Romania
Macroeconomic Situation

February 2013 Edilberto L. Segura, Valentyn Povroznyuk, Radu Mihai Balan

- **Industrial production dropped 2.2% yoy in December 2012.**
- **The consolidated budget deficit reached 2.5% of GDP at the end of December 2012.**
- **Consumer inflation accelerated to 5.97% in January 2013.**
- **The FOB-CIF commercial deficit for goods dropped 17.08% yoy in December 2012.**
- **The current account deficit declined by 15.1% yoy in 2012.**

Executive Summary

Industrial production remained unchanged in monthly terms, but declined by 2.2% yoy in December 2012 because of decreases in all the major sectors. The largest decrease was observed in manufacturing. Retail trade also declined by 4.3% yoy, which is a significant drop from 3.1% yoy growth in November.

According to the signal estimations, the Q4 2012 GDP increased 0.3% yoy thus determining a 0.2% yoy growth for the entire 2012 year. With respect to the quarter on quarter growth, the Q4-2012 GDP, seasonally adjusted expanded 0.2%.

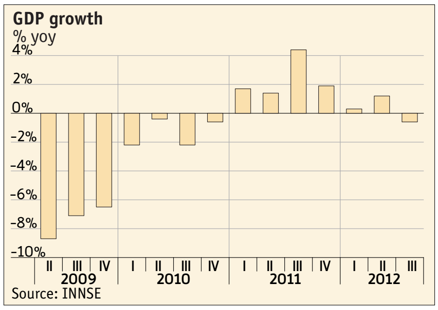
Because of revisions to 2011 GDP and acceleration of the consolidated budget deficit in December 2012, the country finished 2012 with a consolidated general budget deficit amounting to 2.5% of GDP.

Consumer inflation accelerated to 5.97% in January 2013 because of high growth of prices of food and non-food goods. Inflation in the services sector decelerated. Despite the fact that consumer inflation was well beyond the target band of 3%±1%, average annual inflation was at its lowest level in the last 23 years (3.33%).

Both FOB exports and CIF imports of goods decreased in year-over-year terms in December 2012. Imports declined faster (7.9% yoy versus 4.9% yoy) but still exceeded exports in total value, meaning that the commercial trade balance was negative at EUR 0.886 bln. On the other hand, it significantly declined in year-over-year terms.

	2007	2008	2009	2010	2011	2012
GDP growth, % change yoy	6.2	7.1	-6.6	-1.6	2.5	0.5
GDP per capita, $	7 917	9 497	7 649	7 667	8 863	8 721
Industrial production, % change yoy	5.4	0.9	-5.5	5.5	5.6	5.6
Retail sales, % change yoy	17.8	13.0	-10.3	-5.3	-2.5	2.0
Budget balance, % of GDP	-2.3	-4.9	-7.3	-6.4	-4.1	-4.2
Government external debt, % of GDP	7.8	7.6	16.4	22.3	23.8	24.5
Inflation, end of period	4.84	7.85	4.70	8.0	3.3	3.5
Gross international reserves, EUR billion	27.2	28.3	30.9	36	37.3	36.5
Current account balance, % GDP	-13.9	-12.3	-4.1	-4.4	-4.2	-4.2
Gross external debt, % GDP	47.0	51.8	69.1	75.8	71.9	71.0
Unemployment (ILO), end of period	6.4	5.8	6.9	7.3	7.4	7.2
Exchange rate, RON/EUR, annual average	3.34	3.68	4.24	4.21	4.24	4.5

Economic Growth



Industrial production remained unchanged in monthly terms in December 2012 as a 1.5% mom increase in electricity, gas, steam, and air conditioning supply and a 0.1% mom increase in manufacturing were compensated by a 0.1% decrease in mining and quarrying. Compared to the previous month, it is an improvement (0.8% mom decline in November). However, the year-over-year dynamics deteriorated. To be more precise, industrial production declined by 2.2% yoy in December due to decreases in all three sectors compared to a 1.0% decrease in November. Manufacturing declined by 2.4% yoy compared to 1.0% yoy in November. At the same time, mining and quarrying declined by 1.9% yoy in December compared to 3.7% yoy growth in November. As for electricity, gas, steam, and air conditioning supply, its decline decelerated to 1.2% yoy from 3.6% yoy in November. Overall, in 2012 industrial production stayed unchanged compared to the previous year. A 4.5% annual increase in electricity, gas, steam, and air conditioning supply accompanied by a 1.5% annual increase in mining and quarrying were just enough to compensate for a 0.7% annual decrease in manufacturing.

The situation in industrial groupings in year-over-year comparisons mostly worsened in December 2012 compared to November. Capital goods grew by 1.5% yoy, which was an improvement compared to 0.9% yoy in November. Energy

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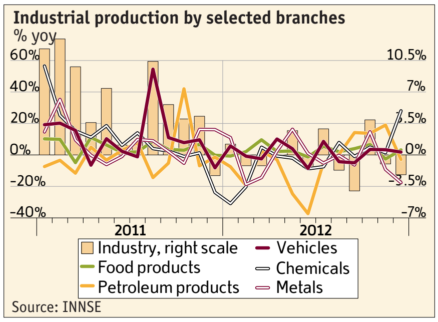
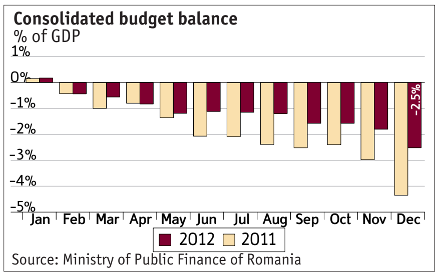


was the only sector that experienced the same dynamics in December compared to the previous month, as it declined by 2.0% yoy. At the same time, consumer durables declined by 7.4% yoy after a 7.0% yoy increase in November. This the most significant drop among all the groupings in December compared to November. Intermediate goods declined by 4.3% yoy or by 1.5% yoy more than in November. Finally, consumer non-durables declined by 2.9% yoy in December, while in November they inched down by just 0.3% yoy. Data for 2012 as a whole shows that consumer durables grew by 3.7%, capital goods by 2.7%, and energy by 2.0% compared to 2011. Intermediate goods and consumer non-durables declined by 3.7% and 0.4%, respectively.

According to the signal estimations, the Q4 2012 GDP increased 0.3% yoy thus determining a 0.2% yoy growth for the entire 2012 year. With respect to the quarter on quarter growth, the Q4-2012 GDP, seasonally adjusted expanded 0.2%.

Retail trade turnover declined by 3.2% mom in December compared to 2.0% growth a month ago due to decreases in all segments of retail trade. In particular, non-food products registered a 4.5% mom drop, fuel retail for motor vehicles in specialized shops declined by 3.6% mom, and sale of food, beverages and tobacco declined by 3.1% mom. The same situation was observed in terms of the year-over-year comparison. Total retail trade turnover dropped 4.3% yoy (grew by 3.1% yoy in November) due to a 6.3% yoy decline in non-food product turnover, a 5.3% yoy decline in fuel retail for motor vehicles in specialized shops, and a 1.3% yoy decline in sale of food, beverages and tobacco. Nevertheless, annual data for 2012 shows that retail trade turnover grew by 2.9% during the year thanks to growth in all retail trade sectors. The highest growth was registered in fuel retail for motor vehicles in specialized shops (6.2%). Sale of food, beverages and tobacco increased by 2.4% in 2012, while sale of non-food products by 1.6%.

Fiscal Policy



As data from the Ministry of Public Finance of Romania suggests, the Romanian government was able to continue fiscal consolidation in 2012. The consolidated general budget deficit decreased by more than 40% compared to 2011 and reached 2.5% of GDP (4.3% last year) according to the cash methodology. The 2.5% of GDP cash budget deficit is above the 2.2% deficit target figure agreed with the IMF, yet under the accrual, ESA-95 methodology, the deficit was below the agreed 3.0% of the GDP target.. However, the deficit could be lower, if not for circumstances beyond the control of the government. In particular, there was a temporary blockage of EU fund reimbursements caused by some violations in distribution of funds in previous years. Another major issue was the revision of nominal GDP with downward adjustment. Blockage of the EU funds added 0.2% of GDP to the budget deficit, while nominal GDP adjustment added another 0.1%. In monetary terms, the consolidated general budget deficit reached EUR 3.3 bln compared to EUR 5.32 bln last year.

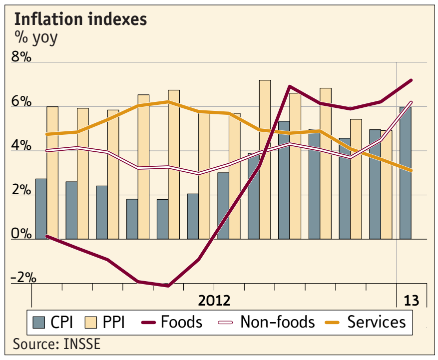
Consolidated budget revenues grew by 6.2% yoy in 2012. They amounted to EUR 43.01 bln, which is 33.0% of GDP (0.3% higher than last year). Amount of funds repaid by the European Union on public resource payment generated the highest growth among general budget revenues at 30.6% yoy. They reached EUR 1.78 bln. Total tax revenues increased by 8.9% yoy thanks to increases in revenues from all major taxes. In particular, income tax revenues grew by 9.9% yoy, excise revenues by 6.0% yoy, while the VAT and corporate tax revenues grew almost identically (5.4% yoy and 5.3% yoy respectively). Tax revenues of the local governments increased by a mere 2.1% yoy. Social contributions amounted to EUR 6.82 bln, which is a 2.0% yoy increase.

General government expenditures grew by 1.0% yoy in nominal terms but decreased by 1.5% as a share of GDP in 2012. They reached EUR 46.31 bln, which is 35.5% of GDP. The highest increase of 22.5% yoy was generated by expenditures of EU-funded projects. Expenditures on public debt interest payments also generated high growth of 20.6% yoy, while expenditures on goods and services generated much lower growth of 8.4% yoy. The wage bill grew by 6.2% in 2012. The reason was return of 8% of salaries in the budget sector, which were cut during the crisis, from July 2012. Investment expenditures reached 6.1% of EUR 7.91 bln.

During February, the Parliament approved the 2013 State Budget Law and the Social Security Budget Law. The 2013 budget is constructed under the assumptions of an 1.6% of GDP growth, 4.3% average annual inflation, and an average exchange rate of 4.5 RON/EUR. The consolidated budget incomes will represent 33.6% of the GDP and the expenses 35.7% of the GDP. This would lead to a cash budget deficit of 2.1% of the GDP, and a 2.4% budget deficit according to ESA 95 rules (accrual).

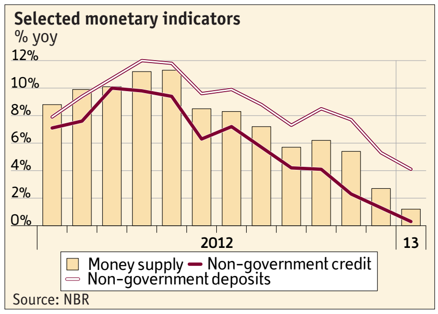
Monetary Policy

Consumer inflation continued to accelerate in January 2013. Total consumer inflation was 5.97%, which is more than one percentage point higher than a month ago. It is well beyond the target band of 3%±1%. Dynamics of prices in major consumer sectors followed exactly the same pattern observed in December, as growth of prices of foods and non-foods accelerated but growth of prices of services decelerated. In particular, prices of food goods grew by 7.19% yoy in January, which is 0.98% yoy higher than in December 2012. Prices of non-foods increased by 6.19% yoy compared to 4.48% yoy in December. Finally, prices of services grew by 3.1% yoy or by 0.51% yoy less than in the previous month. Despite such worrying data, the average annual inflation rate continues to decline. As of the end of 2012, it was equal to 3.33%, which is the lowest rate over the last 23 years.



The annual adjusted CORE inflation rate remained at 3.3% for the third month in a row, according to the National Bank of Romania.

Broad money (M3) amounted to EUR 48.86 bln at the end of January 2013. This is a 1.2% mom decline compared to a 0.6% mom increase in December 2012. Taking into account deceleration in year-over-year growth of broad money observed during the last quarter of 2012, it is quite obvious that this trend remained. The year-over-year growth of broad money was equal just to 1.2% yoy.

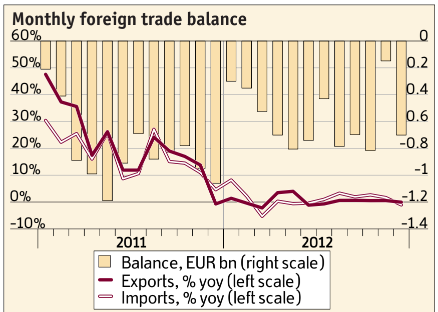


Credit institutions granted EUR 49.76 bln in loans to the private sector as of the end of January 2013. This is a 1.1% mom decrease, which is a slight improvement over December 2012, when the volume of non-government loans decreased by 1.4% mom. Both RON-denominated loans and foreign currency denominated loans fell, but foreign currency-denominated loans fell more (0.1% mom compared to 1.7% mom, if expressed in RON, or 0.6% mom, if expressed in EUR). The data also shows that non-government loans still grew in year-over-year terms even though growth decelerated. The total volume of loans granted by credit institutions to the private sector inched up by a mere 0.3% yoy as of the end of January compared to 1.3% yoy at the end of December 2012. RON-denominated loans grew faster in January compared to December (4.8% yoy versus 3.8% yoy) but foreign currency-denominated loans declined also faster than a month ago (2.2% yoy versus 0.2% yoy if expressed in RON, or 2.6% yoy versus 3.1% yoy if expressed in EUR).

The quality of the credits worsened during last year, with non-performing credits rate reaching 18.2% at the end of 2012, up from 14.3% at the end of 2011. The two largest banks, Banca Comerciala Romana (BCR, part of Ertse Group) and Banca Romana de Dezvoltare (BRD, part of Societe Generale) reported losses for 2012, of RON 1.2 bn (EUR 277 mn) and RON 332 mn (EUR 75 mn) respectively. In spite of these loses, the banking sector remains well capitalize, solvable and liquid, according to the BNR.

International Trade and Capital

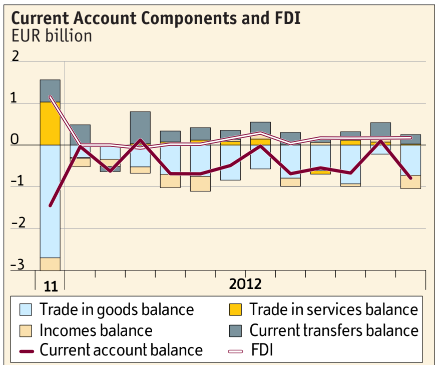
Preliminary data for December 2012 shows that FOB exports of goods decreased in year-over-year terms for the first time in the last three months. They declined by 4.9% yoy. CIF imports of goods declined for the second month in a row. The decline was equal to 7.9% yoy, which is below the 9.5% yoy decrease in November 2012. The total volume of FOB exports of goods was equal to EUR 3.135 bln (which is 25.4% mom), while CIF imports of goods amounted to EUR 4.021 bln (or 12.8% mom lower). Since CIF imports were still higher than FOB exports, the FOB-CIF commercial deficit of trade in goods naturally expanded and was equal to EUR 0.886 bln. This is a 17.08% yoy decrease.



Source: INSSE

According to preliminary data for the year 2012, FOB exports of goods amounted to EUR 45.043 bln, a 0.5% yoy decline. At the same time, CIF imports of goods reached EUR 54.608 bln, which is a 0.6% yoy decline. Since CIF imports experienced a slightly larger decline, the FOB-CIF commercial deficit of trade in goods also declined. It was equal to EUR 9.564 bln or 1.13% lower than in 2011.

The share of EU Member States in Romania's total foreign trade inched down a bit during the last month of 2012. As data shows, the share of Member States in Romania's exports decreased from 70.6% observed at the end of November to 70.2%. The situation is almost the same with the share of the Member States in CIF imports, which decreased from 73.8% to 73.5%. The total value of exports of goods to Member States was equal to EUR 31.596 bln, while total imports reached EUR 40.097 bln.



Source: NBR, INNSE

The final current account deficit for 2012 amounted to EUR 5.039 bln or 15.1% yoy less. Such improvement became possible thanks to a decrease in the income account deficit and trade balance deficit. The former declined by EUR 540 mln, while the later by EUR 96 mln. The EUR 238 mln increase in surplus of services account accompanied by the EUR 25 mln increase in surplus of current account transfers were other factors decreasing the current account deficit.

Foreign direct investments added just EUR 173 mln in December and reached EUR 1.613 bln over the whole 2012. This result is an 11.1% yoy declined conditioned by sluggish performance of FDI during the last couple of months compared to the same period of 2011 (at the end of October, FDI grew by 20.4% yoy, while at the end of November by just 3.75% yoy). The rate of current account deficit coverage by the FDI decreased to 32.0% from 33.9% observed in November.

Thanks to EUR 572 mln of additional loans, the medium- and long-term external debt of Romania finished 2012 at EUR 78.742 bln, which is a 3.7% yoy increase. Its share in total external debt is equal to 79.4%. On the contrary, short-term external debt decreased in both value and share of total external debt. In particular, its value declined by EUR 39 mln to EUR 20.467 bln (a 10.2% yoy decrease), while its share of total external debt decreased by 1% to 20.6%.

Romania's foreign exchange reserves by 0.81% mom in January 2013 and reached EUR 31.459 bln (as of January 31st). Inflows of reserves amounted to EUR 1.985 bln and represented mainly changes in the foreign exchange reserve requirements of credit institutions, inflows into the account of the Ministry of Public Finance of Romania, inflows into the account of the European Commission, and income from management of foreign exchange reserves. As for outflows, the amount was equal to EUR 1.732 bln and represented mainly changes in the foreign exchange reserve requirements of credit institutions and payments of interest and principal on foreign currency public debt. Gold stock remained unchanged in terms of weight but decreased in terms of value by 2.12% due to changes in the price of gold on international markets. The total value of the gold stock of Romania was equal to EUR 4.118 bln at the end of January. Therefore, total international reserves of Romania stood at EUR 35.577 bln at the end of January, which is a 0.46% mom increase.

Other Developments Affecting Investment Climate

During January a team of IMF and European Commission officials visited Romania for the seventh and final review of Romania's economic program. The Romanian government asked for a three months delay in the in complying with the several objectives of the program. Among these objectives are the reduction of government arrears, reform of public enterprises, and the 2013 budget. The IMF noted that preliminary estimates suggest that the 2012 accrual (ESA95 rules) budget deficit was reduced to below 3% of the GDP, even though the cash deficit was missed, mainly due to the suspension of reimbursements for some EU funds due to irregularities.