

New Europe Economics & Strategy

Focus Notes: Romania

Romania: Economy in danger of staying flat or contracting once more in 2010

The first quarter GDP data dashed expectations of a moderate growth rebound in 2010. Romanian GDP contracted by 2.6% yoy in Q4, for a fifth quarter in a row, following a 6.6% yoy decline in the prior quarter. On a seasonal adjusted basis, GDP decline slowed to 0.3% yoy in Q1 against 1.5% yoy in Q4.

The detailed breakdown of the components revealed that except for industry (4.2% yoy in Q1 flat against 4% in Q4 2009), all other important sectors are still mired in recession. Construction kept plummeting by double digit rate (-17.9% yoy). Services remain on a negative territory yet their decline narrowed to -2% yoy against -9.4% yoy in Q4.

On the demand side, consumption shrank further by 4.0% yoy. Gross fixed capital formation remains depressed at -28.9% yoy in line with the construction plummeting. Exports recorded solid gains advancing by 19.5% yoy in Q1 against 2.9% yoy in Q4. However, imports recovered as well by 14.9% yoy from -11.1% yoy in Q4, so that the contribution of net exports is still positive.

In our view, the Romanian economy is in danger of staying flat or even contracting once again in 2010. The prospects of a rebound in domestic demand conditions were already bleak. The relatively high unemployment level (8.1% in April) and negative private sector credit growth (-1.6% yoy in March) created an environment of low growth expectations. On top of those, the aggressive spending cuts in wages and pensions will dampen consumption. The depressed level in business confidence leaves no room for optimism for a revival in investment. The only glimpse of hope is coming from continuous rise in exports. However, this was accompanied by imports recovery, which only curtails the positive contribution of net exports.

Last but not least, the continuous negative news flow on weak growth outlook ensures that the Central Bank will maintain its easing bias for a longer period than originally anticipated. In fact, we now see

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room for rates to drop below the 6% threshold. If there is no significant deterioration in the political environment we anticipate that rates could decline to 5.75% (currently from 6.25%) by the end of 2010.

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