November 2013

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* GDP grew by 2.7% over 9 months of 2013.
* Industrial production grew by 4.3% yoy in August 2013.
* The consolidated budget deficit reached 1.3% of GDP at the end of September 2013.
* Consumer inflation decelerated to 1.88% in September 2013.
* The current account balance turned negative at the end of August, totalling USD 160 million.

## Executive Summary

Preliminary estimates show a 2.7% yoy increase in GDP over the first three quarters of the year.

Deceleration in growth of external demand and continued contraction of domestic demand led to deceleration of industrial production growth. As a result, industrial production grew by 4.3% yoy in August compared to over 11% yoy in July. Manufacturing remained the main driver of industrial production growth. The decline in domestic demand also affected the trade and services sector, the dynamics of which returned to negative territory after one month of growth in July.

Despite sluggish growth in budget revenues, the government managed to keep the consolidated budget deficit within the limits agreed with the IMF, WB, and EU. The deficit inched up to 1.3% of GDP in January-September from 1.27% observed in January-July.

Consumer inflation followed the optimistic scenario and further declined in September. It fell beyond the target band of 3%±1% to 1.88%. The main reason for this, as in the previous month, was deflation in food prices, which accelerated to 1.72% yoy. Growth of non-food goods prices continued to decelerate, while growth in service prices continued to accelerate.

As recovery of national currency lending remained slow, the National Bank of Romania lowered the monetary policy rate by 0.25% to 4.0% pa starting on November 6, 2013. A 2.3% yoy increase in corporate RON-denominated loans ensured a 1.2% yoy increase in the total volume of RON-denominated loans, despite a 0.5% yoy increase in domestic currency loans to the population. Forex-denominated loans declined in both segments, which led to a decline in total loans to the private sector.

Romania’s foreign trade posted good performance in August. The foreign trade deficit declined to EUR 141 million, or by 50% yoy. At the same time, the decline could be larger if not for a decline in exports of services in year-over-year terms in August. Good monthly performance of total foreign trade further improved from the beginning of the year. The total foreign trade deficit declined by 88.5% yoy in January-August 2013 thanks to both a decrease in the deficit of foreign trade in goods and growth in the surplus of foreign trade in services. However, the current account balance turned negative in January-August, mainly due to an abrupt increase in the income account deficit. At the end of August, the current account deficit was equal to USD 160 million.

### Economic Growth

According to initial estimates, Romania’s GDP grew by 1.6% qoq in Q3 2013. At the same time, GDP increased by 4.1% compared to the same quarter of the previous year. From the beginning of 2013, GDP grew by 2.7% yoy.

In August 2013, industrial production continued to grow but at a significantly decelerated rate compared to July. The slowdown in external demand growth and the persistent domestic demand contraction were the reasons for this. In total, industry generated a 4.3% yoy increase on the back of 5.7% yoy growth in manufacturing supported by a 1.9% yoy increase in production and supply of electricity, gas, steam, and...
air conditioning. At the same time, mining and quarrying dropped 8.2% yoy in August. Most of the important manufacturing subsectors reported slower dynamics. Nevertheless, food, automotive, electrical equipment and furniture industries recorded swift, above-average annual growth rates. On the contrary, chemicals and metallurgy were on a decline – chemicals due to the decision of an important operator to reduce its activity for six weeks, and metallurgy due to competition coming from similar yet cheaper products from Black Sea region countries. From the beginning of the year, industrial production expanded by 6.6% yoy. The main driver of growth was manufacturing with 8.1% yoy growth, while mining and quarrying grew by 3.5% yoy. Production and supply of electricity, gas, steam, and air conditioning decreased by 5.0% yoy in January-August 2013.

The trade and services sector was back to negative territory in August due to negative developments in both subsectors. In trade, the year-over-year decline was caused by worsening of growth rates for non-durables, IT and communication products, and motor vehicles. Retail trade grew by more than 2% mom for the second month in a row, but its year-over-year dynamics turned negative again after the increase in July. A 2.7% yoy decline in sales of food, beverages, and tobacco was accompanied by a 6.9% yoy decrease in retail sales of fuel for motor vehicles in specialized shops. These declines overcame the 3.8% yoy increase in sales of non-food products in the reporting period. As for services to households, a 2.1% yoy drop was mainly caused by sharper contraction of receipts from accommodation service activities (by almost 11% yoy). Embellishment activities dropped even more (by 22% yoy) but their share in the subsector is much lower. Gambling and other recreational activities declined by 9.5% yoy. Only activities related to travel and tours posted an increase (12.3% yoy) in August. From the beginning of the year, services to the population declined by 3.7% yoy.

After a couple of months of decline, the trade and services sector in total was back to growth in July (grew by 2% yoy). Retail trade imposed significant progress in July 2013. Its monthly growth of 2.1% helped turn negative year-over-year dynamics positive. The 1.0% yoy increase was generated thanks to an increase in sales of non-food products, which overcame declines in other retail trade subsectors. Turnover of trade in motor vehicles and motorcycles managed to generate a 4.4% yoy increase in July. This growth was driven by 12.9% yoy growth in trade of spare parts and accessories for motor vehicles and a 1.3% yoy increase in trade of motor vehicles stimulated by the car fleet renewal program. Growth could have been much higher, if not for significant declines in trade of motorcycles and in maintenance and repair of both motor vehicles and motorcycles. At any rate, the total sector year-over-year growth in July was not enough to break the downward sector development trend observed over the first seven months of the year. However, the decline decelerated to 0.8% yoy. As for market services rendered to households, they grew by 1.1% yoy on the back of increase in activities of travel agencies (24% yoy) and services of cleaning textiles and furs (15.3% yoy). However, the mentioned increase was not enough to generate growth in the sector in the first seven months of the year. Total volume of market services provided to households decreased by 3.9% yoy over the mentioned period.

**Fiscal Policy**

The government managed to hold the consolidated general budget deficit within the limits agreed with international institutions in January-September 2013, despite sluggish growth in budget revenues. The deficit reached RON 8.1 billion (EUR 1.82 billion), which is 1.3% of GDP. Solely in September, the consolidated general budget deficit grew by RON 0.2 billion or 0.03% of GDP. At the same time, the Ministry of Public Finance reported that the budget primary balance was positive at 0.07% of GDP in January-September 2013.

In January-September 2013, growth of government revenues remained the same as in January-August at 4.4% yoy. Government revenues themselves reached RON 147.3 billion (EUR 33.16 billion) or 23.5% of GDP. The situation with major tax revenues improved compared to that observed a month ago. The only major tax that posted a decline in receipts to the consolidated general budget was corporate profit tax. The decline in receipts was caused by a decrease in revenues from commercial banks, which overcame a 2.1% yoy growth of...
revenues from other business sectors over the first nine months of the year. As a result, the decline in total receipts from the corporate profit tax accelerated to 1.3% yoy (compared to a 0.8% yoy decline observed in January-August). At the same time, receipts from all the other major taxes grew at rates close to or higher than observed a month ago. In particular, receipts from the personal income tax grew by 7.9% yoy, VAT revenues increased by 4.1% yoy, and receipts from excise taxes expanded by 2.8% yoy. Significant growth was observed in revenues from dividends, use tax on goods, and selling certificates emission – RON 0.22 billion (EUR 49.5 million), RON 1.82 billion (EUR 409.69 million), and RON 0.29 billion (EUR 65.28 million), respectively. In January-September 2013, budget revenues from social security contributions expanded by 4.7% yoy. Results at the local level did not support the trend observed at the state level as growth of tax revenues remained unchanged at 8.9% yoy, while growth of non-tax revenues inch ed down by 0.7% to 7.7% yoy over the reporting period. Monthly growth of funds repaid by the European Union also decelerated. Moreover, it almost halved from 18% mom in August to 10.7% mom in September. However, the total amount repaid by the EU from the beginning of the year remained almost the same as the amount repaid over the same period last year.

In January-September 2013, general government expenditures preserved their growth at the level observed in January-August 2013, the same as consolidated general budget revenues. The growth was equal to 4.8% yoy, slightly above the growth of revenues. General government expenditures themselves reached RON 155.4 billion (EUR 34.98 billion) over the reporting period, which is 24.8% of GDP (0.4% lower than a year ago). Major drivers of growth were increases in expenditures on goods and services and wage bill expenditures. Growth of expenditures on goods and services accelerated again to 12.1% yoy in January-September 2013. This happened because of legislative measures related to payment of arrears of local governments and hospitals. At the same time, growth of wage bill expenditures slightly decelerated again to 14.7% yoy. As for investment expenditures, they grew but at a slower pace. The first thing the government has usually done, when growth of budget revenues appeared to be below expectations, was to cut investment expenditures. However, just in September, investment expenditures grew by RON 2.1 billion (EUR 0.472 billion), which is almost the same as the average monthly amount over the previous eight months of the year. The total amount of investment expenditures was equal to RON 19.4 billion (EUR 4.37 billion) in January-September 2013.

**Monetary Policy**

Consumer inflation dynamics followed the optimistic scenario in September 2013. Total inflation almost halved compared to that observed a month ago and fell below the lower boundary of the target 3%±1% level. It reached 1.88% yoy, mainly thanks to a 1.72% yoy deflation in the food goods sector caused by bumper crops, a cut in the VAT rate for bread and some bakery products, and a diminishing negative base effect. At the same time, growth of prices in other sectors remained above 3% (3.2% yoy for services sector and 4.38% for non-food goods sector respectively). Dynamics of prices in both services and non-food goods sectors followed the trends observed in August. In particular, growth of non-food goods prices continued to decelerate (from 4.98% yoy), while growth of services prices, on the contrary, continued to moderately accelerate (from 3.16% yoy).

The successive policy rate cuts in recent months have favorably fed through, albeit with a certain lag, to lending rates to the real sector. The consolidation of the monetary policy transmission mechanism thus paves the way for the revival of sustainable lending, restoration of confidence and the support provided to economic growth. There is still room for lowering lending rates for companies and households, in compliance with prudential rules. Therefore, the Board of the National Bank of Romania has decided to lower the monetary policy rate to 4.0% pa from 4.25% previously starting with 6 November 2013. The NBR Board has also decided to continue pursuing adequate liquidity management in the banking system. The existing levels of minimum reserve requirement ratios on both RON- and foreign currency-denominated liabilities of credit institutions will remain unchanged.

The real annual dynamics of loans to the private sector was still in negative territory in September, despite a relative improve-
ment in the developments in domestic currency loans. Total volume of RON-denominated non-government loans grew by 1.2% yoy as a 2.3% yoy increase in corporate loans exceeded the 0.5% decline in household loans. At the same time, volume of the forex-denominated non-government loans declined at both household and corporate level. Since volume of forex-denominated loans was still higher than that of RON-denominated loans, its dynamics has higher impact on the dynamics of total non-government loans in general. Therefore, a 6.0% yoy decline in forex-denominated non-government loans transferred into a 3.3% yoy decline in total loans to private sector by credit institutions.

Growth of broad money (M3) further accelerated in September. It inched up to 4.8% yoy compared to 4.3% yoy a month ago. Net foreign assets remained as the main driver of this growth even though their growth has rolled back to 90.8% yoy from 98.4% observed in August. Net domestic assets still declined at a rate above 10% yoy.

Favourable investor sentiment towards the Romanian economy and the NBR’s lowering of the policy rate is causing some depreciation pressure on the Romanian currency. At the same time, strong economic performance strengthens the domestic currency. In October, the influence of the economic performance on the RON was stronger than existing depreciation pressure. As a result, the RON/EUR exchange rate appreciated to 4.4306 as of October 31, 2013.

International Trade and Capital

In August 2013, performance of foreign trade was still much better compared to August 2012. The total trade deficit was 50% yoy lower at EUR 141 (FOB-FOB) thanks to both an increase in exports and a decline in imports. Foreign trade in goods still generated a deficit but it was almost twice as low as the one a year ago. The 9.3% yoy increase in exports of goods can be ascribed to robust demand for the products of companies operating in transport means production, food processing, machinery building, and wood-working. Imports declined by 1% yoy due to a drop in imports of goods from mineral fuels, lubricants, and related materials, as well as a decline in imports of food and livestock. At the same time, the services sector continued to generate a trade surplus, although it was 47% yoy lower due to a 25% yoy decline in exports. Imports also declined, but the decline was not that significant (2% yoy). Thanks to positive developments in foreign trade, the total foreign trade deficit of Romania amounted to EUR 498 million in January-August 2013, which is an 88.5% yoy decrease. The commercial deficit of the foreign trade in goods declined by 53.7% yoy during the period and amounted to EUR 2.268 billion in FOB-FOB terms. Exports of goods grew by 7.9% yoy, while imports inched down by 0.8% yoy. Significant growth in the surplus of foreign trade in services helped reduce the deficit generated by foreign trade in goods by almost 80%. As in previous months, such good results were achieved mainly thanks to a boom in transport services, the exports of which grew by 48% yoy in January-August, while imports remained almost unchanged (inched down by 0.8% yoy).

The mentioned increase in the foreign trade deficit was accompanied by a 50% increase in the income account deficit (to EUR 1.957 billion). The increase in the current transfers account surplus of EUR 149 million was enough only to compensate for the increase in the foreign trade deficit. Therefore, the current account balance turned negative and was equal to USD 160 million in January-August (EUR 489 million in January-July). The good thing is that the current account deficit is still much smaller compared to that of the same period last year (declined by 96.2% yoy).

Inflow of net foreign direct investments decreased to EUR 172 million in August compared to EUR 280 million in July and EUR 252 million in June. As a result, the decline in total net foreign direct investments attracted from the beginning of the year accelerated to 35.9% yoy in January-August 2013 (28.9% yoy in January-July). At the same time, there were also changes in the structure of attracted FDI. Intragroup loans amounted to EUR 339 million or 30% of the total amount of foreign direct investments attracted from the beginning of the year. This is twice as low as a month ago. Equity stakes consolidated with the estimated net loss amounted to EUR 779 million.

The total external debt of Romania continued to decline in August 2013. The decline accelerated to 1.1% mom from 0.5% mom observed in July because both medium- and long-term external debt and short-term external debt declined in August. Only non-publicly guaranteed debt slightly increased (by 1.35%) in August. However, declines in all other lines of the medium- and long-term external debt ensured decline of this debt in general. Even though short-term external debt declined faster in relative terms, the
shares of medium- and long-term external debt and short-term external debt within total external debt remained unchanged at 79.7% and 20.3%, respectively.

Issue of Eurobonds helped increase the foreign exchange reserves of the National Bank of Romania in September. The Ministry of Public Finance placed its issue of EUR 1.5 billion nominal value Eurobonds on the foreign markets. Together with other inflows representing changes in the foreign exchange reserve requirements, this allowed generating EUR 1.856 billion inflows of foreign exchange reserves in September, which is almost two times more than foreign exchange reserves outflows for the month. EUR 243.2 million of outflows out of a total EUR 943 million represented the eleventh principal instalment on Romania’s loan from the IMF, equally divided between the Ministry of Public Finance and the National Bank of Romania. The total foreign exchange reserves grew by EUR 913 million or by 2.84% mom to EUR 33.086 billion in September. The gold stock of the country remained unchanged in terms of weight but decreased in terms of value by almost 6% to EUR 3.3 billion because of changes in prices of gold on the international markets. Overall, the positive change in foreign exchange reserves was much higher than the negative one in value of gold stock. Therefore, total international reserves increased by almost 2% mom to EUR 36.386 billion in September.

Other Developments Affecting the Investment Climate
Romgaz Initial Public Offering (IPO) closed successfully in November, the Romanian government attracting RON 1.7 bn (US$ 534 mn) for a 15% stake, thus implying a market capitalization of RON 11.6 bn (US$ 3.6 bn). This is the largest IPO of a Romanian company. The listing was dual, with shares traded on Bucharest Stock Exchange, and Global Depository Receipts (GDR) traded on the London Stock Exchange. Following the offer, the float is 15%, the Romanian Government owns 70% of the shares, and Fondul Proprietatea, managed by Franklin Templeton owns another 15%. EBRD announced that it had acquired 1.9% of the Romgaz shares.