

Romania monthly economic review

May 2009

Latest developments

In this issue:

- ▶ INS: GDP drops by 6.4% in Q1
- ▶ INS: Q1 trade deficit down 54.8%
- ▶ The stock of provisions for bad bank loans rises by 35% in Q1
- ▶ Industrial production down 13% in Q1
- ▶ Retail sales drop by 5.5% y/y in March and 5.2% y/y in Q1
- ▶ BNR: The current account of the payment balance – EUR 709 mn deficit in Q1
- ▶ Gross external debt drops by 2% ytd to EUR 71.6 bn at the end-March
- ▶ Budget deficit widens to 1.76% of GDP
- ▶ Romania to register 2% GDP contraction in 2009
- ▶ Non-governmental crediting declines in April

INS: GDP drops by 6.4% in Q1

Romania's Gross domestic product (GDP) dropped by 6.4% in the Q1 of 2009, compared to the same period in 2008, and went down by 2.6 % from the last quarter of 2008, National Institute of Statistics (INS) data say. According to the seasonal adjusted data, GDP increased by 0.3% and 0.4% in the Q2 and Q3 of 2008 when compared to the previous quarter. Romania's GDP diminished by 3.4% in the last quarter of 2008 compared to the Q3. The Romanian Central Bank (BNR) Governor showed optimism about the possibility that Romania should register an economic growth in 2009 as well saying that the deceleration in the economic growth was obvious in the Q1 of 2009, but a year has four quarters and he believes that Romania will have an economic recovery. As a result of the negotiations with the IMF and the EU, the Government altered the public budget on a projected economic decrease by 4% in 2009, after the budget had been initially built based on a 2.5% economic growth. BNR initial projection for Romania's economic growth stood at 2% - 2.3 %.

INS:Q1 trade deficit down 54.8%

Romania's trade deficit fell 54.8% in the Q1 against the year-earlier period, to RON 8.479 bn, amid a 25.2% drop in imports, a lot lower than the 6.7% decline in exports. Romania's Q1 exports and imports totaled RON 27.978 bn and RON 36.48 bn respectively, according to the National Institute of Statistics (INS). The Q1 trade deficit accounts for less than half of the RON 18.769 bn in the year-earlier interval. The value of the intra-EU exchange of out-going goods equaled RON 20.99 bn, and incomings, RON 26.89 bn, or 75% of exports and 73.8%, imports namely. Machinery, transport equipment and other manufactured products make up the bulk of exports and imports. March exports matched RON 10.97 bn, and imports, RON 13.39 bn. Compared to March of 2008, the RON value of exports rose 7.8%, and imports fell 25%. Against February, the RON value of exports was up 22.8% in March, and imports, 8.2%. March trade deficit therefore came to RON 2.42 bn, down RON 5.27 bn from the same month a year earlier.

Ernst & Young SRL

Premium Plaza Building, 3rd Floor

63-69, Dr. Iacob Felix Street

Sector 1, 011033 Bucharest

Tel: (40-21) 402 4000

Fax: (40-21) 310 7193

Email: office@ro.ey.com

www.ey.com

In this issue (continued):

-
- ▶ IMF: Unemployment will continue to rise in Romania
 - ▶ Unemployment rate stagnates at 5.7% in April
 - ▶ Romanian salaries should not rise above inflation to avoid price hikes
 - ▶ Government preparing second economic plan
 - ▶ Romania's business sentiment remains negative in May
-

Foreign direct investments in Romania lose 13.9% in Q1

Foreign direct investments (FDI) in Romania dropped during the Q1 by 13.9 % y/y to EUR 1.456 bn, becoming twice as large as the current account deficit, according to the information published by the Central Bank (BNR). In contrast, FDI corresponding to the first 2 months of the year hiked by 38.1%, to EUR 1.374 bn. The investments stood during last year's Q1 at EUR 1.691 bn, covering 42.8% of the current account deficit at the time. Of the FDI recorded this year, the capital participations accounted for 50.8%, the reinvested profit for 9.3% and the intra-group credits for the remaining 39.9%. The loans contracted by companies headquartered in Romania from their mother-companies outside borders have the potential of widening the gap, as they will be returned when maturing. Their weight has nevertheless dropped from last year's 42.8%. In 2008 the current account deficit was covered 53.5% by FDI, which amounted to EUR 9.02 bn, 24.45% up from 2007.

The stock of provisions for bad bank loans rises by 35% in Q1

The stock of provisions for bad loans increased by 35% y/y in Q1 to EUR 2.42 bn at the end of March, as the share of loss-type loans alone surged by 2% to 6.5% of total stock of loans over the period. When expressed in EUR, the stock of provisions increased by EUR 517 mn, which severely hurt the financials of the banking system that reported combined losses of around EUR 50 mn. The stock of provisions compared to the total bank loans increased from 3.9% at the end of last year to 5.3% at the end of March. In annualized terms, the quality of bank loans deteriorated even more. Thus, the share of loss-type loans more than doubled from 3% at the end of March 2008 to 6.5% one year later. Consequently, the stock of provisions more than doubled from EUR 1.1 bn to EUR 2.4 bn. At the same time however, the stock of bank loans increased by only 7% y/y to EUR 46 bn.

Industrial production down 13% in Q1

The industrial production in the Q1 of 2009 dropped by 13%, compared to the same time period of the previous year, based on a press release issued by National Institute of Statistics (INS). The drop in the industrial production, during the first 3 months of 2009, was induced by the decline in processing industry, by 15.2%, in electric and thermal energy, natural gas warm water and conditioner air, by 2.5%, as well as in the extracting industry, which reduced by 1.8%. Declines were registered for all categories of goods within a breakdown by large industrial groups. The intermediary goods industry dropped by 18.7%, the long term use goods, by 18.3%, capital goods industry, by 14.4%, current use goods, by 8.9% and energy by 5%. The industrial production, series adjusted on the basis of number of working days and seasonality, was lower by 11.8% in Q 1 of 2009, compared to Q 1 of 2008, because of the drop in the processing industry, by 15.6% and electric and thermal energy by 2.8%.

Retail sales drop by 5.5% y/y in March and 5.2% y/y in Q1

The retail sales volume index decreased by 5.5% y/y in March, marking a slight improvement from the 9.2% y/y narrowing in February, but still in line with the average 5.2% y/y negative correction in full Q1. The effects of thinner, if any, consumer credit available to households and shrinking disposable incomes was visible in the pattern of Q1 sales. Namely, the food sales demonstrated some resilience, yet slightly inching down in the past two quarters, while the sales of non-food items dropped more visibly by 3.4% y/y. Finally, the sales of car fuel plunged by 15.9% witnessing smaller disposable incomes. The sales of cars and repair services plunged even more dramatically by 37.4% y/y in Q1 as the bank lending

narrowed close to zero. Current Account shrinks by 75% y/y to EUR 614 mn in January-February

BNR: The current account of the payment balance - EUR 709 mn deficit in Q1

The current account of the payment balance posed, for Q 1 of 2009, a deficit amounting to EUR 709 MN, down by 82.1% compared to Q1 2008, the National Bank of Romania (BNR) informs. The prevailing impact on the decrease of the current account has been the represented by the reduction of the trade balance, which amounted to EUR 1.337 bn, down by 67.2% as against the first 3 months of 2008. The current account deficit in Q 1 2009 was fully financed by direct investments of non residents in Romania (as against 42.8% in Q1 2008), which amounted to EUR 1.456 bn, compared to EUR 1.691 bn in Q1 of 2008. The medium and long term debt amounted, on 31 March 2009, to EUR 51.115 bn (71.4% of the total foreign debt), by 0.6 % more than on 31 December 2008. The short term debt amounted, on 31 March 2009, to EUR 20.517 bn (28.6% of the total foreign debt), down by 7.6% when compared to 31 December 2008.

Gross external debt drops by 2% ytd to EUR 71.6 bn at end-March

The country's gross external debt decreased by EUR 1.4 bn ytd to EUR 71.63 bn at the end of March, mainly as an effect of the drop in the stock of short-term debt. In annualized terms, the debt moderated to a 17% y/y growth from 24% y/y at the end of December and 32% y/y one quarter earlier. Direct comparison for detailed annualized dynamic is not fully available. The debt service was EUR 11.2 bn in Q1, which includes EUR 10 bn roll-over of short term debt and related service. The medium and long-term debt continued to increase slightly over the period, by EUR 311 mn, boosted by the private sector's EUR 696 mn net borrowing. On the opposite, the short-term debt shrunk significantly by EUR 1.7 bn over the period to EUR 20.5 bn. Banks and private companies account for the vast majority of the short-term debt, judging from past detailed data.

Budget deficit widens to 1.76% of GDP

The general government budget widened to RON 9,375 bn (EUR 2.2 bn) in January – April (or 1.76% of the projected full-year GDP from 1.5% of GDP in Jan-Mar) according to the Ministry of Finance. Out of this, the social security fund accounts for 0.5% of GDP deficit. The general government's gap was slightly above the Ministry's 1.7% of GDP projection consistent with 4.6% of GDP full year deficit. The balance was on the positive side one year earlier, when the surplus was 0.2% of GDP in January - April after negligible deficit in Q1. The revenues decreased by 4.7% y/y, or real 10.7% y/y in January - April this year as the profit tax (-6.8%) and VAT collections (-14.7%) shrunk significantly on the back of lower profitability and consumption. The income taxes increased by 15.6% y/y as the wages kept rising and the employment inched down only marginally, while the excise taxes expanded by 24.7% on excise tax hikes on alcohol and tobacco. The revenues to the social security fund decreased by 0.5% y/y, surprisingly under the circumstances of the rising wages and the 3.8pps hike in the statutory contribution rate levied against the gross wage as of January. The expenditures widened by 14.3% y/y (7.1% in real terms). Against the government's opposite claims, the current spending with personnel (wages, bonuses) surged by 50% y/y to RON 17 bn while the spending for capital investments narrowed by 25% y/y to RON 4.3 bn. The spending under the social security funds surged by 23% y/y following the pension hikes operated last fall.

Romania to register 2% GDP contraction in 2009

Romania's Gross domestic product (GDP) will register this year a 2% contraction after a 7.1% growth in 2008 and, in 2010, it will return to positive territory, with an estimated growth of 1%, followed by a 3% growth in 2011, says the latest economic report released by the World Bank (WB), dedicated to the European Union (EU) newly entered member states. 'The impact of the international economic crisis upon the new EU member states proved to be more severe than anticipated a few months ago. The latest estimations indicate a GDP decline in EU10 of 2.9% in 2009, followed by a 0.3% growth in 2010. These estimations remain very uncertain because they depend, on their turn, on the estimations related to the recession turning point and the economic growth of the main commercial partners, mainly of those in the EU', WB report further says. The report draws the attention upon some factors which explain the impact that the crisis had upon the new EU member states. A first factor is the reduced access to foreign funding, under conditions in which the foreign financing needs are lower in the countries with a current account deficit below 10% of the GDP (the Czech Republic, Hungary, Poland, Slovakia and Slovenia) compared to the countries with a higher than 10% deficit (the Baltic countries, Bulgaria and Romania). A second factor which explains the differentiated impact of the crisis upon the EU10 is the stage of their banking system. The international banks, mainly in the EU member countries, play a very important role in the new member states and these banks' behavior in the current context is the one which determines, to a great extent, credit availability and the banking system's stability in EU10. In its turn, this behavior depends on the refinancing needs of the parent banks, on the incentives aimed at the reduction of the indebtedness degree in the current crisis context and on raised risks triggered by the adjustment of the exchange rate and the macro-economic decline. A third factor of differentiation is the exchange rate type. There are two countries (Slovakia and Slovenia) which joined the European Exchange Rate Mechanism - ERM and therefore gave up the possibility to adjust the exchange rate and to have an independent monetary policy. There are countries with a fixed exchange regime (Estonia, Lithuania and Bulgaria) and countries with a floating exchange rate (the Czech Republic, Hungary, Poland and Romania). The WB report underlines that the countries with a floating regime registered a sudden depreciation of the exchange rate throughout the financial crisis. EU10 includes Romania, Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. Reports in the series of "EU10 Regular Economic Report", published starting with March 2004, offer a summary of the economic evolutions in the region and analyses on current economic subjects.

Non-governmental crediting declines in April

The volume of credits given by banks to population and companies declined in April for the second consecutive month, to RON 200.55 bn while the annual growth rate went down to 18.9%, in nominal figures, from 23.1% in March, according to data released by the Central Bank (BNR). In March, non-governmental crediting lost 2.1% from February – a month when it had scored a slight increase, in nominal terms and in terms of RON equivalent. Compared to the peak reached at the end of February, at RON 206.89 bn, non-governmental crediting has lost RON 6.34 bn in a 2-month interval. Crediting in lei (RON) diminished in April by 0.5% (-0.8% in real terms) from its value in March, down to RON 82.6 bn. Compared to the end of April 2008, crediting in the national currency only rose by 7.8%, a figure that stands under 10% for the first time in the last years. Credits in foreign currency to population and companies, in RON equivalent, declined by 1.4% in nominal terms, to RON 117.5 bn. Credits in foreign currency to companies were, too, on the fall by 1.1% from March, to RON 57.79 bn, but they still are 20% higher than a year ago. Governmental crediting (by central administration, local administrations and the administrators of welfare systems) rose by 8.4% in April, up to RON 31.8 bn, after

an 18% increase in March. At the end of April, governmental crediting scored a year-on-year increase by 215.7% (196.6% in real terms). The Central Bank also released data on deposits in RON and foreign currency made by population and companies, which resumed a growing trend last month, as they gained 0.3% over the previous month, up to RON 154.55 bn. The positive evolution of deposits in lei compensated for the decline registered by those in foreign currencies. In March, bank deposits lost 0.2% from February, down to RON 154.11 bn. Bank deposits in RON gained 1% in April over the end of March, to RON 97.85 bn. Compared to a year ago, deposits in the local currency rose by 10.6%.

Employment and wages

IMF: Unemployment will continue to rise in Romania

Unemployment will continue to rise in Romania in 2009 and early 2010, because this is an indicator with a delayed reaction to economic growth. When the economy decreases, unemployment reacts later, and when economy bounces back, the decline in unemployment is also delayed, according to representatives of the IMF Mission in Bucharest. There are reasons for satisfaction in the way the Romanian authorities reacted to achieving the objectives included in the arrangement, adding that the abrupt drop in Romania's Gross domestic product (GDP) in Q1, 2009 does not warrant a revision of conditions included in the arrangement, at least not for now, although the drop was more abrupt than economists were expecting. A positive sign, is that the largest 9 foreign parent banks of banks incorporated in Romania have agreed to adjust the solvency indicator from 8 to 10% for the 24 months of the arrangement. This will mean about EUR 1 bn will be injected into the Romanian banking system in 2 installments, in September 30, 2009 and March 2010. This buffer capital is provided between the bleakest scenarios from the stress tests conducted by the IMF and the National Bank of Romania. There is tight interdependence between Romania and European countries, which makes that result in countries like Austria to depend on the results in Romania and the other way around. The effects of a forecasted drought on Romania could be a shock, but what is important is the social effects of the drought. 2009 will be a difficult year even with the IMF assistance. According to the IMF, the optimism found in Romania and other countries is the result of economic downturn having slowed down, but growth has not resumed yet. Any pay rises should be considered against economic performance, and they will have to be discussed by the Romanian Government with the IMF. There is currently a weaker collection of Government revenues, but there is a possibility of the parameters agreed upon with the IMF in the arrangement to be released in the weeks ahead, being met.

World Bank foresees 8% unemployment in Romania in 2009

The World Bank estimates that the unemployment rate will be this year 8% and will drop below this level in 2010. Romania is the only EU country from Central and Eastern Europe in which the unemployment situation will improve, according to a report published by the institution. Romania had last year unemployment of 5.8% calculated according to criteria of the International Labour Office. The National Prognosis Commission expects that at the end of the year there will be 620,000 jobless people, the unemployment rate going up from 4.4% to 6.8%, while IMF estimates the number of unemployed persons will be 800,000 at the end of the year. According to ILO methodology, which broadens the number of criteria according to which a person is considered unemployed there will be 795,000 jobless people in 2009 and the jobless rate will be 8%. According to the Ministry of Labor the increase of number of jobless persons by only 0.1% in April against March could reflect an improvement of Romanian economy which could continue in

following months so we might not reach 800,000 unemployed at the end of the year.

Unemployment rate stagnates at 5.7% in April

The number of jobless persons increased by only 4.1 thousands in April, after it surged by 30-40 thousands per month in each of the past three months and by 47% y/y to 518 thousands (5.7%), according to preliminary data quoted by the Labour Ministry. The unemployment rate inched up marginally by 0.1% m/m in April but surged by 1.8% in annualized terms. The projection for 800,000 jobless persons by the yearend is seemingly pessimistic but alternative projections can not be derived sooner than in Q3.

Romanian salaries should not rise above inflation to avoid price hikes

According to the Adviser of the Central Bank Governor, the salary hike in 2009 should not exceed inflation rate, estimated at 4.4% for this year, adding that unjustified hikes should be avoided as they would only trigger price hikes. The International Monetary Fund sees Romanian salaries up 5.9% in nominal terms in 2009, up 3.9% in 2010, and up 3.5% in 2011, a growth pace similar with the average consumer price index projected increase. Nominal wages in the public sector will grow by 5.1% in 2009, while in the private sector they are seen up 6.2%, according to IMF forecasts.

Other developments

Government preparing second economic plan

The Government is preparing a second economic re-launch plan, after the agreement with the IMF and the EC, which includes state aid granted to companies in strategic areas and securing the loans contracted by young people for the purchase of their first home. This second economic plan represents a continuation of the anti-crisis measure program adopted early this year, showed the head of Government at the Parliament debate on the censure motion tabled by the Liberal Party (PNL) and the Hungarian Union (UDMR). The plan provides for the granting of state guarantees and aid for companies operating in areas considered strategic, such as agriculture, construction, infrastructure, tourism, environment and health, and the securing of loans contracted by the young for the purchase of their first home, as a way to re-launch the construction market.

Romania's business sentiment remains negative in May

Romanian managers remain mostly pessimistic about the performance of the country's economy in the 3 months through July, expecting negative developments in the retail and services sectors, according to the National Institute of Statistics (INS). Managers in the industrial sector expect stable output and prices through July but the number of employees is seen falling, according to INS. Managers of construction companies expect stable output and a fall in the number of employees, whereas property prices are expected to stabilize. In the retail sector, sales and employment are seen falling. Prices are seen rising in the 3 months through July. In the services sector managers are expecting decreased demand through July. Prices are seen stable and the number of employees is expected to fall. For its May, INS has interviewed managers in a total of 8,087 companies in the 4 sectors.

Key macroeconomic indicators

Years	Months	Employed people (% y/y change) ¹⁺²	Monthly net average wage (RON) ²	Registered unemployment rate (% of labor force) ²	Consumer Price Index (% y/y, end of period) ¹	Central + Local Budgets (% of GDP)	Exports (EUR million, fob) ¹	Imports (EUR million, cif) ¹	Trade balance (EUR million, fob-cif) ¹	Monthly FDI, net (EUR million) ²
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
2007 out of which:										
	October	3.00	1084	4.10	6.84	-0.37	2819	5023	-2203	5958
	November	2.80	1121	4.20	6.67	-1.44	2763	4986	-2223	6644
	December	3.10	1266	4.10	6.57	-3.09	2253	4325	-2072	7069
2008 out of which:										
	January	2.50	1200	4.30	7.26	+0.20	2487	3900	-1413	663
	February	2.20	1134	4.30	7.97	-0.20	2826	4338	-1512	475
	March	2.10	1192	4.20	8.63	-0.40	2706	4698	-1992	450
	April	2.20	1282	3.90	8.62	-0.20	2723	4827	-2104	1630
	May	2.00	1248	3.80	8.46	-0.80	2971	4754	-1783	768
	June	1.80	1273	3.80	8.61	-1.40	3034	5047	-2013	772
	July	1.80	1308	3.80	9.04	-1.00	3190	5077	-1887	924
	August	1.70	1277	3.87	8.02	-1.40	2619	4330	-1711	754
	September	1.90	1296	3.90	7.30	-1.70	2915	5253	-2338	549
	October	1.80	1327	4.00	7.39	-1.80	3219	5229	-2010	954
	November	1.20	1361	4.10	6.74	-3.00	2536	4215	-1679	492
	December	0.50	1489	4.40	6.30	-3.70	1923	3374	-1451	539
2009 out of which:										
	January	1.24	1355	4.9	6.71	-	1912	2489	-577	-
	February	-	1358	5.3	6.90	-	2072	2836	-764	-
	March	-	1402	5.6	6.70	-	2560	3126	-566	-

Sources: ¹ INSSE ² National Bank of Romania (Monthly Bulletins) ³ cumulated from the beginning of the year, compared with the same period of previous year