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Romania economy briefing:

The impact of the international auto market's evolution in Romania

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The impact of the international auto market's evolution in Romania

The turbulences on the auto market at international level had different impact on the Romanian market, where the auto industry accounts for 14% of GDP. On one hand, there was a drop by 1.8% in the car components exports, while on the other hand, vehicle exports increased by 5.1% in the first semester of 2019, due to competitive prices. While the car production is expected to expand in the following period, Romania is facing the challenge of reducing carbon emissions and adjusting to the global trend of adopting electrical vehicle.

The evolutions at global level, shaped by the trade wars and potential contraction of the Euro area industry due to the accentuated decline of the activity in the enterprises in Germany, risk destabilizing the entire economy in the European Union. Romania is not immune, as there is a high dependency of the exports to the demand of the large economies in the EU, such as Germany, France, Italy or the Netherlands. One of the most affected sectors is that of the auto industry. Due to the fact that car manufacturers have long supply chains, are important consumers of raw materials, chemicals, textiles and electronics, and generate indirectly a lot of jobs in the services sector such as sales, repairs and maintenance, their impact on the economy is extensive.

In this context, Erste Group Research (EGR) forecasted a decrease of one million units in the auto industry in Germany as compared to the average in the period 2015-2017, which is close to the minimum level in 2009. In Central and Eastern European countries, almost 10% of the total added value and between 6-9% of the total jobs are directly and indirectly generated by the auto industry, as the region has the second highest capacity production in Europe after Germany. However, the close ties with this country will negatively affect the auto production causing even a 1% drop in GDP, according to specialists. In addition, the industry is also confronted with the changes in the structure of production and demand in the following years, giving the development of electrical cars.

A decrease as that forecasted by EGR is similar to a decline of 21% of the auto industry in Germany this year, which could lead to a proportional decrease of the German demand for car equipment manufactured in Romania, totalling RON 3.6 billion (EUR 0.76 billion), according to analysts. For the last year, the contribution of the auto industry to the formation of

GDP was about RON 132 billion, and the production of auto equipment for Germany was over RON 18.3 billion.

In Romania, the auto industry accounts for 14% of GDP and has a contribution of 26% in exports, according to Christophe Dridi, general manager of Automobile Dacia and Groupe Renault Romania, therefore having an important impact in the economy. It encompasses about six hundred companies that produce not only cars or collections of components that can be assembled abroad, but also a diversified range of related parts such as cables, conductors, electronic components, lighting fixtures, accumulators, tires, etc.

In this respect, the recent global developments led to different impacts. On one hand, it strongly affected the demand for car components and thus severely altered the volume of exports, which further has a negative impact on GDP in a period in which Romania is confronted with severe current account and budgetary deficits. The National Bank of Romania announced that the annual dynamics of the volume of exports of goods became negative, induced exclusively by deliveries to EU markets (a decrease of 1.7%). Such an evolution is registered mainly by goods produced in industrial branches integrated in the international production chains, among them the auto industry. Thus, exports of car components and accessories reduced their volume by more than 10% for the fourth consecutive quarter. In addition, if comparing external deliveries in the first half of 2019 with those in the same period in 2018, Romania's auto industry was affected by a lower demand from Germany, where the drop was almost 4% in exports, while the evolution of exports to France and Italy remained the same. In addition, Brexit has already affected the demand in the auto industry, as there was a 30% drop in the auto parts exports during this period.

On the other hand, the production of car increased in the first part of this year. The two Romanian car factories, Automobiles Dacia and Ford, produced 407,931 cars in the first ten months of the year, increasing by almost 2% as compared to the same period last year, according to data from the Association of Automobile Builders of Romania (ACAROM). If the same rhythm is followed, the total production could surpass the threshold of 500,000 cars for the first time in 2019. Such an evolution is possible, as Ford launched the production of the new Ford Puma last month, which is the first hybrid vehicle manufactured in Romania. Car exports registered a growth of 5.1% in the first semester of this year as the cars produced locally having an extremely competitive price on European markets. It is possible to further see an upward evolution driven by the launch of two new models.

However, exports of car components have surpassed those of cars in the last years. The dependency on external evolution is high and highly influences the internal economic evolution.

At the local level, however, the auto industry is one of the most performing sectors and has important competitive advantages. The turnover of the local auto industry, including both car producers and component manufacturers, registered a growth of 20% in 2018, to EUR 28 billion, according to data of the Romanian Association of Automobile Builders. In addition, it is among the few sectors in which the annual dynamics of wage costs was covered by that of labour productivity, according to the data of the National Bank of Romania, following the automation process.

In addition, Dacia started to produce cars in the upper range, which caused an ascending trajectory of quality. Further improvements of technology and human resource specialization attracted the production of more advanced models or the implementation of some upgrades to those already made here. In fact, improvements on the qualitative side at the level of motor vehicle production in Romania are certified in a report of the National Bank of Romania. Following this virtuous circle, the models manufactured in Romania have succeeded in being known on the foreign markets, which allowed further expansions of the industry. The shift to a higher range of cars contributed to maintaining high production and exports, although in the meantime labour costs increased.

Perspectives

Car production has good perspectives for the following period and the auto industry is an important source of attracting foreign investments, which are more stable in case of crisis than other type of investments. These forecasts are driven by the fact that the Ford plant in Romania will become closer to full capacity in 2020, while Dacia will complete the investment for increasing the production capacity of its plant.

Ford Romania carried out a recruitment program under which it employed 1,700 new workers for the production of the new SUV Puma, which started last month. It is for the first time since Ford took over the plant in Craiova in 2008 when two vehicles are being manufactured in parallel, and the production volume requires three shifts. Ford invested EUR 200 million for the introduction of the new Ford Puma, therefore Ford's total investment in Craiova amounts to about EUR 1.5 billion since 2008. Following the employment process, it is possible that Romania will surpass United Kingdom in the top of the first five countries with the most employees working in the auto industry.

Automobiles Dacia celebrated 20 years since the privatisation process. The company invested EUR 3 billion in this period and have plans for further providing capital of around EUR 800 million in the next three years.

At the beginning of October, Volkswagen Group announced the postponement of the final decision to build a car factory in Turkey. Production was set to start in 2022, and the investment was estimated at EUR 1.3 billion. As a consequence, Romania launched new rounds of negotiation with Volkswagen for a location where the new Skoda factory to be implemented, but no final decision was announced yet.

New investments in infrastructure are announced and could also be financed with European funds. The difficulties in recruiting qualified personnel could also be overcome by focusing on more automatized and robotized production processes, less intense in labour, as Dacia already started to do. This could also increase the quality of the production processes.

However, the industry is affected by the evolutions of the main players on the global auto market, such as the sharp decline in the Chinese market and the reorientation towards electrical vehicles, or the commercial war between USA and Europe. The threats of introducing taxes on cars and car equipment could lead to new problems for the industry in Romania. Some analysts envisage a growth of 2.7% in the local auto market in the next year only if the US does not introduce tariffs on cars and auto components.

Faced with the challenge of reducing carbon emission and the transition towards electrical vehicle, Romania has to create an attractive environment for further foreign direct investments inflows, based on conducting the necessary public investments (such as charging stations for electrical vehicles), ensuring the qualification of the workforce, encouraging the research and development activity, and providing friendly and predictable legislative and business environment.