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Romania Macroeconomic Situation

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

February 2014

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- **Industrial production grew by 9.0% yoy in November 2013.**
- **The consolidated budget deficit met the target of 2.5% of GDP in cash terms in 2013.**
- **Consumer inflation reached 3.98% in 2013.**
- **The foreign trade deficit totalled EUR 653 million in January-November 2013.**
- **The current account deficit grew to EUR 1.326 billion at the end of November 2013.**

Executive Summary

Growth of industrial production decelerated to 9.0% yoy due to deceleration in manufacturing and energy sectors. Mining and quarrying continued to decline. Acceleration of a decline in the services sector led to deceleration in growth of the trade and services sector as a whole. Major declines were registered in food services activities and activities of travel agencies.

Thanks to the balanced fiscal policy of the government, Romania met the consolidated general budget deficit target for 2013 in cash terms agreed upon with the international financial institutions. Despite deceleration of revenues from most of the major taxes, general government revenues grew by 3.6% yoy. The government had to adjust budget expenditures in the second half of the year because of difficulties with collection of revenues and limited their growth to 3.8% yoy.

Consumer inflation missed the target of 3% in 2013. The main reason was the bad harvest of 2012, which fueled food prices in the first half of 2013. However, thanks to the bumper harvest of 2013, prices of food goods started to fall in the second half of the year, pushing down total consumer inflation. It's expected that consumer inflation will soon return to 2.5%.

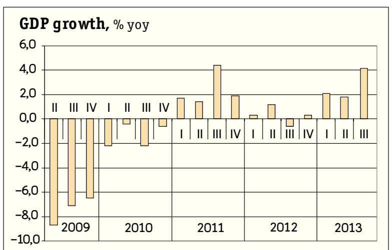
The National Bank of Romania is sure that the Romanian economy is strong enough to successfully withstand external shocks. Therefore, it decided to continue its policy of stimulation of national currency lending through policy rate lowering, thanks to optimistic forecasts of inflation dynamics. The policy rate was lowered to 3.75% starting from January 9th, 2014. The volume of non-government loans, however, continued to decline on the back of a drop in forex-denominated loans and insignificant growth of national currency loans.

Thanks to increased demand for Romanian goods, the growth rate of exports remained high in November despite some deceleration. At the same time, the growth of imports accelerated over the month in year-over-year terms. The balance of foreign trade did not grow significantly, however, because of a favorable base effect. At the same time, the current account deficit increased by 38.85% mom in November due to a significant increase in the income account deficit. On the positive side, the current account was still around one quarter of the level observed for same period of time in 2012, despite the mentioned increase.

	2008	2009	2010	2011	2012	2013
GDP growth, % yoy	7.1	-6.6	-1.6	2.5	0.2	2.7
GDP per capita, USD	9,497	7,649	7,667	8,863	8,030	8,080
Industrial production, % yoy	0.9	-5.5	5.5	5.6	0.0	7.0
Retail sales, % yoy	13.0	-10.3	-5.3	-2.5	2.9	3.5
Budget balance (cash methodology), % GDP	-4.9	-7.3	-6.4	-4.3	-2.5	-2.2
Government external debt, % GDP	13.4	23.6	30.5	34.7	37.8	38.0
Inflation, eop	6.3	4.7	8.0	3.1	5.0	3.1
Gross international reserves, EUR billion	28.3	30.9	36.0	37.3	36.4	37.0
Current account balance, % GDP	-11.6	-4.2	-4.4	-4.5	-4.0	-3.6
Gross external debt, % GDP	51.8	68.7	74.4	75.2	75.1	75.0
Unemployment (ILO methodology), % eop	5.8	6.9	7.3	7.4	7.2	7.0
Exchange rate RON/EUR, annual average	3.68	4.24	4.21	4.24	4.45	4.5

Economic Growth

In November 2013, industrial production posted robust performance even though its growth slightly decelerated. A 1.6% decline in the growth rate to 9.0% yoy was mainly attributed to slowdowns in manufacturing and the energy sector. In particular, growth of manufacturing decelerated by more than 1%, but still remained in double digits at 10.1% yoy in November. Notable performance was registered in chemicals, rubber, and plastics, as one of the leading operators extended its output thanks to earlier investments. Other positive developments worth mentioning were registered in the equipment and machinery subsector and in electronics. On the other hand, growth in



Source: INSSE

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Where Opportunities Emerge.

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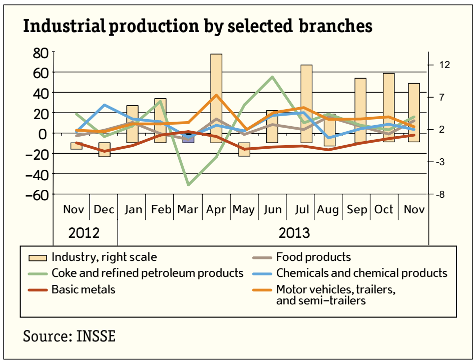
the transportation industry decelerated due to a temporary halt in activities at the Ford plant. The slowdown in the energy sector was more significant (from 11.1% yoy in October to 2.9% yoy), but this decline was expected as growth last month was caused by early supply of heating due to weather anomalies. The decline of mining and quarrying was cut in half to 1.2% yoy in November. Overall, industrial production grew by 7.6% yoy in January-November on the back of a 9.0% yoy increase in manufacturing and a 2.2% yoy increase in mining and quarrying. The energy sector dropped 2.0% yoy over the period.



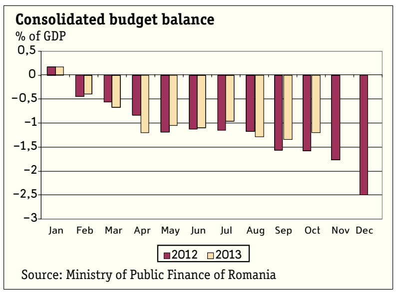
Source: INSSE

Growth of trade and services decelerated in November due to negative developments in both subsectors. The growth rate was half that of October and reached 1.0% yoy. Slower growth of retail trade (1.8% yoy) was attributed to declines in sales of food and fuels (by 0.5% yoy and 0.6% yoy, respectively). The 5.2% yoy increase in sales of durables helped offset the mentioned decreases and was generated mainly by sales of household appliances and IT products. Trade with motor vehicles and motorcycles grew by 4.6% yoy in November on the back of sales of cars and spare parts and accessories. As for market services to households, their decrease rate doubled because of a marked decrease in food service activities and activities of travel agencies, which were only partly offset by growth of receipts from accommodation activities.

Fiscal Policy

The government policy on fiscal consolidation was successful in 2013. Preliminary results show that the consolidated general budget deficit fell within the limits agreed with the international institutions over the year. Its total value was equal to RON 15.77 billion (EUR 3.54 billion). This is 2.5% of GDP. The target level for the deficit was RON 15.9 billion (EUR 3.57 billion) after the last amendment of the budget, which is 2.5% of planned GDP.

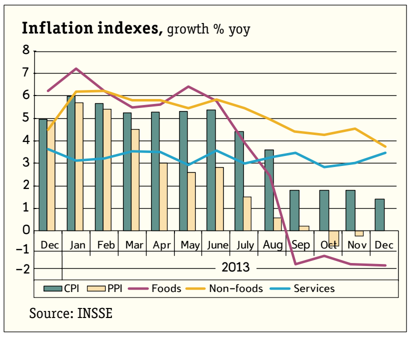
Growth of receipts from some of the major tax revenues declined by the end of the year, but the government managed to collect total revenues close to the target level. Growth of corporate profit tax revenues almost halved to 0.7% in January-December 2013, compared to the value observed in January-November of the year. VAT revenues followed similar dynamics over the mentioned period, as their growth decelerated from 4.0% yoy to 2.6% yoy. Growth of personal income tax revenues also decelerated but remained quite high at 6.5% yoy. Excise tax was the only major tax growth of revenues that accelerated in December. Non-tax revenues of the consolidated state budget declined in 2013, mainly due to a decrease in National Bank of Romania payments to the budget. Dividends, use tax on goods, and selling emission certificates generated an additional RON 1.5 billion (EUR 337 million) compared to 2012. Local authorities generated a 7.2% yoy increase in property tax revenues and a 3.9% yoy increase in non-tax revenues. A 31.6% mom growth in the amount paid for EU funded projects in December led to an 11.7% yoy increase in the total amount repaid by the EU over the year. Overall, consolidated general budget revenues grew by 3.6% yoy and totaled RON 200.0 billion (EUR 44.9 billion) in 2013. This is 32.0% of GDP, or 0.9% of GDP less than in 2012.



Source: Ministry of Public Finance of Romania

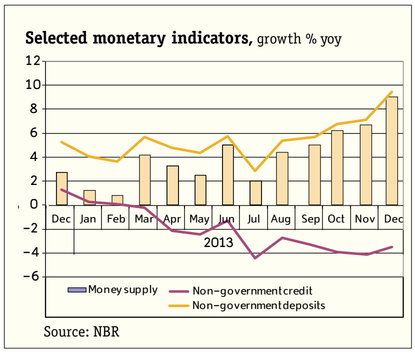
Government efforts to control expenditures were successful in 2013 despite some difficulties with collection of revenues in the second half of the year. Thanks to prudent fiscal policies and efficient management of public expenditures, the government managed to limit growth of its expenditures at 3.8% yoy. Total general government expenditures reached RON 215.8 billion (EUR 48.45 billion) or 34.5% of GDP (0.9% of GDP lower than in 2012). The major growth was registered in the wage bill, as its share of GDP grew by 0.5% mainly because of reunification of budget salaries. At the same time, the share of social expenses in GDP decreased by 0.5% in 2013 compared to 2012, despite a 8.5% increase in the minimum wage, a 30% increase in family support allowance, and a 4% increase in pensions over the year. Social expenses decreased mostly because of improved targeting of social assistance programs. Investment expenditures and related development programs financed from internal and external sources reached RON 31.6 billion (EUR 7.1 billion) or 5.1% of GDP in 2013.

Monetary Policy



Consumer inflation continued to decelerate in year-over-year terms in December 2013. In particular, consumer price index stood at 1.55% yoy in the month, declining from 4.95% in the previous year. Such dynamics of the index was attributed mainly to a 1.81% decline in the food prices. The non-food prices, however, increased 3.62% yoy in December due to a 7.50% increase in utilities and 8.66% increase in tobacco and cigarettes prices. The services prices, in turn, increased 3.43% yoy in December, mainly due to an increase of 12.07% in water, sewage and communal cleaning prices. Overall, the average consumer inflation finished the year at 3.98%, which is almost 1% higher than the target value for 2013. The major reason for this was the bad harvest in 2012, which preconditioned high food goods inflation in the first half of the year. The bumper harvest of 2013 ensured deceleration in total consumer inflation in the second half of the year, through deflation in food prices starting from September. Overall, prices of foods grew by 2.96% yoy in 2013. At the same time, prices of non-food goods increased by 5.19% yoy over the year, while prices of services added 3.19% yoy. It is expected that consumer inflation will further decline to historical lows in the first half of 2014, on the back of a favorable statistical base effect and the impact of the 2013 harvest. Annual inflation is expected to return and subsequently remain within the variation band of a flat 2.5% target.

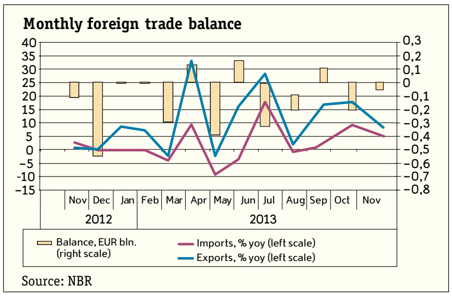
The National Bank of Romania decided to continue its policy of national currency lending stimulation. Having positive inflation forecasts and confidence in the resilience of the country's economy to external shocks thanks to consistent implementation of an adequate macroeconomic policy mix and precautionary external financing arrangements with the international financial institutions, the National Bank of Romania found it sustainable to lower its policy rate to 3.75% starting from January 9th, 2014. Moreover, in order to support sustainable lending and to bring the minimum reserve requirements mechanism in line with European Central Bank standards in the field, the National Bank also decided to cut the minimum reserve requirements ratio on both RON-denominated liabilities of credit institutions (to 12%) and forex-denominated liabilities of credit institutions (to 18%) starting with the January 24-February 23, 2014 maintenance period. At the same time, support provided to national currency lending did not bring any significant results yet. The volume of total non-government loans continued to decline as the decrease in forex-denominated non-government loans exceeded the insignificant growth in national currency loans. Growth of national currency lending was observed in both corporate and household sectors, but this growth was not very high. Moreover, growth of national currency loans in the corporate sector decelerated for the second month in a row, and this deceleration was not compensated for by some positive developments in the household sector.



Growth of broad money (M3) significantly accelerated in December 2013. A 2.8% monthly increase helped accelerate the total broad money increase to 8.8% in year-over-year terms. The increase was generated mainly thanks to net foreign assets, which grew by 85.7% yoy in December 2013. If not for a 5.7% yoy decline in net domestic assets, which are almost three times larger than net foreign assets, total broad money growth could have been higher in the reporting month. The share of net domestic assets within broad money remained almost unchanged at 72.9%.

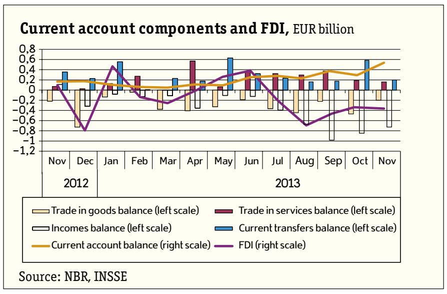
International Trade and Capital

Development of foreign trade of Romania slowed down a bit in November 2013. Growth of total exports decelerated to 7.6% yoy, while growth of imports accelerated to 5.1% yoy. However, the total foreign trade deficit decreased by 73.2% yoy in November thanks to a favourable base effect. Growth in exports of goods decelerated from 12.0% yoy to 7.7% yoy, because the commodity category with the largest share in exports – machinery and transport equipment – saw quasi-stagnation over the reporting month. The largest contribution to growth of exports was made by food products and live animals commodity category. On the other hand, machinery and transport equipment generated nearly three fourths of the growth in imports of goods in November. The FOB-FOB commercial deficit of the foreign trade in goods decreased by 21.0% yoy in the reporting month. Foreign trade in services posted slightly better performance in November compared to that of trade in goods. Exports of services grew by 7.1% yoy, while imports declined by 2.4% yoy. Transport services still made the largest contribution into the surplus of foreign trade in services, which grew by 80.2% yoy to EUR 146 million and covered almost 80% of the deficit of foreign trade in goods in November. From the beginning of the year, the total foreign trade deficit dropped 88.6% yoy. This is because of a 53.5% yoy decline in the deficit of the foreign trade in goods and a 158.3% yoy increase in surplus of the foreign trade in services.



Monthly foreign trade balance
Source: NBR

Development dynamics of the income account balance was the major factor of the current account dynamics in November. This is because the surplus of foreign trade in services almost balanced the deficit of the foreign trade in goods, as mentioned above, and the current transfers account balance steadily grew through the year. Actually, the surplus of the current transfers account increased as expected in November. However, the increase of EUR 207 billion was by one third lower than the average over the previous ten months of the year. The income account deficit, in turn, added EUR 536 million in November which is almost 60% higher than the average monthly amount in January-October. As a result, the current account deficit grew by 38.85% to EUR 1.326 billion in November.



Current account components and FDI, EUR billion
Source: NBR, INSSE

The situation with foreign direct investments significantly improved in November at the expense of intragroup loans. Net FDI inflows amounted to EUR 572 million during the month, which is almost one third of the total FDI inflows over the first ten months of the year. Intragroup loans more than doubled in one month to EUR 1.041 billion, while equity stakes consolidated with the estimated net loss remaining almost unchanged at EUR 1.347 billion. Total FDI reached EUR 2.338 billion in January-November 2013, which is a 22.3% yoy increase and significant improvement over January-October period (8.2% yoy decline).

External debt of Romania decreased by 1.7% mom in November. The medium- and long-term external debt declined by 2.0% mom thanks to decreases in all its major components, except for the medium- and long-term deposits of non-residents, which insignificantly increased. The largest decrease was registered in the size of the IMF borrowings (13.3% mom). The short-term external debt inched down by 0.4% mom. The share of medium- and long-term external debt within total external debt remained almost unchanged at a level slightly above 80%, while the share of short-term external debt, obviously, remained at a level slightly below 20% of the total external debt.

The foreign exchange reserves of Romania remained almost unchanged in November. Inflows of reserves totalled EUR 1.391 billion and represented mainly changes in the foreign exchange reserve requirements of the credit institutions, inflows into accounts of the European Commission and of the Ministry of Public Finances of Romania. Outflows of reserves amounted to EUR 1.280 billion, more than one third of which represented payment of a principal instalment on the loan from the IMF (EUR 228 million on the side of the National Bank of Romania and EUR 120 million on the side of the Ministry of Public Finances). The rest of the outflows represented mainly changes in the forex reserve requirements of the credit institutions. The positive difference between inflows and outflows was equal to less than 0.35% of the reserves at the beginning of November equal to EUR 32.414 billion. The gold stock decreased in value by 4.7% in November due to changes in the international price of gold. Since the decline in value of gold stock exceeded growth of foreign exchange reserves, the total international reserves decreased for the second month in a row in November 2013. However, the decrease was so low in relative terms (0.09%) that it is negligible.

Other Developments Affecting the Investment Climate

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