Romania

Macroeconomic Situation

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• Industrial production grew by 5.0% yoy in June 2013.
• The consolidated budget deficit declined to 0.96% of GDP at the end of July 2013.
• Consumer inflation decelerated to 4.4% in July 2013.
• The foreign trade deficit declined 11 times yoy to EUR 315 million in January-June 2013.
• The current account balance remained positive and increased to EUR 695 million by the end of June 2013.

Executive Summary

GDP expanded 1.8% yoy over the first half of the year, 1.1% was ensured by industrial production growth. In June 2013, external demand continued to be the main stimulus of real sector development. Manufacturing was the main driver behind a 5.0% yoy increase in industrial production this month. Increases in the volume of receipts from accommodation and food services helped to generate increases in the total volume of rendered services for the first time in five months, and to decelerate the decline in the trade and services sector in general.

The consolidated general budget deficit inched down from 1.1% in January-June 2013 to 0.96% in January-July 2013. The January-July fiscal budget deficit was 0.23% yoy lower than the corresponding deficit last year.

In July 2013, consumer inflation declined to 4.4%, compared to 5.4% in June. It is projected to decline to 3.1% by the end of the year. This year’s good harvest is pushing food prices down. This has led to deceleration of consumer inflation because of the high share of food products in the consumer basket.

The National Bank of Romania continued pursuing its goal of ensuring control over inflation, revival of national currency lending, and cushioning adverse internal and external effects on economic recovery. Therefore, it further decreased the policy rate to 4.5% from August 6th and continued implementing prudent monetary policy. At the same time, the policy rate cut transfers rather slowly to interest rates on national currency loans. Therefore, policy measures introduced by the NBR have shown little progress so far.

In January-July 2013, the foreign trade deficit was 11 times lower than that over the same period last year. At the end of June, it was equal to EUR 315 million. Surplus of the current transfers account covered both the foreign trade deficit and income account deficit and generated a current account surplus of EUR 695 million in January-June 2013.

Economic Growth

Romanian economy continued to perform well in Q2 2013 which led to higher than expected growth from the beginning of the year in general. The Q2 2013 growth was 1.5% compared with the same quarter of last year and 0.5% compared with the previous quarter (seasonally adjusted figures). At the same time, during the first half of the year, the GDP increased by 1.8% yoy, according to the updated data of statistical office. In terms of GDP resources, industrial production made the highest contribution to this growth at 1.1%. However, within the structure of GDP, its growth was the second best at 3.9% yoy after growth of agriculture at 6.1% yoy. Such a high growth in agriculture is the result of very good harvest this year compared with very bad one last year. In terms of GDP uses, final consumption inched down by 0.1% yoy, gross capital formation declined by 15.3% yoy, while export of goods and services increased by 10.7% yoy.
In January-June 2013, growth of industrial production remained almost unchanged at 6.0% yoy thanks to the sector’s good performance in June. In particular, industrial production was back to growth in year-over-year terms this month after one month of decline. A 6.0% yoy increase in manufacturing led to a 5.0% yoy increase in the industrial sector in general, as a 3.6% yoy growth of mining and quarrying almost fully compensated for a 4.2% decline in energy supply. The highest growth was observed in manufacture of coke and refined petroleum products in June. However, the 55.6% yoy increase was mainly the result of a low base effect, as one of the sector’s leaders underwent an overhaul in June 2012. Production of transport means, production of chemicals and chemical products, and food industry also posted very good performance, growing by 17.8% yoy, 17.7% yoy, and 8.3% yoy respectively in June. Growth in transportation means manufacturing is of a special relevance, since this sector growth is mainly driven by external demand. The number of automobiles produced and assembled in Romania increased by 44.7% yoy over H1 2013, reaching 225,759 cars. 84% of these cars were exported. This year, Romania might become the 9th largest auto producer in the EU, moving ahead of Italy, which produced 397 thousand cars in 2012. To summarize, external demand remained the major factor of growth in industrial production in Romania, as the highest growth rates were observed in industries which are export-oriented (food industry is oriented to both external and internal markets).

The trade and services sector continues to show declines in activity, but posted some progress in June 2013. In particular, its decline decelerated to 4.0% yoy thanks to further slowdown in the decrease of the trade component and a rebound in the services component. The start of the car fleet renewal programme improved the situation of auto sales (the decline decelerated from 19.3% yoy in May to 12.8% yoy in June). Trade with spare parts and accessories for motor vehicles was the only components of trade with motor vehicles that registered growth in June in yoy terms. And its growth was high enough to compensate for most of the declines in other components. As a result, the total decline in trade with motor vehicles totalled 5.8% yoy in June, just half of the decline a month ago. Sales of other durables continued to decline but at lower rates (0.7% yoy in June compared to 2.5% yoy in May) possibly due to an increase in sales of small household appliances and communication devices. Improvement in sales of cars and the harvest campaign led to some deceleration in decline of volume of fuel sales. As for services rendered to households, their dynamics returned to positive territory in June 2013 after five consecutive months of decline. The growth was not very high at 0.7% yoy, and was generated thanks to growth of receipts from hotels and restaurants, and accommodation and food service activities. At the same time, retail trade declined by 4.2% yoy in June and by 1.1% yoy for the first half of 2013. In June, the deepest decline was registered in fuel sales at 9.7% yoy. Food, beverages, and tobacco sales lost 3.8% yoy, while non-food Index down by 0.7% yoy.

Fiscal Policy

In July 2013, the Romanian government further improved execution of the consolidated general budget. Thanks to the budget adjustment program, the consolidated general budget deficit of EUR 1.37 billion was 13.6% yoy lower in January-July 2013. As a share of GDP, the consolidated general budget deficit amounted to 0.96% over the period, which is 0.2% lower than the deficit over the same period of the previous year.

In January-July 2013, consolidated general budget revenues grew by 5.2% yoy to EUR 26.44 billion (18.5% of GDP) over the reporting period thanks to growth in revenues from all major taxes. This is 1.1% faster than growth of total government expenditures. Return of budget sector wages to their pre-crisis level and increase of the minimum wage in February 2013 both continued to boost personal income tax revenues as they grew by 8.7% yoy in January-July 2013. Receipts from dividends and use taxes on goods generated an additional EUR 0.52 billion during the reporting period mainly thanks to collection of license fees for rights to use radio frequencies. At the same time, local governments managed to generate a 9.5% yoy increase in property tax revenues and an 8.2% yoy increase in non-tax revenues. Payments from the EU grew by 26.9%
in July. As a result, in January-July 2013 their total amount became almost equal to the amount observed over the same period last year.

The government managed to limit growth of its total expenditures to 4.1% despite significant increases in the wage bill and expenditures on goods and services by reducing capital investments over the reporting period. The wage bill grew by 16.4% yoy due to the mentioned return of the budget sector wages to their pre-crisis level. Expenditures on goods and services expanded by 7.4% yoy due to payments to the National Health Fund and accelerated repayment of arrears on the side of local authorities. Investment expenditures were cut by 13.9% yoy to EUR 3.4 bln.

Monetary Policy

The good harvest helped to decrease consumer inflation in July 2013. Growth of food prices decelerated to 3.9% yoy in July compared to 5.8% yoy observed in the previous month. This immediately lowered total consumer inflation to 4.4% from 5.4% observed a month ago because of the high share of foods in the consumer basket. Growth of prices of non-food goods and services also decelerated. Furthermore, CORE2 inflation still remained below CPI at 2.8% in July 2013. This means that the downward trend in consumer prices will continue in the coming months.

Low inflation expectations and little progress in national currency lending recovery prompted the NBR to lower the monetary policy rate for the second month in a row. Starting from August 6th, the policy rate was decreased by 50 basis points to 4.5%. The inflation forecast for the third quarter predicts faster disinflation in the period along with a pick-up in economic growth. In addition, interbank money market rates and yields on government bonds have recently been close to or below the policy rate. This means consolidation of the monetary policy impulse transmission. In addition, the data assured the NBR that its current monetary policy is likely to encourage recovery of national currency lending in the private sector. Therefore, the bank has decided to continue pursuing adequate liquidity management in the banking system and to leave the existing levels of minimum reserve requirement ratios on liabilities of credit institutions unchanged.

However, the policy rate cut rather slowly transfers to interest rates on new corporate and household loans in domestic currency. This was accompanied by continued curtailing of borrowing activities in national and especially in foreign currency on the side of households in January-July 2013. Therefore, total growth in volume of RON-denominated loans decelerated to 0.7% yoy over the reporting period. This increase was too low to compensate for the accelerated decline in forex-denominated loans. The total volume of forex-denominated loans was equal to 7.2% yoy because of an almost 10% yoy decline in corporate loans in January-July 2013. As a result, the total volume of non-government loans declined by 4.4% yoy in January-July 2013.

Growth of broad money (M3) decelerated in July 2013. As of 31st July, M3 grew by 2.0% yoy, which is 3.0% lower than growth over the first six months of the year. This deceleration is a result of a slow down in growth of net foreign assets to 74.9% yoy and acceleration of the decline in net national assets to 10.6% yoy at the end of July (95.0% yoy increase and 7.0% yoy decline at the end of June, respectively).

Stronger volatility in investors’ risk appetite and persistence of uncertainties surrounding economic activity in Europe and elsewhere both temporarily entailed wider fluctuations in RON exchange rate. In particular, the RON/EUR exchange rate appreciated from 4.4588 observed at the end of June 2013 to 4.4048 as of July 31st. At the same time, the NBR initiative to lower the policy rate for the second month in a row led to the largest depreciation in the RON over the last seven weeks on August 7th, 2013. The NBR lowered the policy rate by 0.5%, which was twice as high as expected. Therefore, market players started to price in more rate cuts on the back of lower forecasted inflation. As a result, the RON/EUR exchange rate depreciated by 0.9% to 4.4446 by the end of trading on August 7th, 2013.
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Fast growth in foreign trade in services was the major factor for the improvement in Romania’s foreign trade sector over the first half of 2013. Exports of services grew by 32.4% yoy to EUR 4.703 billion (FOB-FOB), while imports remained almost unchanged at EUR 3.547 billion (inched down by 0.8% yoy). Transport services posted the best performance as they generated EUR 1 billion of trade surplus, while trade in tourism and travel services continued to gradually deteriorate. Foreign trade in goods further improved in January-June 2013. Exports of goods grew by 5.9% yoy over the period, which is almost the same as the increase in January-May 2013. At the same time, imports of goods declined by 2.7% yoy over the reporting period compared to 1.9% yoy in January-May 2013. The high surplus of trade in services compensated for a significant part of the deficit of foreign trade in goods. Therefore, in January-June 2013 the total foreign trade deficit was 11 times lower year-over-year at EUR 315 million.

In January-June 2013, the current account surplus of Romania was EUR 381 million higher compared to that in January-May 2013. The increase was generated thanks to the mentioned improvements in foreign trade and growth in surplus of the current transfers account. Surplus of current transfers grew by one fifth in one month and almost reached the level observed in January-June 2012. On the other hand, the income account remained in deficit. Moreover, its deficit grew by 16.0% yoy to EUR 904 million. Overall, the current account surplus totalled EUR 695 million over the reporting period.

During June 2013, Romania’s total external debt declined by 1.13% mom thanks to decreases in both long- and medium-term external debt and short-term external debt. In particular, long- and medium-term external debt inched down by 0.73% mom to EUR 78.918 billion. Short-term external debt decreased by 2.69% mom to EUR 19.917 billion. The share of long- and medium-term external debt remained almost unchanged at 79.85% of the total external debt of the country as of June 31st.

Foreign exchange reserves significantly increased during July 2013. As of July 31st, they stood at EUR 33.353 billion, which is 3.2% higher than a month ago. The National Bank of Romania managed to triple its foreign exchange reserves inflows to EUR 1.833 billion compared to June. At the same time, foreign exchange reserve outflows decreased by almost 25% to EUR 787 million during July. The gold stock once again remained unchanged in terms of weight at 103.7 tonnes. However, its value grew by almost 9% to EUR 3.344 billion thanks to changes in the international price of gold. Total international reserves totalled EUR 36.697 billion at the end of July, which is a 3.7% mom increase. However, we expect them to decrease as Romania is obligated to pay EUR 1.637 billion on public and publicly guaranteed foreign currency denominated debt during August. This is 10 times more than payments the country made in July.

Other Developments Affecting the Investment Climate

Initial Public Offer (IPO) of Nuclearelectrica, Romania’s nuclear electricity producer, was announced for September 2013. Nuclearelectrica’s IPO was agreed with the IMF, same as IPO of several other companies, yet plans have been repeatedly delayed. The company operates Romania’s two nuclear reactors which produced 20% of country’s electricity in 2012. According to the IPO prospect, 10% of the share capital will be offered to investors, out of which an 85% tranche will be offered to Institutional Investors.