MONETARY AND FISCAL POLICIES DURING THE NEXT RECESSION
- THE CASE OF ROMANIA -

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BUCHAREST
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MOTTO(S)

“There have been three great inventions since the beginning of time: fire, the wheel, and central banking.”

Will Rogers

“Victorians heard with grave attention that the Bank Rate had been raised. They did not know what it meant. But they knew that it was an act of extreme wisdom.”

John Kenneth Galbraith

"3.0 percent means 3.0 percent and not 3.2 percent."

Theo Waigel

"The four most dangerous words in finance are 'this time is different'."

Martin Wolf
I. INTRODUCTION
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INTRODUCTION
END-OF-CYCLE POLICY-MIX CHALLENGES

- The accumulation of maturity signs for the global post-crisis cycle
- Romanian economy highly integrated with the EU economic cycle
- Strong divergence between the overheating consumption and sluggish investments
- The acceleration of the economy accompanied by the return of twin deficits
- An expansionary and pro-cyclical, but unsustainable policy-mix
- At present there lacks maneuver room in case of shocks
- A rebalance of the policy-mix starting 2018 very likely
- Several challenges in terms of real economic convergence and development
GLOBAL AND EUROPEAN MACROECONOMIC CLIMATE
STRONG GLOBAL MACRO-FINANCIAL CLIMATE

Real economy vs. financial economy

Source: Bloomberg
US ECONOMY – THE MATURITY OF THE CYCLE

Labor productivity and employment in US

Source: BT based on US Bureau of Labor Statistics (BLS)
EU ECONOMY – AT THE PEAK OF THE CYCLE

Investor confidence in Euro Zone

Source: Sentix
THE END OF DELEVERAGING IN EUROPE

Domestic credit to private sector / GDP (%)

Source: Eurostat, NBR, BT
INCREASING CONVERGENCE IN EUROLAND

Standard deviation for GDP/capita in Euroland

Source: own estimates based on the methodology, using Eurostat, AMECO databases
UNSUSTAINABLE MONETARY DIVERGENCE

Monetary policy rate differential (FED vs. ECB)

Source: Federal Reserve, European Central Bank, BT forecasts
ROMANIAN ECONOMY IN THE POST-CRISIS CYCLE
ROMANIA – THE CHAMPION OF GROWTH IN EU

GDP (%, YoY)

Source: Eurostat, BT forecasts
THE PEAK OF THE CYCLE

- Romanian GDP accelerated to 5.9% YoY in 1H2017 (and 7% YoY during 9M2017), the highest paces since 2008, evolution supported by the expansionary policy-mix.
- Household consumption up by 7.6% YoY, due to the increase of the real disposable income, the dynamics of the credit markets and the wealth effect.
- However, the fixed investments contracted by 0.3% YoY in 1H2017, given the increase of the labor costs, the decline of the public investments and the policy-mix related uncertainties and distortions.
- Negative contribution of the net foreign demand.
- The intensification of the twin deficits.
- Unemployment at record low levels.
- The inflexion of the YoY CPI dynamics.
- NBR ready to start a new monetary cycle.
STRONG CONSUMPTION vs. LOW INVESTMENTS

Private consumption vs. fixed investments (% YoY)

Source: Eurostat, AMECO, INS
IT&C – THE STAR OF THE ECONOMY

Value added by sector (%, YoY, MA4)

Source: National Institute of Statistics (NIS)
RETURN OF TWIN DEFICITS

Source: AMECO, IMF, Banca Transilvania forecasts
LABOR MARKETS (OVER)HEATING

![Graph showing labor markets climate with real wage and unemployment rate trends from Jan-07 to Apr-17.](graph.png)

Source: Romanian Statistics Office (INS), Banca Transilvania estimates
POLICY-MIX IN ROMANIA
CONVERGENCE GOES ON ... WITH LOWER PACE

The dynamics of the structural component of GDP/capita (YoY)

Source: the results of the methodology applied by using data from Eurostat and AMECO
STRONG PRO-CYCLICAL FISCAL POLICY

Output gap vs. structural budget deficit

Source: the results of the methodology applied by using data from Eurostat and AMECO
AN EXPANSIONARY MONETARY POLICY

Source: the results of the methodology applied by using data from Eurostat, NBR, Bloomberg
MACROECONOMIC EQUILIBRIA AT RISK AGAIN

Investments – Savings differential (% GDP)

Sursa: IMF, October 2017
BT MACROECONOMIC SCENARIO FOR ROMANIA
## A LANDING IN SIGHT

<table>
<thead>
<tr>
<th>Indicator / year</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
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</thead>
<tbody>
<tr>
<td>GDP (nominal) (EUR, bn)</td>
<td>160.3</td>
<td>169.6</td>
<td>177.6</td>
<td>187.2</td>
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<td>GDP (real) (%, YoY)</td>
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<td>3.4</td>
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<tr>
<td>Private consumption (%, YoY)</td>
<td>5.9</td>
<td>7.4</td>
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<td>5.4</td>
<td>4.5</td>
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<td>Fixed investments (%, YoY)</td>
<td>7.4</td>
<td>-3.5</td>
<td>1.3</td>
<td>3.2</td>
<td>2.5</td>
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<tr>
<td>Public consumption (%, YoY)</td>
<td>0.2</td>
<td>4.7</td>
<td>3.5</td>
<td>2.0</td>
<td>1.1</td>
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<tr>
<td>Exports (%, YoY)</td>
<td>4.6</td>
<td>8.3</td>
<td>8.8</td>
<td>6.7</td>
<td>4.3</td>
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<tr>
<td>Imports (%, YoY)</td>
<td>8.0</td>
<td>9.8</td>
<td>8.9</td>
<td>7.1</td>
<td>4.5</td>
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<tr>
<td>Unemployment rate (%)</td>
<td>6.8</td>
<td>5.9</td>
<td>5.1</td>
<td>4.9</td>
<td>5.1</td>
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<tr>
<td>Inflation (HICP) (%, YoY, average)</td>
<td>-0.4</td>
<td>-1.1</td>
<td>1.1</td>
<td>3.1</td>
<td>2.9</td>
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<td>Monetary policy rate (%)</td>
<td>1.75</td>
<td>1.75</td>
<td>1.75</td>
<td>3.50</td>
<td>3.25</td>
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<td>Budget deficit (% GDP)</td>
<td>0.8</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Public debt (% GDP)</td>
<td>38.0</td>
<td>37.6</td>
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<td>37.9</td>
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<tr>
<td>Current account (% GDP)</td>
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<td>-3.4</td>
<td>-3.4</td>
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<tr>
<td>10 YR interest rate (%)</td>
<td>3.5</td>
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<td>5.1</td>
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<td>EUR/RON (yearly average)</td>
<td>4.44</td>
<td>4.49</td>
<td>4.56</td>
<td>4.65</td>
<td>4.63</td>
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</table>

*Source: Statistics Office, Eurostat, European Commission, AMECO, BT forecasts*
CONCLUSIONS
MANEUVER ROOM NEEDED FOR NEXT CRISIS

- A policy-mix rebalancing needed in order to build maneuver room for the end of cycle
- The financing costs would be higher than forecasted in the mid-run if the rebalancing is postponed
- The degree of freedom in terms of monetary policy is relatively low, due to the strong macro-financial integration of Romania with the Euroland and the high speed of capital flows, in a context of unprecedented expansionary ECB policy
- Without a rethink of the fiscal policy there increases the risks for Excessive Deficit Procedure, with negative consequences for the sovereign rating
- A stronger coordination of monetary and fiscal policies important to avoid boom/bust
- Structural reforms needed for sustainable development and for a successful integration in OECD and Euro Area in the future