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Weekly Briefing

Romania economy briefing:

The impact of the coronavirus crisis on the economic activity

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The impact of the coronavirus crisis on the economic activity

The deceleration of the economic activity could be seen during March in the drop of the volume of economic activity by 30%, and a reduction by 22% in exports and by over 25% in imports. Confidence in the economy fell in March to the lowest level since July 2012. The range of GDP estimations is large due to uncertainty and it goes from a 0.3% increase according to the World Bank to a 4.7% drop based on BCR estimates. The package of economic aid raises at 2% of GDP, but it is considered insufficient by the private environment. The pressure on hikes in budget deficit limits the space for fiscal measures.

Macroeconomic conditions

The estimations on the GDP growth for this year are extremely volatile due to high uncertainty. The World Bank has revised significantly the estimations regarding the advance of the Romanian economy this year, up to 0.3%, from 3.8% as estimated three months ago, but count on a positive return to 4.4% in 2021. The negative impact of the COVID-19 pandemic on the economy is expected to be substantial, at least in the first half of the year. However, the risk of the recession in 2020 remains considerable and increasing. National institutions are more pessimist about the recession. According to the president of the Fiscal Council, Romania has no way to avoid a recession, but the economy will not collapse, as the basic services, several businesses and work in agriculture are continuing. There is high uncertainty and estimations are vulnerable to the advancement of the pandemic. The representatives of the ING Bank also indicate towards a recession, with a GDP decrease of 0.9%, according to their estimations in mid-March. However, the economists of one of the largest banks in Romania, BCR, envisage a decrease by 4.7% of the economy due to the epidemic, from a previous growth forecast of 1.8%. GDP would decline by 15.2% in the second quarter and return to a rapid growth of 12.8% in the third quarter, due to the gradual resumption of activity. The GDP growth in 2021 would be of 3.9%. Total recovery will last for several quarters, as some companies will not survive the shock and others will need time to reach full capacity and resume the hiring process. The unemployment rate would rise almost three times by the end of the year, reaching 11%. Romania had one of the lowest unemployment rates in the EU during 2019.

Signals on the slowing of the economic activity is starting to be captured by official data. The volume of economic activity, as measured by the turnover of the companies in Romania could decrease by 30% during March and may drop further, by 40% during April, according to a survey conducted by the National Institute of Statistics. A similar ad-hoc investigation of the same institute suggests that exports decreased by about 22% in March. The main causes for these reductions were the drop of production capacity (in the case of 16.6% of the respondents), transportation problems (22.4%), temporary legal export bans (16.5%), lack of imported raw materials (14.1%) and cancellation of contracts (9.1%). However, imports saw a higher contraction, of over 25%. Importers also accused, on a larger extent, the reduction of production capacity (20.8%), problems related to transport (29%), temporary legal prohibitions on imports (20.4%), and contract cancellation (8,4%). Such a situation may lead to the reduction of the foreign trade deficit, which hit 7.8% of GDP in 2019.

Romania confronts a high risk is on the side of the budget deficit, which has surpassed the alarm limits of 3% of GDP since 2019. The Ministry of Finance warned that the 2020 budget deficit could exceed 5% of gross domestic product, while the experts of the CFA Romania Association anticipates an even higher value, of 6.5% of GDP. BCR representatives expect an explosion of 7.8% of GDP. World Bank's forecasts for this year indicate that the deficit will rise at about 5.5% of GDP, as compared to the planned amount of 3.6% of GDP, according to a recent report. The increases in deficit will trigger a surge of the public debt up to 41% of GDP by the end of 2022, from 36.3% in 2018. However, Romania will still register the lowest debt in the EU. In fact, president Iohannis already draw the attention that the public deficit will likely record a significant increase, following the planned revision of the budget planning for this year.

The Government is proceeding to a full revision of the budget, since the allocation of money envisaged at the end of 2019 was made on assumptions which are not available at present, such as the scenario of 4.1% of GDP increase and a public deficit of 3.6% GDP. In the meantime, following the coronavirus crisis, the Government postponed the collection of several taxes which diminishes the state revenues, while more funds are needed in the public health sector, for social assistance and for paying technical unemployment and other unemployment indemnities.

The indicator measuring the confidence in the economy fell in March to the lowest level since July 2012, according to the CFA Romania Association. The confidence indicator is based on two components: one of the current conditions (the reality in the economy) and another one regarding the expectations in the future. Both registered a sharp decrease as compared to the previous month. In addition, most of the respondents (48%) anticipate that the economic impact of cornavirus will be strongly felt by the fourth quarter of the year.

The Government's aid package for supporting the economy

The Government took several measures, most of them similar to other countries, for providing economic aid to those affected by the pandemic, such as:

- Providing guarantees for loans up to RON 10 billion, interest subsidy for working capital and investment loans and facilities for companies experiencing financial difficulties.
- Adopting a moratorium on bank loan repayment which allows to suspend the payment of loan instalments until December 31, in order to help individuals and companies hit by the COVID-19 crisis. Until present, more than 150,000 persons requested to benefit from this measure.
- Accelerating VAT refund.
- Suspending tax controls.
- Extending the payment terms for local taxes paid by the population.
- Postponing the payment of utilities and rents for several small enterprises.

IMF estimated that the measures comprising taxes and budgetary expenses raise to about 2% of GDP. These involve the additional expenses in the health system, partial coverage of the wages of the parents who stay at home while the schools are suspended and the measures to support the business environment including partial coverage of salaries for people in danger of being fired.

In addition, the National Bank of Romania (NBR) quickly implemented a package of exceptional measures, such as:

- Reducing the monetary policy interest rate from 2.5% to 2%.
- Maintaining the interest rate for the deposit facility at 1.5% (in order not to reduce the deposit remuneration in the banking system).
- Lowering the interest rate related to the lending facility to 2.5%, from 3.5%.

- Providing liquidity to credit institutions through repo transactions (a repurchase agreement for government securities) in order to ensure the smooth functioning of the monetary market and other segments of the financial market.
- Purchasing government securities in national currency on the secondary market in order to strengthen the structural liquidity of the banking system.

The possibility of NBR in reducing interest rates is limited by the large budget deficits and current account (twin deficits), which means a higher risk premium. According to experts, if NBR were to reduce the interest rate more aggressively, the exchange rate of the national currency would have depreciated sharply.

There are, however, opinions stating that these measures would not be enough or that they would be small compared to the incentives package implemented by other countries. The 2% of GDP anti-Covid economic package is similar to the one in Turkey, Tunisia, Togo, Egypt, Georgia and Ireland. However, as dimension, it is one of the weakest, as compared to 6% of GDP in Poland, 18% of GDP in the Czech Republic and 28% of GDP in Germany.

The private environment requested an intervention for restoring the economy of 15% of GDP, namely approximatively EUR 30 billion. Such an amount would decrease the risk of recession (or reduce it to a very short term) and would enhance a good position the end of the year, thus providing a better situation at international level and increased competitiveness.

In addition, the private environment is asking for an adjustment of the state apparatus, as it adds a considerable pressure on budget spending. It is very possible that future weeks will bring measures for the public environment employees similar to those already taken in the business environment: technical unemployment, reduction of revenues, suspended employment contracts. Romania faced harsh austerity measures during the financial crisis of 2008-2009, such as the reduction by 25% of the revenues in the public sector. The Prime Minister considers that measures should focus on maintaining the purchasing power of the population for preserving consumption and providing financial injections in certain areas to help restart the economic engine. The austerity measures were not the most appropriate solutions during the last crisis since they delayed the economic recovery.

The German business community in Romania also consider that the measures are not enough and ask for the implementation of reduced and flexible schedule work, accelerating the VAT refund, reducing the wage contributions and the introduction of bonuses for the payment of taxes on time.

However, economic analysts state that the Romanian government cannot implement a large package of fiscal incentives, such as tax cuts or spending increases, because it has no fiscal space. Romania's budget deficit is very high following the expansionist policies of the last 3 years, and, from this point of view, Romania is the most unprepared economy amid the EU countries which has to confront the crisis.