



## ROMANIA'S MAIN ROLE IN THE CURRENT GLOBAL ECONOMIC CONTEXT

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### **Abstract**

*The purpose of this article is to highlight Romania's role in the current international economic context. The analysis herein refers to the domestic macroeconomic developments of our country in 2015, which will influence in the future the evolution of the Romanian economy. In this article we will cover Romania's current international position, Romania's external position, the developments in the labour market from Romania, as well as the international context in which our country finds itself also.*

**Keywords:** *macroeconomic indicators; inflation rate; deficit; financial sector; banking sector; direct foreign investment; current account; economic growth; internal and external balances.*

**JEL Classification:** E2, E6, F4

### **Introduction**

This paper covers the issue of Romania's role in the current international economic environment through the domestic macroeconomic developments, as well as through the role played by our country in the international context. This issue is important in order to highlight our



country's place in the international context, as well as the measures that can be taken in the future starting from the current status quo. In this article we, as writers, are trying to analyse the state of the Romanian economy referring to its main macroeconomic indicators and propose ways and measures to revive the economy of our country for the following period. This study is based on statistical information gathered from annual reports of the NBR, as well as on the data extracted from its monthly bulletins on various micro- and macroeconomic issues.

### **Romania's internal economic position**

From **macroeconomic perspective**, 2015 was a favourable year for Romania. *Internal and external balances* of the economy have been strengthened, while *the economic growth* has registered a rapid rate of 3.8%, compared with the European average. Production losses from the recession period have been recovered in full from the first quarter of 2015. *The current account deficit* stood at a low level of 1.1% of the GDP and the consolidated general budget deficit has recorded even a restriction from the previous year, reaching 0.7% of the GDP according to the ESA 2010 methodology.

Regarding *the annual inflation rate*, this ended 2015 on a negative territory, with -0.93%, but the evolution has been determined almost exclusively by the expansion in June 2015 of the reduced VAT rate of 9% in all foods, soft drinks and catering services. The exceptional nature of the negative values of the inflation rate in Romania, significantly lower than those recorded at European level, is revealed as well by the assessments of the European Commission and the European Central Bank, which have decided that in the Convergence Reports published in 2016 to exclude Romania from the calculation of the reference value of the Maastricht criterion on price stability.

In the absence of the above-mentioned tax measure, the indicator would have been found inside the variation band of  $\pm 1$  percentage point associated to the stationary inflation target of 2.5%. Also in 2015 it has basically concluded *the repayment of the loan taken from the IMF* in 2009, under the multilateral funding agreement signed by the Romanian state with the international financial institutions, the final payment ending in January



2016. The entire process of repayment has conducted without repercussions on the dynamics of the currency market and without the erosion of the international reserves adequacy indicators. Moreover, the level of the international reserves reached the end of 2015 has exceeded by over 7 billion Euros the one from 2008, the year before the loan has been contracted. The gains in the macroeconomic plan – result of an sustained adjustment effort – however, are not irreversible and the accumulation of risks cannot be ignored, especially as the measures already adopted – some effective, others to be implemented – are likely to put to the test the sustainability of the economic growth. Thus, *the tax cuts* planned for 2016 and 2017 and the permanent expenses increases, mainly salaries, enacted to the end of 2015 and the first half of 2016 will position the budget deficit close to the ceiling of 3% of the GDP and will re-enter the share of the public debt in the GDP on an upward trend. *The sustainable character of the economic growth* is conditioned by the regaining of the coherence of the economic policy mix, i.e. each component's orientation towards preserving or restoring the macroeconomic balances.

Similar to the developments in the plan of the macroeconomic stability, those from **the field of the financial stability** have indicated as well its notable strengthening in 2015, accompanied, however, especially towards the end of the year – but also in the first part of 2016 – by the amplified concern of the risks that is confronted with. *The banking sector* in Romania has kept its solidity, the main aggregated indicators remaining at an adequate level (solvency, liquidity) or knowing remarkable improvements (asset quality, profitability). Thus, *increased solvency* – reflected by the high rates of the own funds, which have exceeded the double of the regulated thresholds at EU level – has been supported including through new capital contributions from the shareholders. It is worth noting that the Romanian banking sector is among the best capitalized from the European Union and in the context of a domestic and international macroeconomic framework, characterized by very low interest rates and marked by uncertainties, the higher capacity of covering the losses is essential. After recording a negative financial result in 2014 – amid the massive provisioning effort in the endeavour to heal the balances – the banking sector has re-become profitable in 2015.

However, indicators related to banking asset quality have improved, the nonperforming loans ratio having a pronounced downward trend, from 20.7% at the end of 2014 to 13.5% in December 2015, while the coverage degree with provisions of the non-performing loans has continued to be



above the European average. Another positive development has been recorded *in terms of liquidity*, which has kept its comfortable size on the account of strengthening the domestic deposit base. This has compensated the downward, but orderly, trend of the financing from the mother banks, with the effect of reducing the risk of contagion, a more welcomed evolution in a volatile regional context. *To the resumption of the lending activity of the private sector*, the process of cleaning the banking balance sheets of a significant part of bad loans, started in 2014, the appropriate level of the capital position and the revival of the credits demand have contributed. After nearly three years, *the annual real dynamic of the loans* has re-became positive, reaching 3.9% at the end of 2015. The crediting redressing has been due solely to the lei component, the banks turning to granting loans in the national currency under the combined effect of the macro-prudential measures associated with foreign currency crediting, of the decrease of the interest rates for the loan products in lei and the continuance of the “First Home” programme, exclusively in lei. *Loans in national currency* have regained thus their major position in the banks’ portfolio, this having, in its turn, a series of positive consequences: currency risk decrease, improving the structure on currencies of the banks’ balance sheets, improving the transmission mechanism of the monetary policy interest rate. Emphasising the risks to financial stability has aimed both their number and intensity. The most important systemic risk, which increased in intensity in the second half of 2015, but also thereafter, was that of *an uncertain and unpredictable legal framework*. Other significant systemic risks are generated by: the return on the internal level to the pro-cyclical fiscal policies (and the reversal of the fiscal consolidation tendency), the uncertainties regarding the global economic growth, the state of the international financial system, monetary policy decisions of the major central banks, as well as Britain’s exit from the European Union (BREXIT) – the latter one having the ability of affecting Romania through weakening the European project, which is an anchor for Romania’s development. Very important for the proper management of the threats to the financial stability is the appropriate configuration of the macro-prudential policy.



### Romania's external economic position

In 2015, the external position of the Romanian economy has remained sustainable, given that the current account deficit has continued to be placed at a low level, although superior to the previous year (1.1% of the GDP), the external debt has remained on downward trend and the international reserves have kept their proper level.

This year as well, the negative balance of the trade transactions has been compensated, to a large extent, by the proceeds obtained from the provision of services (Figure no. 1).

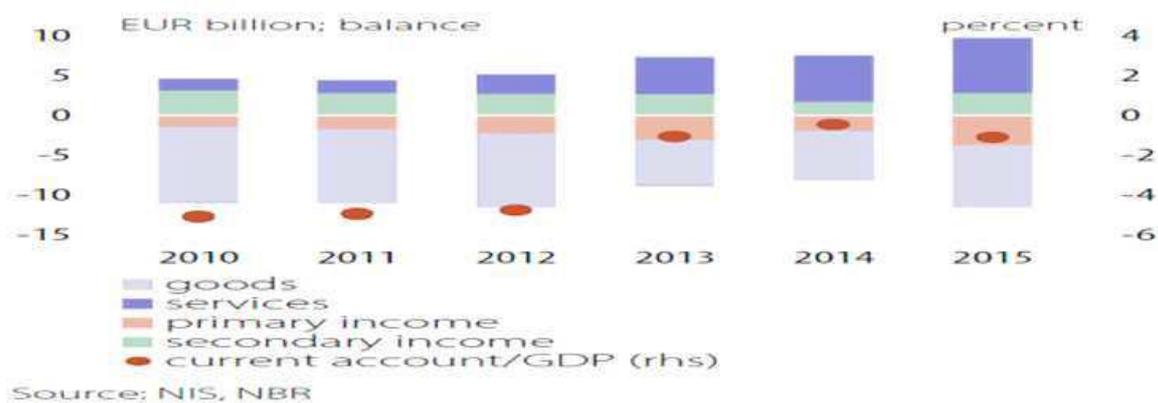


Figure no. 1. Current account

Source: Annual Report of Romanian National Bank, 2015

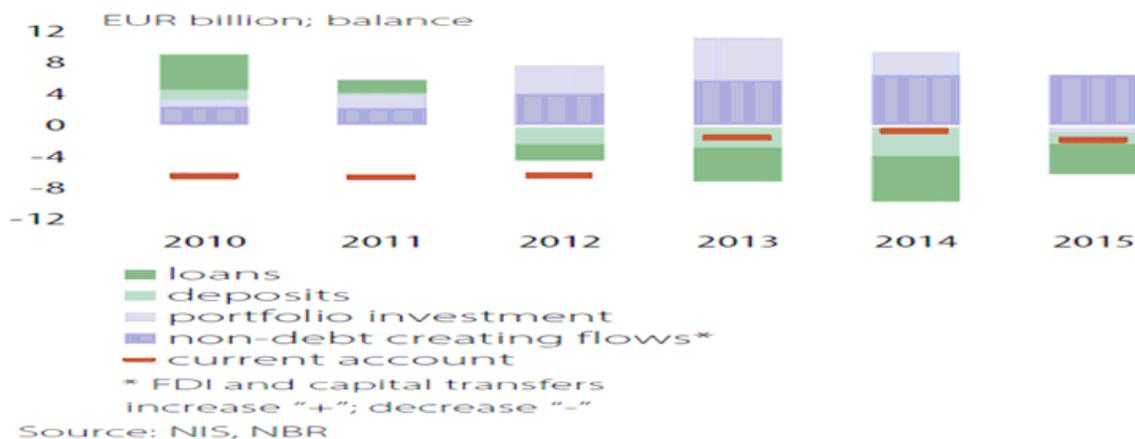
Thus, the increasing trajectory on which the exports of goods were placed in recent years has led to the expansion of the international transport of goods, specialized companies realizing large investment projects aimed at renewing the fleet, developing the storage capacities, while increasing the customers' portfolio. Consequently, Romania has consolidated its position as international logistic hub, but the interest of the big developers from this area remains high, given the saturation of some markets in the region, such as the Czech Republic, Hungary, Slovakia as well as the advantage offered by the more stable local environment in a regional context characterized by volatility.

Outstanding export performances have also recorded the IT & C companies. The expansion of this economic sector has been favoured by the investments made by a number of multinational companies, attracted by the



increase of competitiveness offered by this segment of the labour force, which consisted of complex skills and high degree of adaptability to comparatively reduced costs. As a consequence, the increase of the VAB related to the IT&C services exceeded in 2015 as well the threshold of 10%, and the outlook remains optimistic, the recent developments indicating a maturing tendency of the market, through the more pronounced orientation of the profile companies towards providing products and services with highly added value.

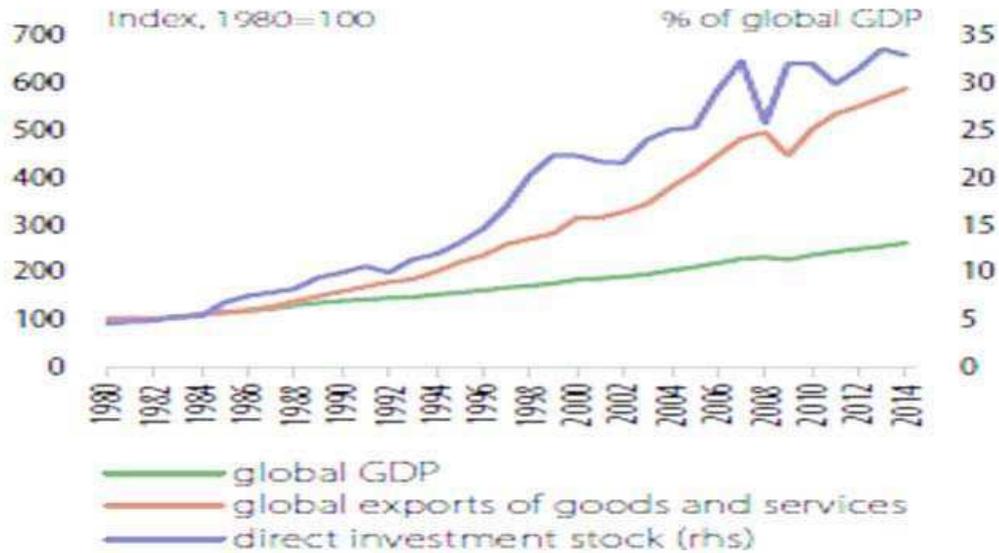
*The current account deficit of the balance of payments has been further covered entirely on the account of the non-debt generating capital flows (Figure no. 2).*



**Figure no. 2. Current account deficit financing**

Source: Annual Report of Romanian National Bank, 2015

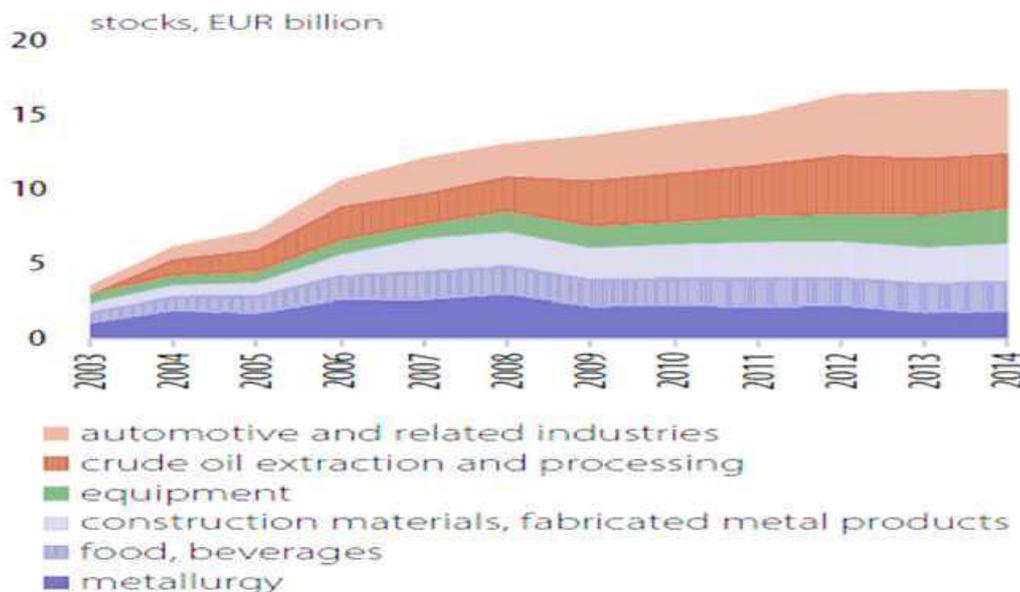
Their volume reached 6.5 billion Euros, consisting of new entries in the form of direct foreign investment and capital transfers, dominated by the absorption of non-refundable European funds. From a broader perspective, *the infusion of direct foreign investments* recorded in the last years has demonstrated its beneficial effects on the economy, companies with foreign capital concentrating about half of the gross added national value and over 75% of the total volume of the foreign trade operations (Figure no. 3, 4 and 5).



Source: IMF, UNCTAD

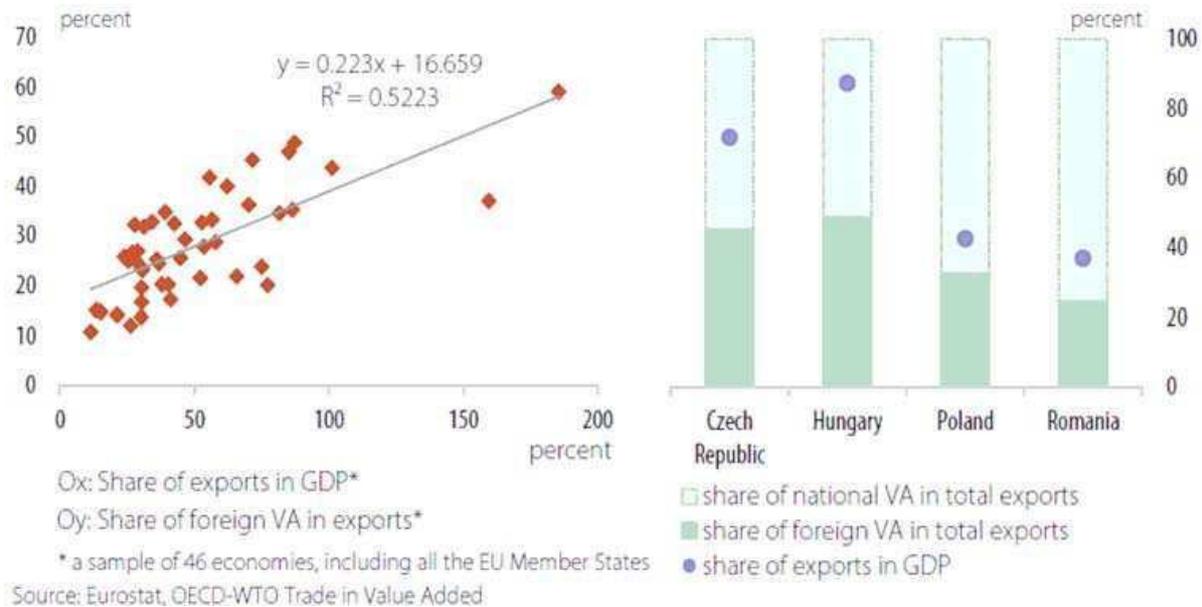
**Figure no. 3. GDP, international trade and direct investment stock at global level**

Source: Annual Report of Romanian National Bank, 2015



**Figure no. 4. Direct investment in main industrial activities**

Source: Annual Report of Romanian National Bank, 2015



**Figure no. 5. Export performance and share of foreign value added in exports (2011)**

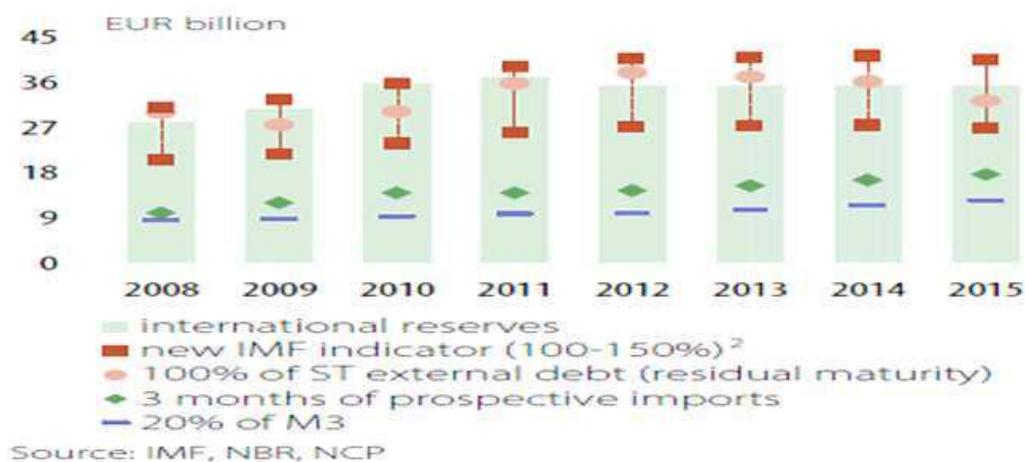
Source: Annual Report of Romanian National Bank, 2015

A satisfactory evolution has been noticed as well in regard to *the categories of capital with high volatility*, the recent trend outlined on the international financial markets – of reorienting the investors from emerging economies to the advanced ones – marginally affecting the financial account of the our country's balance of payments. Thus, the net outflow of capital in the form of deposits have eased noticeably in comparison with the previous years, compared to 2014, these flows have been reduced by 60%, and those associated with the investment portfolio have been of small amplitude, below 0.8 billion Euros. In addition, *external liquidity* has kept its comfortable level, consistent *international reserves* ensuring the coverage of about six months of prospective imports of goods and services, as well as of the short-term external debt at residual maturity date, in a ratio of about 110%.

The favourable picture of the evolution of the financial flows at the level of 2015 is complemented by the accelerated reduction of the total external debt stock – it reached the lowest level in the post-crisis period, namely 56.1% of the GDP, including as a result of the almost integral repayment of the loan contracted by Romania in 2009 under the stand-by



Arrangement with the IMF, the final payment in January 2016 being limited to about 100 million DST. The whole process of paying the loan went smoothly, without repercussions on the dynamics of the currency market and without eroding the international reserves adequacy indicators (**Figure no. 6**).



**Figure no. 6. Reserve adequacy indicators**

Source: Annual Report of Romanian National Bank, 2015

Moreover, the level reached by the international reserves at the end of 2015, of approx. 35.5 billion Euros, has been neatly superior to that from December 2008, which has recorded 28.3 billion Euros.

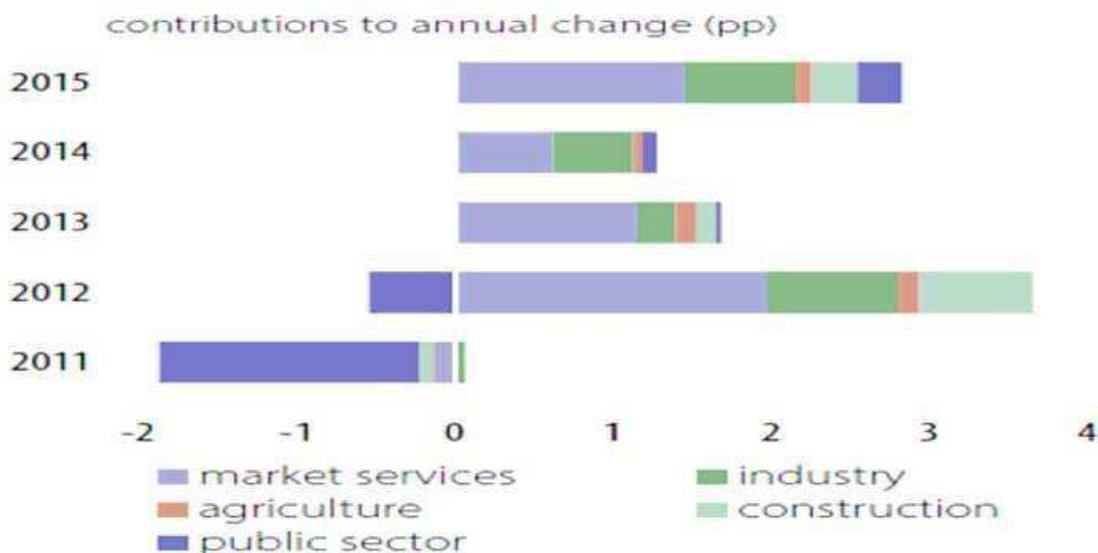
### **Romania's developments on the labour market**

On the background of dynamizing the economic activity, the labour market conditions have improved during 2015. Thus, *the hiring pace has intensified*, the growth in the number of employees doubling compared to the previous year. However, the substantial increase in the rate of vacant jobs has not resulted in a corresponding advance of recruitment from the unemployed group, thus suggesting the persistence of some structural weaknesses related to required skills training in the labour market and the evolution of the population of working age.

The number of employees in Romania advanced by 2.8% in 2015, half of this increase being due to the employment achieved in the market services – especially IT&C, trade and transport, sectors undergoing rapid



expansion. Moreover, the revival of the construction activity has favoured the jobs creation, the number of employees exceeding 350 thousand people, number close to which it has been placed for three consecutive years. Also, personnel schemes have been extended in the industry as well, especially in the automotive sector and in the one related to the electrical equipment, against the background of maintaining the investment interest for this field, as well as in the food industry, which benefited in the second half of the year of a significant demand boost, following the enlargement of the scope of the reduced VAT rate of 9% (Figure no. 7).



Source: NIS, NBR calculations

**Figure no. 7. Dynamics of the number of employees economy-wide: sectoral contributions**

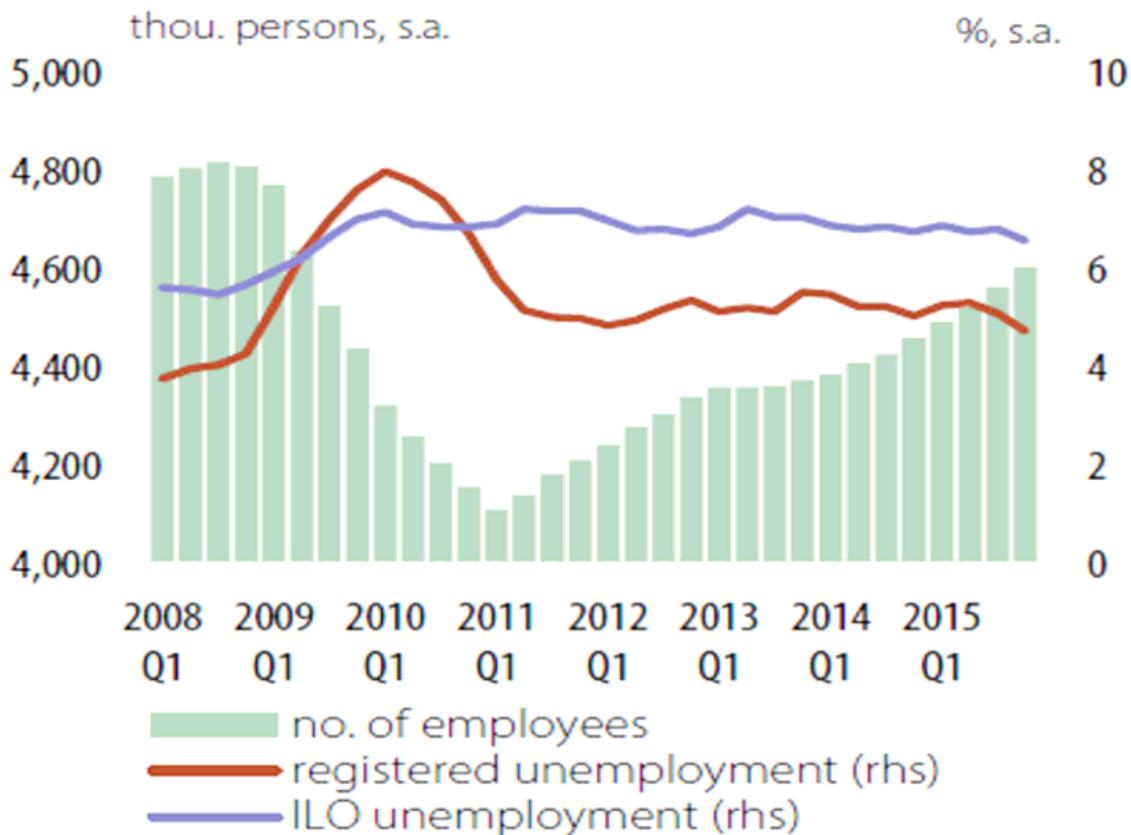
Source: Annual Report of Romanian National Bank, 2015

However, the return of the economic activity to the pre-crisis level in the first quarter of 2015 has not been accompanied by a similar recovery of the number of employees, so that by the end of 2015 had been regained only 70% of the jobs lost after the crisis. The only segment of the labour market where has been exceeded the level during the economic boom period was that of market services – the recovery of the construction activity is still in



its infancy, and in the industrial sphere structural changes have occurred that have emphasized the relative importance of some branches less dependent on the labour factor.

Increasing economy's capacity to create jobs observed during 2015, knowing an advance of more than 25% of the job vacancies, has not been reflected, however, in a corresponding reduction of the superfluous offer of labour force: the unemployment rate has marginally tempered, up to 5.1%, with -0.2 percentage points, and the BIM unemployment rate remained at 6.8% (**Figure no. 8**).



Source: NEA, NIS, NBR calculations

**Figure no. 8. The number of employees economy-wide and unemployment rate**

Source: Annual Report of Romanian National Bank, 2015



To some extent, the stagnation may be associated to the increase in the number of inactive people who are looking for a job, encouraged by the favourable economic environment, but the progress reports especially the persistence of the structural weaknesses in the labour market.

Intensifying the labour force absorption has been accompanied by an acceleration of the annually dynamics of the average gross salary up to 8.5%, after four years in which it has been placed around 5%. The evolution reflects the tightening trend observed on the labour markets, the two stages of increasing the minimum wage threshold in economy, with a cumulative impact higher than that of 2014, a series of salary increases awarded in the public sector, and in some sectors, prior productivity gains (**Figure no. 9**).



Source: NIS, NBR calculations

**Figure no. 9. Wage earnings economy-wide**

Source: Annual Report of Romanian National Bank, 2015



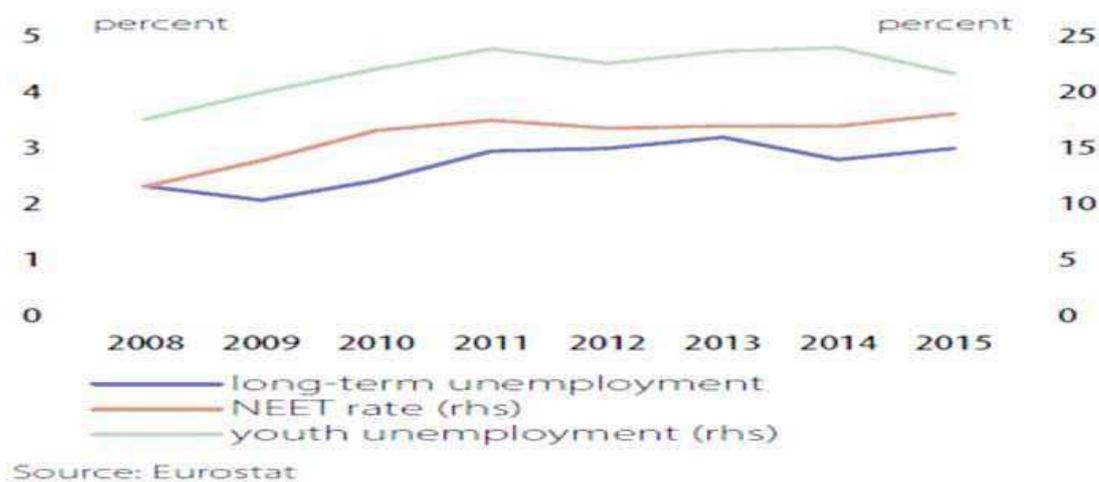
During 2015, a *faster pace of the wages* has been observed in the market services, especially in the segment of IT&C, due to business expansion, but also increased competition for candidates, as well as in constructions, given the trend of works revival. Though it has been situated below the economic average, a consistent pace has been recorded in industry as well, of approx. 6.8%, up with 0.3 percentage points, more accentuated in the branches orientated towards growth such as metal constructions and electrical equipment, but also in the sectors with a significant share of workers employed with the minimum wage, such as furniture, woodworking, light industry and food industry.

At the same time, *the level of the earnings in the public sector* it has exceeded that of the private sector since the fourth quarter of 2015, mainly due to the high level from the public administration, even if the wage increases have targeted several business segments such as education; local and public administration. Beyond the direct impact, the increases awarded in the public sector have the potential to influence the dynamic of the wages throughout the whole economy by showing a demonstration effect, thus exacerbating the increase pressures associated with the progressive tensions on the labour market.

*The situation of long-term unemployed* does not seem to have improved, their share in the active population maintaining higher than that from the pre-crisis period even after the economy returned to the positive growth rates, namely 3% between 2011-2015, compared to about 2% previously. The phenomenon, known in the literature as hysteresis effect, requires attention whereas the persons unemployed for a long period are likely to deteriorate their level of competences, being therefore less attractive to the employers, but also more difficult to integrate at the work place. Another basic problem is the situation of young people aged between 15 and 24 years, for which the unemployment rate, although it has decreased in 2015, remains at a high level, of 22%. In addition, the share of young people who are not employed or engaged in educational activities – the NEET3 rate – has continued to increase to 18.1%, among the highest in Europe, the gender gap being substantial, of approx. 6%, most likely as a result of the higher dropout rate in the case of female persons. At the same



time, the educational system proves to be inadequate in the light of the economy's requirements, both in terms of the range of created skills and the quality of training. The emphasis of the constraints on the development of the economic activity as a consequence of the shortage of qualified staff has determined more and more companies to create their own training facilities or financially support special classes within existing ones (**Figure no. 10**).



**Figure no. 10. Structural indicators**

Source: Annual Report of Romanian National Bank, 2015

### **The international economic context**

*The increase of the global economic activity* has remained fragile in 2015, knowing a rate attenuation of 0.3 percentage points, up to 3.1%. The modest recovery of the developed countries, of 1.9%, has been overshadowed by a new slowdown at the level of the emerging economies, up to 4.0%. The latter have steadily lost ground in the recent years, amid the increase of the risk aversion of the foreign investors, but also of the steep drop of the main raw materials' quotations on the international markets.

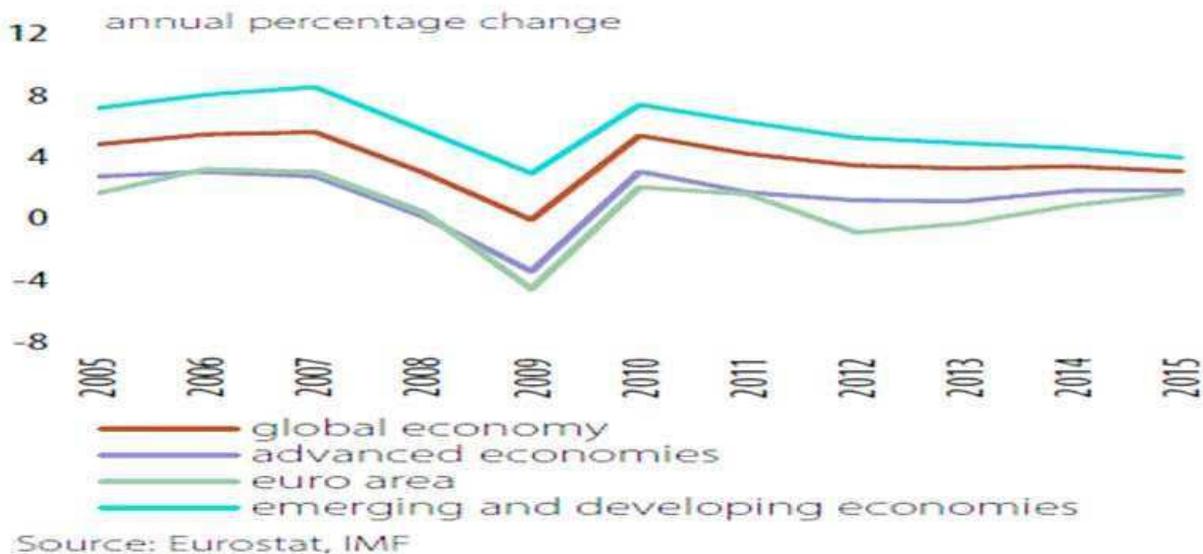
In the context of the outlooks regarding *the inflation persistence at low levels*, but also of *the slow economic recovery in advanced countries*, the monetary policy of the main central banks has maintained its accommodative character during 2015. Undoubtedly, the most important evolution concerns the Chinese economy, whose growth rate has continued



to decline, so that the annual dynamics of the GDP has fell for the first time in the last 25 years below 7%, reaching a level of 6.9% in 2015. Given *the high degree of China's integration* on the international chains of added value, the transition of this economy from a growth model based on investment and exports towards one oriented towards domestic consumption has led to a slowdown of the global trade activity, while exacerbating the decline in commodity prices from the recent years. Meanwhile, in the main countries net exporters of raw materials, such as Brazil and Russia, the free fall in commodity prices has been one of the main causes of the severe economic contractions, with almost 4%, together with the intensification of the internal political tensions, in the case of Brazil, or external, consisting in the persistence of strained relations between Russia and the EU. Instead, *the low commodity prices*, especially oil, have supported the consumption growth in net importing countries, such as India, but also in most of the advanced countries – in case of the latter, a role was held as well by the expansionary monetary policies. *Resuming consumption in the advanced countries* has been the main engine of global economic growth in 2015. In the USA, the gradual recovery of the domestic consumption, at the same time with the improvement of the labour market conditions, but also of the investments, except those related to the energy sector, have favoured the maintenance of a robust economic growth, of 2.4%. Instead, the sluggishness of the external demand and the appreciation of the dollar have inhibited exporters' activity. *A revival of the economic activity* took place as well in the Euro area, with an acceleration rate of 0.7 percentage points, up to 1.6%, against the improvement of agents' confidence in the economy, of easing the financing conditions, of the labour market recovery, but also of the depreciation of the European currency. However, the positive influence of the latter evolution has not been sufficient to counterbalance the decline of the external demand, so that the contribution of the net exports to the economic growth has become slightly negative in 2015, for the first time since the beginning of the crisis. Regarding the other advanced economies, Britain has recorded a deceleration of the growth rate, up to 2.2% in the context of the uncertainties concerning the possible exit from the EU, and



Japan's economy grew timidly, with 0.5%, after the 2014 recession induced by the increase of the VAT quota (**Figure no. 11**).



**Figure no. 11. Global economic growth**

Source: Annual Report of Romanian National Bank, 2015

*The decline in commodity prices* has offered an extra boost to the expansion of the domestic demand in developed economies in 2015, contributing largely to the growth of the disposable income of the population and to the reduction of the production costs for businesses. In *the context of the significant increase of the global offer over-plus*, the oil's price on the international markets has been halved in 2015. The amplification of supply surplus on this market has been the result of a strong advance of the crude oil production – primarily from the OPEC, as part of the strategy of certain members to expand the market share to the detriment of the competitors outside the organization, essentially of the oil producers through hydraulic fracturing in US – that took place, however, in terms of the economic downturn in emerging countries, particularly in China, the second largest consumer of oil worldwide.

However, over the year, *financial markets* have experienced a considerable volatility enhancement, on the background of the deterioration of growth prospects in emerging economies, of the expectations

materialisation regarding the closing of Fed's quantitative easing cycle, but also of the negotiations carried out between Greece and its international creditors. During this period, a number of emerging economies have experienced significant outflows of capital (flight to safety), which have put pressure meaning the depreciation of the domestic currencies, eroding the foreign currencies reserves of the central banks.

### **Conclusion**

In an *internal and external environment marked by a highly degree of uncertainty*, in which the vulnerabilities that the Romanian economy has faced not long ago are risking to reappear, only a coherent set of policies in the macroeconomic, structural and macro-prudential field make possible the upward evolution of the Romanian economy on long-term and the insurance of price and financial system's stability. In these circumstances, the process of economic convergence – nominal and real – would take place in a sustainable manner, its advance being achieved while maintaining the macroeconomic balances. In the absence of a serious effort in this regard, there is the danger that the notable performance on these fronts – visible especially in 2015, but achieved over time – to not last.

In perspective, connected to the international context in which our country is as well, it is expected that *the normalization of Federal Reserve monetary policy* to be achieved gradually over the coming years, given the fragile global context and the appreciation pressures on the US dollar. The climate of uncertainty that has characterized the international economic and financial context in 2015 and the first half of 2016 has been emphasised at European level as well by the BREXIT. Beyond the short-term implications associated with the increased volatility on the financial markets, the materialization of this risk had the potential to weaken the cohesion of the EU, marking on the long-term the evolution of the European economies, especially the peripheral ones, in whose development the European project has been an anchor.



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