 14.2% yoy in August to -0.5% yoy in September.

The overall performance of the economy during the first three quarters of this year is encouraging. In January-September, the amount of construction works in -0.5% yoy in September.

In September-October, the amount of construction works decreased by 0.7% yoy, decreasing slightly slower than in August due to weaker performance in the mining sector, where output contraction was registered for the first time since January. In September, output in manufacturing accelerated to 7.9% yoy from 7.1% yoy in August on the back of higher growth rates in the food processing industry (17.6% yoy), automobile industry (30.5% yoy) and furniture processing and other sectors (34.4% yoy). At the same time, the evolution of the chemical industry was somewhat disappointing as the output in this sector decelerated to 5.1% yoy from 56.4% yoy in August. However, this deceleration can be partially explained by the particularly weak performance of the chemical industry in August 2005 when output in this sector shrank by about 24% yoy. As a result, the record high growth rate of the chemical industry in August 2006 can be largely explained by the low statistical base. In September, production in fuel processing and machine building continued to decline by 12.3% yoy and 5.8% yoy respectively, though at a slower rate than in the previous month. The growth rate of the metallurgical industry was on a downtrend as well and output in this sector fell by 2% yoy in September after a modest 0.7% yoy recovery in August. Finally, output in utilities noticeably decelerated from 14.2% yoy in August to -0.5% yoy in September.

Fiscal Policy

In January-September, consolidated budget revenues grew by 22.1% yoy in nominal terms totaling RON 76.5 billion. Consolidated budget expenditures posted a slower growth rate of 17.4% yoy and amounted to RON 70.9 billion. As a result, the consolidated budget surplus increased to RON 5.6 billion (EUR 1.6 billion) or 1.69% of projected full-year GDP.

On the back of an improved macroeconomic forecast for 2006, the Government of Romania passed the fourth rectification of the 2006 budget on November 20th, maintaining a consolidated budget deficit at 2.5% of full year GDP. The principle purpose of this revision is to achieve a more efficient utilization of budget resources through the reallocation of financing between public institutions as well as a redistribution of redundant funds accumulated by ministries. The Ministry of Transportation, the Ministry of Labor and the Ministry of Administration and Internal Affairs are to receive the highest amounts, while the consolidated budget deficit was widened by RON 109.1 million (EUR 30.9 million). In addition, the value of the pension reference point will be raised by 16.8% on December 1st from RON 339.3 to RON 396.2, generating a RON 55 average increase of payments for pensioners in the public pension system.

A record high adjustment of wages in the public sector is projected to occur in the coming year. The government approved a 22% wage hike in education in 2007 and a 44% wage increase for public servants employed in the sanitary sector in 2007-2008. Both projected wage increases in the public sector and the upward adjustment of pensions at the end of 2006 will fuel aggregate demand and put additional pressure on the central bank’s efforts to maintain the 2007 inflation target. Furthermore, the government’s bias toward fiscal loosening is likely to increase as incumbent politicians will be more inclined to approve higher spending on social programs before parliamentary elections.

Preliminary data on fiscal revenues released by the Ministry of Public Finance reveals a slight deceleration of consolidated budget revenues, as budget revenues amounted to RON 81.7 billion in January-October increasing by 17.6% yoy. A slowdown of fiscal revenues is rooted in slower growth rates of proceeds from excise taxes (down to 10.8% yoy growth rate from 16.7% yoy posted in January-September) and custom duties (down to 19.3% from 28.8% yoy) as well as a minor deceleration in VAT collection (down to 23.9% yoy from 25.3% yoy). On a positive note,
over the first ten months of 2006 fiscal revenues from income taxes hit a record high growth rate of 40.4% yoy. In addition, proceeds from the corporate profit tax grew at faster rate as well, increasing by 21.3% yoy — their highest growth rate in 2006.

Higher prices of non-food commodities and service tariffs are the main factors that shape the inflationary outlook in 2006. Furthermore, the impact of increasing prices of non-food products has the tendency to increase, as their contribution to CPI inflation exceeded 2/3 in October — up from 1/2 in the same month of the previous year. In October, the contribution of higher tariffs of services to CPI exceeded 1/5 due to the growing tariffs of water supply (up by 19.4% yoy) and higher transportation tariffs. At the same time, moderate inflation of telecommunication tariffs (only 2% yoy in October) supported slower growth of price index of services.

Monetary Policy
In October, disinflation continued to accelerate as the consumer price index (CPI) increased by only 4.8% yoy as compared to 5.5% yoy in September. For the first time since the beginning of the year, CPI inflation fell below the 2006 inflation target of 5% yoy. Favorable inflationary developments were largely driven by relatively flat prices of food commodities, which inched up by only 0.9% yoy, and a slowdown in inflation of service tariffs to 6.9% yoy from 8.3% yoy in September. Steady disinflation is an evidence of the developing capacity of the central bank to perform effective monetary policy. In addition, growing aggregate demand appears to be largely absorbed through higher aggregate supply of both domestic and imported products rather than increasing prices. Moderate inflation of prices of food commodities provides strong support for this argument. If in October 2005 higher prices of foods (on the back of poor performance of agriculture) explained about 30% of yoy CPI inflation, the contribution of increasing prices of foods to CPI fell below 1/10 in October 2006 and was more than three times lower than in the same month of the previous year. In addition, inflation developments are supported with lower prices of imported commodities due to slower growth rates of prices of imports, lower world prices of energy resources and a stronger national currency against the Euro and US dollar.

due to the relative stability of world oil prices, the impact of higher prices of fuels is declining. However, upward revisions in administered prices as well as increasing excise duties on tobacco remain principle sources of CPI inflation as well as major threats to the disinflation process. In addition to growing pressures from the demand side due to fiscal loosening and faster growing economy, further adjustments of administered prices and a harmonization of excise taxes with EU regulations pose a considerable risk for price stability. On a positive note, total CPI inflation in 2006 was determined by non-monetary factors (higher administered prices and excise taxes).

Macroeconomic Situation

Romania
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Where Opportunities Emerge.

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: (1-713) 621-3111 Fax: (1-713) 621-4666
E-mail: sbleyzer@sigmableyzer.com

Bucharest Office, Romania
12Bis, Dr. Dragneaescu St., Sect. 5,
Bucharest, 050579
Tel: 40 (21) 410-1000 Fax: 40 (21) 410-2222
E-mail: bucharest.office@sigmableyzer.com

Source: INSSE, The Bleyzer Foundation
2007. The inflation targets were kept the same at 5.0% and 4.0% for 2006 and 2007 respectively, with a +/- 1.0% deviation band. The central bank decided to proceed with tight monetary policy as the policy interest rate was kept unchanged at 8.75% and tight control over market liquidity is maintained. Starting January 1, 2007, the earlier adopted regulation on the exposure of credit institutions to unhedged borrowers of foreign-currency denominated credits will be removed. This regulation, introduced in the last quarter of 2005, limited the forex denominated credit exposure of banks to three times their own funds.

International Trade and Capital

In September, exports (FOB) further decelerated to 6.1% yoy from 7.4% yoy in August. A similar trend was registered for imports (CIF), which posted a slower growth rate of 18.8% yoy as compared to 24% yoy in August. As a result, the merchandise trade deficit (FOB/CIF) amounted to EUR 1.2 billion, increasing by 52.1% yoy.

Over the first three quarters of this year, the current account deficit widened to EUR 6.7 billion, increasing by 46.7% yoy. A deceleration of the growth rate of the current account deficit from 51% yoy in January-August was supported by the larger surplus of trade in services in September as well as a slower growth rate of the deficit of incomes transfers, which grew by 11.3% yoy as compared to 20% yoy in January-August. About 73% of the current account gap was covered with FDI inflows, which amounted to EUR 4.9 billion or 32.4% higher than in the same period of 2005.

In January-September, exports (FOB) totaled EUR 19.1 billion, increasing by 16% yoy, while imports (CIF) amounted to EUR 28.7 billion, growing by 24.5% yoy. Faster deceleration of exports and a minor slowdown of imports continued to widen the merchandise trade deficit (FOB/CIF), which grew to EUR 9.6 billion or by 45.6% yoy over the same period of the previous year. During the first nine months of 2006, the slower growth rate of exports was driven by decelerating exports of chemicals (down to 13.1% yoy from 19.3% yoy in January-August), machinery (down to 35.8% yoy from 38.3% yoy) and transportation means (down to 53.7% yoy from 63% yoy) as well as declining exports of textiles (down by 1.5% yoy). At the same time, the exports of metallurgical products have been accelerating since April and posted 12% yoy growth in January-September. A slight deceleration of imports was registered due to the slower growth of exports of mineral products (on the back of lower world oil prices) and machinery.

The International Bank for Reconstruction and Development (IBRD) and the Ministry of Public Finance of Romania signed a loan agreement in the amount of $180 million for the modernization of national roads and railways networks. The project is to be launched in 2007 and is designed to improve the quality of the transportation infrastructure in Romania after EU accession.

Other Developments Affecting the Investment Climate

In November, Germany and Denmark ratified the Accession Treaty of Romania and Bulgaria to the European Union. As a result, the Treaty is now ratified by all members of the European Union.

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