China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 24, No. 2 (RO)

Dec 2019

Weekly Briefing

Romania economy briefing:

Overview of economic developments in 2019

Oana Cristina Popovici

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.

+36 1 5858 690

office@china-cee.eu

china-cee.eu

Overview of economic developments in 2019

Romanian confronts economic slowdown and a budgetary deficit which will surpass 3% of GDP this year. Under high volume of imports, trade deficit hit 6.5% of GDP in the first ten months of the year. The economic and fiscal slippages are difficult to be adjusted given the following rounds of elections in 2020, which could further lead to deepening of the deficits. In these circumstances, the international rating agency Standard&Poor's downgraded the outlook of Romania's rating from stable to negative. Notwithstanding the above, one of the best news in the economy this year, comparable to that of the adhesion to the EU, was the promotion of the Bucharest Stock Exchange from the status of frontier market to that of Secondary Emerging Market, which expands the pool of investment funds available to Romania.

Fears at the beginning of 2019 related to the slowdown of the economic growth and the difficulties of keeping the budgetary deficit under the limit of 3% of GDP were justified.

The economic growth slowed down to 4% in the first three quarters of the year, according to a recent release of the National Institute of Statistics, after a continuous quarterly decrease of the economic performance. The third quarter of 2019 saw a GDP increase of 3%, as compared to 4.6% in the first half of the year. The industry and the agriculture had a negative impact on GDP growth. Industry is contributing with 22.6% in GDP, but the reduction of the activity volume by 1% led to a negative contribution with 0.2 percentage points to the GDP growth. Agriculture's output reduced even higher, by 4.1%, but since its contribution in GDP is limited at 5%, the impact on GDP growth was a decline by 0.1 percentage points. Consumption and constructions were the main sectors with a positive contribution of 0.9 percentage points and 0.6 percentage points respectively in GDP growth. The economic growth continues to be driven by consumption, which economists warn is not sustainable on the long term.

The problem of the trade deficit amplified. The last data on the first ten months of this year indicates that the trade deficit has already exceeded EUR 14 billion (6.5% of GDP), which is 18.4% higher than in the first ten months of 2018. The increase is almost double compared to the official forecasts of the trade deficit growth for 2019, initially established at 9.9%. The trend of higher increase in imports than in exports is perpetuating. Therefore, although the cumulated value of the exports reached EUR 58 billion in the first 10 months, meaning a 1.7% increase, the imports hit EUR 72 billion, after a 4.6% increase as compared to the previous year.

Such a situation is the consequence of the social budgetary expenditures. The increase of the wages and pensions stimulated the demand for goods and services. As the local companies could not provide the required goods, the adjustment was made by price and imports. In these circumstances, Romania remained the country with the highest annual rate of inflation in the European Union, which reached 3.2% in October as compared to last year, although on a decreasing trend. However, official data record an increase for November, and the National Bank of Romania expects a value of 3.8% at the end of the year.

Once with the accommodation of the new Government, a huge debate related to the budgetary deficit emerged. One of the most important predictions for this year – that of the impossibility of having a budgetary deficit lower than 3% of GDP, became true. The budgetary deficit is estimated at 4.3% of GDP this year and there are accusations that the previous government did not initiate the needed measures for preventing such a situation in time. Unfortunately, the budgetary situation could not be adjusted in 2020. The budget for the next year will be built on a budgetary deficit of 3.6%, as agreed following negotiations with the European Commissions. However, there are fears that such a target could not be achieved if pensions will further increase, as already established.

Under these circumstances, the economic perspectives at the end of the year are gloomy.

The international rating agency Standard&Poor's recently took the decision of downgrading the outlook of Romania's rating from stable to negative, following the risks emerging from increased budgetary deficit and the plans of implementing new raises of pensions in 2020. Estimates show that if the pension law adopted in July is applied starting with next year, the state's pension spending will increase by over 3% of GDP in 2020-2022.

S&P' opinion is that the large spending deviations of the previous government are going to be difficult to be adjusted by the actual government given the following rounds of elections in 2020 and therefore the budget deficit will be even higher, of 4% of GDP in 2020, and, in the absence of measures regarding pension increases, it will reach 6% of GDP in 2022. As a consequence, the share of public debt in GDP will increase, which will lead to an increase in interest expenditure. The situation would be worsened, as an economic growth of only 3% is forecasted for that period.

However, the country's long- and short-term foreign and local currency sovereign credit ratings were maintained at 'BBB-/A-3'. Over the next two years, the agency could lower its rating if no action is taken for adjusting the external and fiscal imbalances.

In the same vein, an Erste Group report points that investor confidence deteriorated at the end of 2019 following the raising awareness about the state of public finances.

The Emergency Ordinance (EO) 114 at the end of 2018, through which new taxes and radical changes in the energy and banking sector were imposed to the business environment for increasing the budgetary revenues, had to be adjusted several times for correcting some disruptions in certain sectors or for avoiding the triggering of the infringement procedure by the European Commission. In the end, the main aim for the EO 114 – to increase the budgetary revenues – was not fulfilled; instead it generated distortions in economy which had to be reconsidered. The budget for 2020 is under planning and several other measures for changing EO 114 could be taken into account. Some of them were already announced, such as the elimination of the tax bank or of the capital requirements for the managers of the second pillar pension funds. Several declarations of the officials also target the abrogation of the provisions in the energy sector, such as the ceiling of the price for the producer, with a transition period of between 6 and 9 months until the re-liberalization of prices.

The industry, driven by the manufacturing sector and especially by the automotive sector, also saw a reduction of the activity. Romania recorded in October 2019 the fifth consecutive month of a sharp decline in industrial production, establishing a negative record of -7.7% for the values adjusted by the number of working days and seasonality compared to the same month of the previous year. The industrial sector is the one determining the economic trend, and the cumulated general decline in the first 10 month of this year was of 2.8% on the series adjusted by working days and seasonality. In fact, as the auto industry accounts for 14% of GDP and has a contribution of 26% in exports, industry was highly influenced by the evolutions at global level during this year, shaped by the trade wars and the accentuated decline of the activity in the enterprises in Germany.

This strongly affected the demand for car components, which is a major industry sector in Romania, and thus severely altered the volume of exports. However, the difficulties at international level reoriented the demand towards cars with competitive prices, which are produced in Romania by the two factories, Dacia Renault and Ford. Therefore, the production of cars increased in the first part of this year, while Ford launched the fabrication of the new Ford Puma, the first hybrid vehicle manufactured in Romania, at the end of this year. In this regard, car production has good perspectives for the following period and foreign investments could further be attracted in this sector for increasing the production capacity of the plants of the two car producers.

One of the best news in the economy this year was the announcement in September on the promotion of the Bucharest Stock Exchange from the status of frontier market to that of Secondary Emerging Market. The decision of the global evaluation agency FTSE Russell followed the fulfillment of the liquidity conditions and will become effective in September 2020. The performance was compared by the economists with the adhesion of Romania to the EU, due to the opportunities it can provide. Romania will have access to investment funds 30 times higher than those usually allocated until now, according to estimates, as large global investment funds, which were restricted through their prospectus to invest in frontier markets, could now target the country. This will lead to the increase of the demand for the shares of the companies listed in the Bucharest Stock Exchange and of their market value. The Bucharest Stock Exchange goal for the next 10 years is to double the capitalization level of Romanian listed companies, from 10% of GDP at present to 20% of GDP.