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Romania Economy briefing:

The foundation of a sovereign investment fund

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Romania decided the foundation of a sovereign investment fund

Romania saw an increase of 4% of GDP in the first trimester of 2018 and the growth rate of exports surpassed for the first time this year the growth rate of imports, signalling a tendency towards diminishing the large trade deficit. Still, the evolution of inflation registered a level record in May. On the background of such macroeconomic evolutions, the foundation of a sovereign investment Fund – the first one of this kind in Romania – and the ongoing discussions related to the indebtedness level will also impact the economic framework.

After numerous debates related to the GDP growth in 2018 and fears related to its unsustainable increase, the National Institute of Statistics confirmed the signal estimation of GDP in May and announced an increase of 4% of GDP on the gross series and 4.2% on the seasonally adjusted series in the first trimester of 2018 as compared to the same trimester in 2017. The increase was of 0% as compared to the previous trimester, which means that the GDP stagnated. The National Commission for Strategy and Prognosis forecasted a GDP growth of 6.1% for this year. Several other changes in the growth rate of GDP could be assessed, such as the fact that the industry had the main contribution to the final increase rate (with 1%), while trade fell on the second place (with 0.8%), thus redressing the fundamentals of GDP growth, previously considered to be based exclusively on consumption. In a specialized conference, the Director for Romania of the European Bank for Reconstruction and Development (EBRD) mentioned that Romania’s GDP is increasing over potential. In order to accelerate convergence, Romania needs a new growth model based on innovation and integration in the global value chain. He draws the attention to the improvement of infrastructure, whose development could generate spillovers in the whole economy, contributing to the stimulation of social inclusion, geographic integration and productivity increases, by enhancing trade and foreign direct investments.

The situation of the trade balance entered on a new path once with the higher increase of the growth rate of exports (9.7%) as compared to the one of imports (7.3%) in April, for the first time this year. This also signals a moderation of consumption goods imports. Still, the trade deficit surpasses 1 billion euro and is 11% higher in the first four months of this year as compared to the first four months of 2017. While the evolution is a good signal for Romania, it is certain that it should continue in the next months of this year, also for encouraging a health economic growth.

One of the major problems remains the high level of inflation, which reached 5,41% in May, a record level. The largest increases in prices were registered by the vegetables and canned vegetables, while other two type of goods have prices that are influenced at international level (the fuels and tax increases for tobacco). Such effects will continue to manifest in the months of June and August, while adjustments are forecasted for the autumn months, in order to draw the inflation to the estimated target of 3.6% for this year.

On this background related to the economic evolution, several other events and decisions in the last period tend to impact the economic development, such as the establishment of a sovereign investment Fund and discussions related to the indebtedness level.

The establishment of a sovereign investment Fund

The Parliament adopted the establishment of the Sovereign Development and Investment Fund (SDIF), an initiative that was initially announced at the beginning of 2017, as a measure inscribed in the governing programme of the actual coalition. The Fund is including 33 state companies and its role is to develop and finance cost-effective and sustainable investments in various economic sectors. Such measures will be supported by either the direct effort of the Fund, either with the participation of other investments funds, companies or private investors, by enhancing the role of the public-private partnerships. In addition, one of the aims is to get profit by managing the own financial assets. The share capital will amount to 9 billion lei.

The Romanian state is the shareholder of the Fund, acting through the Minister of Public Finances. In addition, the Minister has attributions of evaluating the activity and the achievements of the goals.

The SDIF will function as a dual-funded company managed by a Supervisory Board and a Directorate. In addition, it will have an Advisory Committee, which will gather representatives from the Government, the National Bank of Romania (NBR), the Financial Supervision Authority, the academic environment, the financial-banking industry, the Parliament and the civil society. Its aim is to evaluate the measures launched by the Fund and to provide directions of action. The members of the committees are going to be appointed by the Government.

The investment strategy is approved by the Government and is correlated with a set of performance indicators that also shape the direction of the Fund's investments, mainly related to the development of infrastructure, job creation, stimulating innovation and technology, raising the quality of the human capital and the increase of economic competitiveness. Besides these, the governmental sectoral strategies must be taken into account. The indicators of performance and their goals, which were not established yet, are going to be elaborated by the Ministry of Public Finances and will be approved by the Government and the Advisory Committee.

The launch of the SDIF was discussed between the Romanian statistical authorities (namely the National Institute of Statistics) and Eurostat related to the treatment applied to the entity in the national accounts. The subject is of importance as Romania is placed by the European Commission in a process of significant diversion from medium-term budgetary objectives. Therefore, the

Fund also has statistical significance, since the European officials are concerned if it will have or not influence on the budgetary deficit.

The legislative project for the creation of the Fund was earlier submitted to be consulted by Eurostat in order to comply with European legislation. The European institution then required several changes to some provisions that ensure independence from the state, as the sovereign fund must be classified as a company outside the public sector by Eurostat in order not to have an impact on government deficit and debt. Among others, it suggested the introduction of an explicit provision that the Fund will not benefit from government guarantees, the elimination of those provisions that lead to state control or intervention in the administration process (such as the approval for borrowings), ensuring the decision autonomy of the companies that are members of the Fund, etc. Still, through the recent votes, the law was passed without expecting Eurostat to classify SDIF as a company outside the public administration sector without impact on budget deficit and public debt. Based on the fact that the legislative project for the creation of the Fund does not take into account some of the recommendations made by Eurostat in April 2018, the two major opposition parties immediately announced that they would appeal to the Constitutional Court.

One of the main controversial issues is related to the revenues to the state budget; the opinion of the analysts is that companies that are now covered by the Fund used to provide important revenues to the state budget; under the new legislative approach, the money will be redirected to a fund that is no longer under the public control. Moreover, among the initial societies mentioned to be part of the Fund, ten other societies have been added, whose profitability is uncertain. In addition, the lack of transparency is indicated in the future functioning of the Fund, as there is no impact study elaborated for identifying the costs and the benefits of such a project, and the sources that will replace the budgetary revenues are not mentioned.

Plans for limiting the indebtedness level

The representatives of NBR are working to an analysis related to the indebtedness level of the population. The regulation would establish certain conditions for granting and developing loans for individuals and non-financial entities in Romania, with the purpose of maintaining financial stability. Therefore, the indebtedness level could reach 50% for real estate loans and 25% for consumer loans with variable interest rate, if such loans are contracted in lei. For loans in foreign currency, the maximum level of indebtedness would reach 35% for real estate loans and 15% for consumer loans, respectively. In addition, the bankers will have to inform the credit seekers about the impact of a possible severe depreciation of the domestic currency and to provide scenarios related to the evolution of the credit rate under the circumstances of an increase of the interest rate.

The perception from the market and the stakeholders is that the NBR interest is to temper consumption, which is considered an unsustainable growth engine in a country like Romania. In this respect, fixed-interest loans in national currency are encouraged, while the consumer spending is tempered. Moreover, specialists incline to consider that the Romanian real estate market is overheating in the last two years.

The possibility of limiting indebtedness was launched since September 2017, when the NBR officials have noticed that loans to individuals exceeded the signal threshold, approaching the alert threshold. Under these circumstances, the NBR is bound by the European Systemic Risk Board to take measures in this direction, the most usual one being that of capping the indebtedness level. The NBR officials ensure that the aim of such measures is oriented towards guiding lending in a sustainable direction and supporting it especially through loans in the national currency, with fixed interest rate on the long term, without restricting access to credit.