

Romania: the State of the Nation

- September 2013 -

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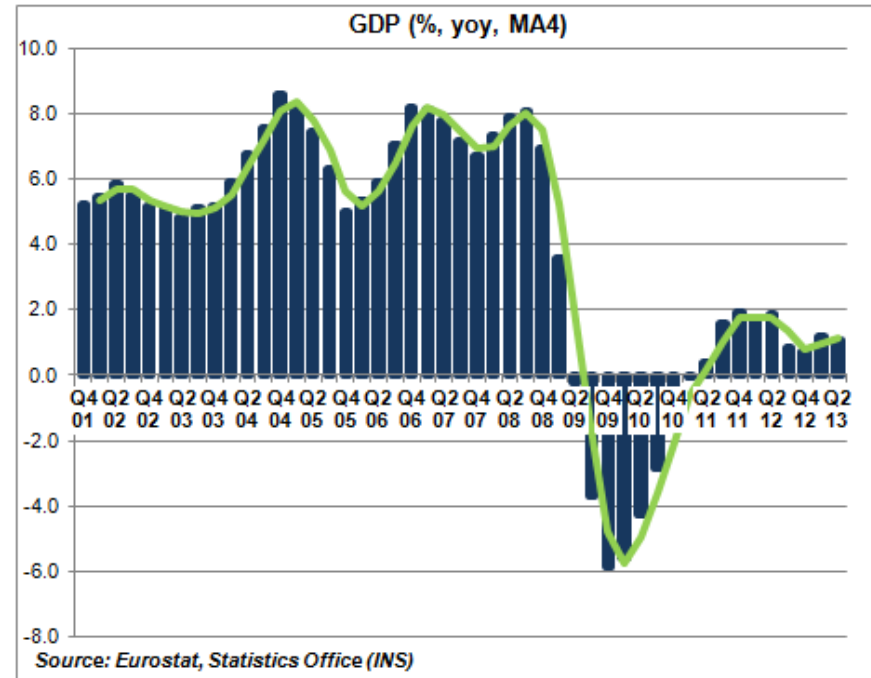
9th of September 2013

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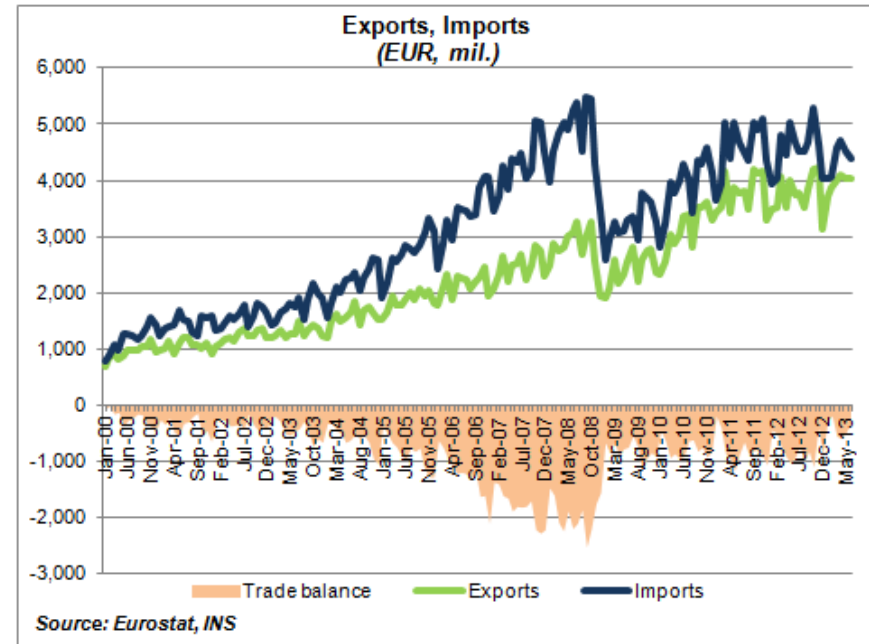
ECONOMIC CLIMATE MID 2013 I

- GDP rose by 1.8% yoy during 1H 2013, evolution determined by the dynamics of the net foreign demand (+5.3 pp);
- On the other hand, the domestic demand continued to contract during 1H 2013, contributing by – 3.5 pp to the formation of the GDP pace;
- There can be noticed the contribution of the agriculture during 2Q 2013, determined by the positive weather climate (the primary sector rose by 17.7% yoy in the second quarter).



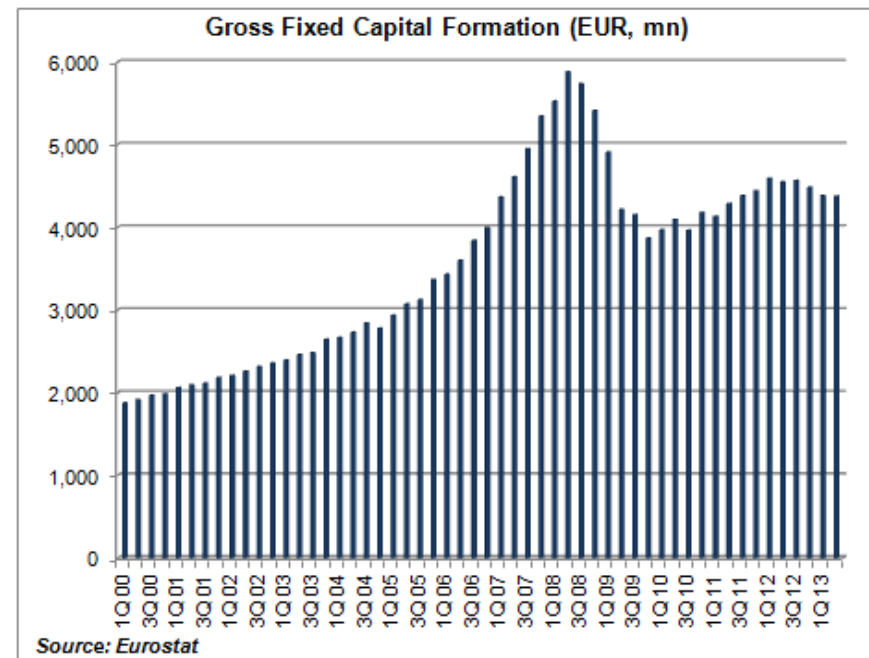
ECONOMIC CLIMATE MID 2013 II

- In what regards the net foreign demand:
 - The exports rose by 10.7% yoy to record levels;
 - The imports declined by 0.9% yoy;



ECONOMIC CLIMATE MID 2013 III

- In terms of the domestic demand:
 - The private consumption (the main component of the GDP) stagnated yoy;
 - The public consumption continued to contract, due to the fiscal consolidation process;
 - The gross capital formation severely declined (by 15.3% yoy), due to the persistence of a tough investment climate;
 - During 2Q 2013 the gross fixed capital formation was 26% lower compared to the pre-crisis level.
- In this context, the unemployment rate rose to 7.5% - very close to the record levels.



METHODOLOGY I

- Cobb-Douglas method

$$Y_t = \alpha N_t + (1-\alpha)K_t + U_t$$

$$Y_t^* = \alpha N_t^* + (1-\alpha)K_t + U_t^*$$

- The Labour Input (N_t) – labor force multiplied by labor participation rate, by (1-unemployment rate) and by the average number of hours worked;
- The Capital stock (K_t) – the Perpetual Inventory Method, a 5% depreciation rate;
- $\alpha = 0.65$;
- The Trend component of the production factors determined by H-P filter;
- Annual data, 1997-2012, Eurostat.

METHODOLOGY II

- Hodrick-Prescott filter:

$$\text{Min} \sum_{t=1}^T (Y_t - Y_t^*)^2 + \lambda \sum_{t=2}^{T-1} ((Y_{t+1}^* - Y_t^*) - (Y_t^* - Y_{t-1}^*))^2$$

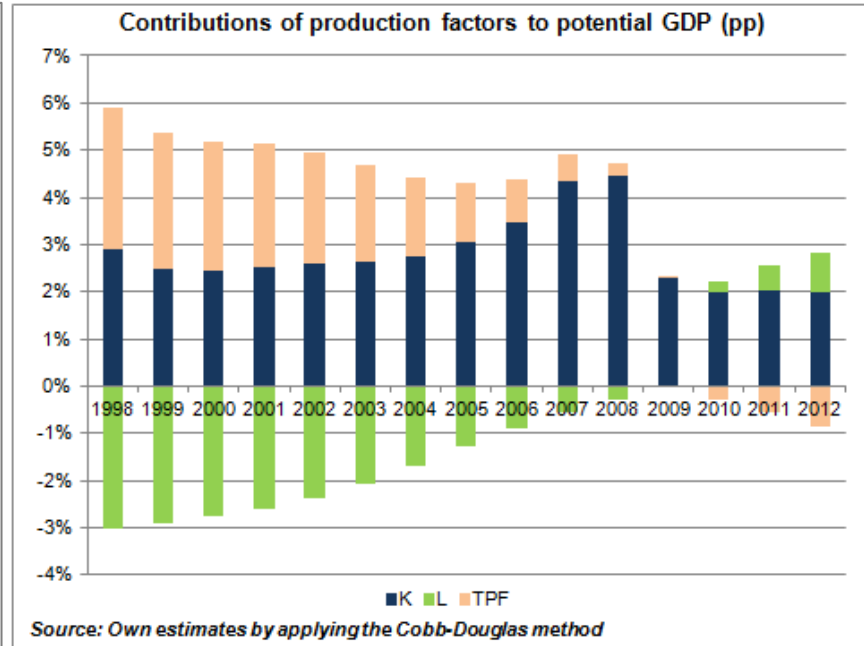
- $\lambda = 100$

- Annual data (1997 – 2012) – Eurostat;

- Econometric Software – E Views.

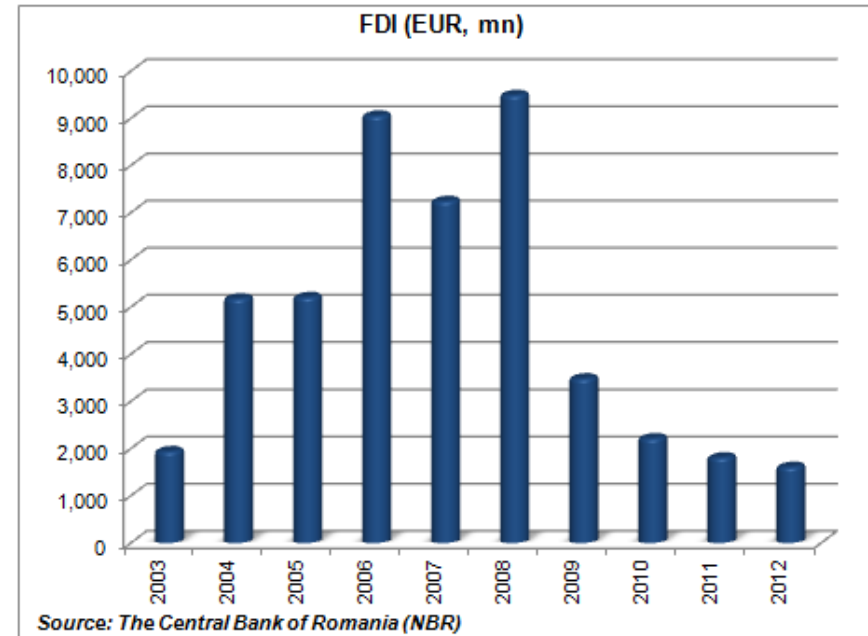
POTENTIAL GDP I

- At present, the potential GDP pace – the lowest since 1998 (around 2% yoy);
- The pre-crisis growth (potential GDP pace up from 2.4% yoy in 2000 to 4.5% yoy in 2008) was not sustainable;
- This evolution was determined by the massive foreign capital investments, with positive impact for the total factor productivity during first half of the 2000s;
- However, these capital inflows did not have a positive impact for the labor stock;
- At the same time, the acceleration of the capital inflows in the last years of the Great Moderation was not directed to the tradable sectors, leading to macroeconomic disequilibria.



POTENTIAL GDP II

- After the first wave of the Great Recession hit Romania, the sudden stop of the capital flows and the pre-crisis macroeconomic disequilibria determined the severe deterioration of the potential GDP pace;
- The contribution of the capital stock to the dynamics of the potential GDP diminished from 4.5 pp in 2008 to 2.3 pp in 2009 and 2 pp during 2010-2012;
- The decline of the capital inflows determined an unfavorable evolution of the total factor productivity (from a positive contribution of 0.3 pp in 2008 to 0 pp in 2009 and -0.9 pp in 2012);
- On the other hand, the contribution of labor to the formation of the potential GDP turned positive since 2010 (after the severe decline over the past 2 decades).

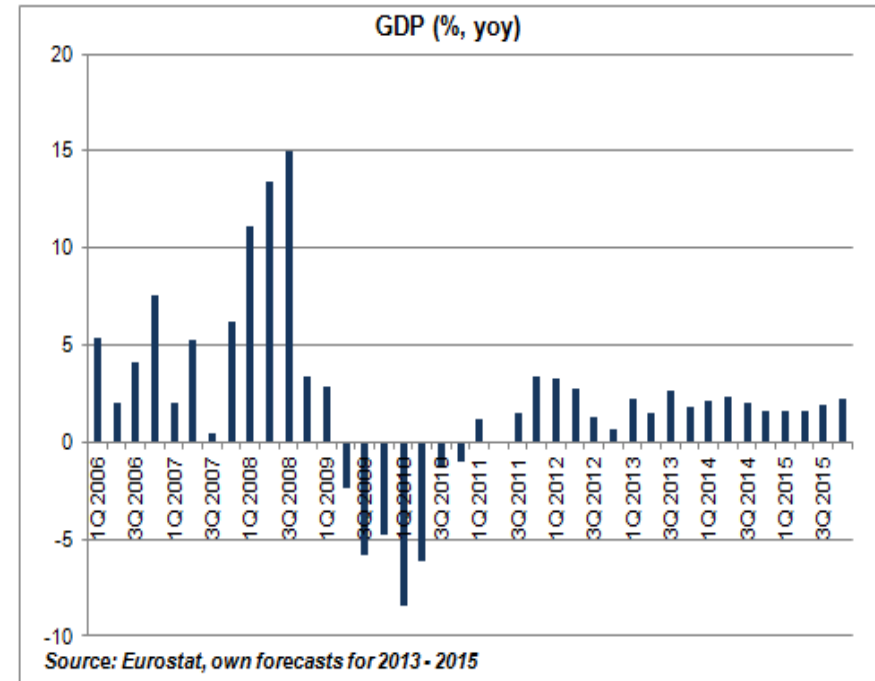


POST-CRISIS CHALLENGES

- **Main post-crisis challenges**
 - Recovery of the potential output pace in a context of domestic capital deficit and fiscal consolidation;
 - The implementation of further structural reforms;
 - The development of the domestic capital;
 - The human capital problem: labor represents the permanent problem in Romania.

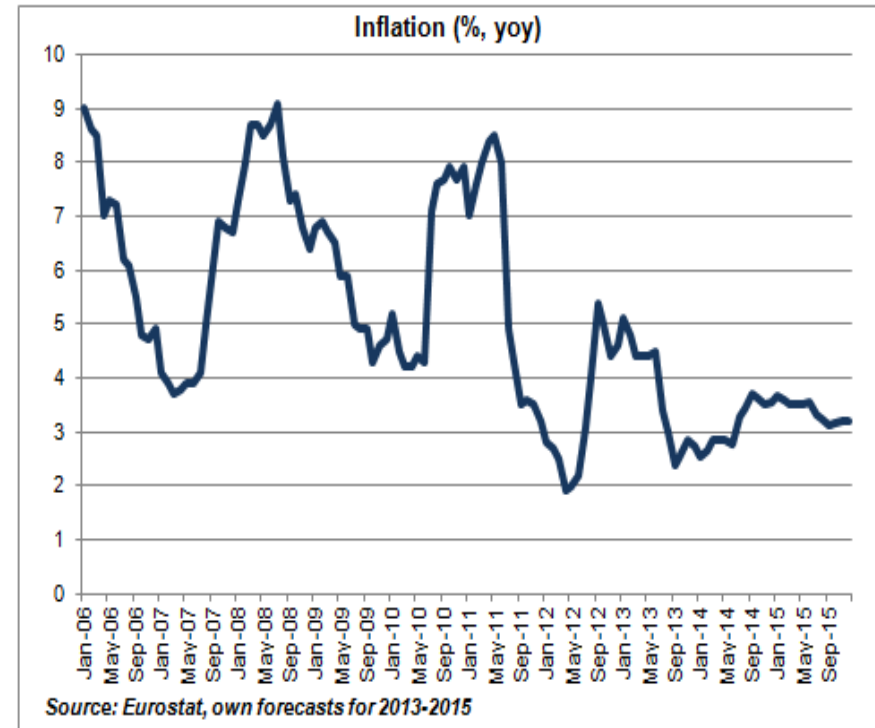
ECONOMIC OUTLOOK I

- Convergence towards potential pace in the medium-run, supported by the net foreign demand and by the Central Bank's monetary policy rate cut cycle;
- A new exports / investments in industry driven cycle;
- If the Government implements the structural reforms (agreed in the new Stand – By Agreement with the international financial institutions) the economy will enter a sustainable growth pace (with positive impact for the potential GDP pace);
- Persistence of risk factors (both foreign or domestic).



ECONOMIC OUTLOOK II

- Deceleration of inflation in the following quarters, due to the positive agricultural production in 2013, but also to the below potential evolution of the domestic demand;
- New monetary policy rate cuts (from 4.5% at present), with positive impact for the credit markets and for the private investment;
- In this context, the domestic demand may turn the trigger of the economy in the medium-term.



THANK YOU!