



ASPECTS CONCERNING THE EVOLUTION OF SOME MACROECONOMIC INDICATORS IN 2008

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Rezumat

Perioada 2007-2013 este hotărâtoare pentru evoluția economiei naționale în drumul spre adoptarea monedei euro. În acest sens, economia românească, o economie vulnerabilă după aderarea sa la UE, merită o atenție deosebită și un efort analitic. Prezentul articol reprezintă o sinteză în plan macroeconomic a evoluției unor indicatori relevanți pentru anul 2008 - produsul intern brut (PIB), rata inflației, rata șomajului și rezerva valutară oficială. Această analiză se dorește a fi un îndemn la o reflecție asupra evoluției economiei românești în anul 2009 și asupra evoluției viitoare a acesteia, până la adoptarea monedei euro.

Abstract

The period 2007-2013 is decisive for the evolution of the national economy on its road towards the euro. The Romanian economy is vulnerable after its accession to the EU; it deserves special attention and an analytical effort. We proposed ourselves to make a synthesis of the evolution of some macroeconomic indicators in 2008 – the gross domestic product (GDP), the inflation rate and the official currency reserves. This analysis is an urge towards reflection on the evolution of the Romanian economy in 2009 and on its prospects until the adoption of the euro.

Keywords: GDP, inflation rate, unemployment rate

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1. The indicator which reflects the most synthetically the trend of the Romanian economy, the contribution of the different sectors of the economy and society and the concluding consequences of the process of reorganization is the *gross domestic product (GDP)*.

In the *first quarter* 2008, the economic evolution of Romania exceeded all market expectations. The GDP (as real variation) reached 8.2% compared to the first quarter 2007 (6.1%). This was a rate of growth higher than the level of the potential GDP, which showed a process of economic overheating. During the same period, EU and euro zone economies increased by 2.3% and 2.1%, respectively, compared to the similar period of 2007.

The evolution of the contribution of the various sectors to the GDP is important and significant just like the dynamics of the total GDP.

During the first three months of this year the sector of constructions was the drive of the economy, where the highest growth was reported: 32.4%. Since this is a strong sector one may ask whether a decline in this sector would be premises for a “rough landing” of the economy (there were arguments doubting the sustainability of an economy relying on the sector of constructions, which has the disadvantage of stimulating excessively the imports).

The contribution of the services to the economic growth was 7.5% and that of the industry was 5.4%.

Agriculture had an almost null contribution, i.e. 0.5%. In the economies of the advanced countries, agriculture accounts for 2% to 5% of the GDP. Having in view the increase of food price worldwide and the effects of the global warming, this sector of the Romanian economy can not be treated superficially or at random. We consider that urgent measures were required to work and protect properly the agricultural land so that it can produce the required food and a decent income for the farmers. The EU had to rethink the reform of the Common Agricultural Policy.

The industry, despite its positive contribution to GDP formation, had a poor evolution during the first quarter 2008, with low competitiveness, based on the production of low added value-goods.

In terms of GDP distribution by destinations, the domestic demand – consumption plus investments – increased by 15% and its main component, the actual final household consumption, increased to 14.3% after two quarters of slowing down.

It is established that the very large domestic demand creates an excess of demand which fuels the current account deficit and the inflation.

Having in view that price stability is NBR goal, the rate of the economic growth reported for the first quarter 2008 was not good news for the monetary authority, which was forced to increase the key interest rate. All the economic policies had to be strengthened during the subsequent period.

It was difficult to predict the sustainability of the economic growth since it includes many unknown factors which work and which can surface at any time; one thing was sure, though: a growth relying disproportionately on the consumption of imported goods can not be healthy and sustainable.

In conclusion, according to the National Institute of Statistics (NIS), the GDP was 86.7 billion lei (23/5 billion euro) in this quarter, 8.2% higher than in the first quarter of the previous year, much over the expectations of the analysts. The large gap between the real GDP, actually produced, and the potential GDP in relation to the real power of the economy, the difference given by the increase of the demand much over the offer, produced the overheating of the Romanian economy. This evolution manifested with priority by the high level of inflation, by the increase of imports and by the higher current account deficit.

A clear sign that the Romanian economy overheated and that it tends to have two major unbalances (an foreign one, reflected in the current account, and an internal one given by the high speed of inflation) results from these evolutions, if we look at the correlation between inflation and unemployment (on the short term this correlation is negative).

Thus, for an economic growth that exceeded 8%, with an unemployment rate around 4% and with more than 8% annual rate of inflation increase, the signs of overheating were obvious.

Since overheating increases inflation and reduces the capacity of reimbursing the credits taken by the population and by the commercial companies, it “chases away” the investors and has an adverse influence on the power of the national currency; this shows that the phenomenon of economic overheating is very dangerous for Romania and that it can postpone reaching the goal of convergence and adhesion to the euro zone.

This phenomenon can be solved only by properly strengthening the macroeconomic policies.

In the *second quarter*, the rate of GDP growth (in real terms) reached 9.3%.

This second quarter showed a consistent (even higher) difference between production and consumption, between imports and exports.

The impressive growth of the GDP during this period was not good since it brought its share to the economic overheating.

For the first time since the introduction of the euro, the economy of the euro zone decreased in the second quarter 2008, compared to the similar period of the previous quarter. The economy of the 15 states using the euro decreased by 0.2% in the second quarter 2008, but it increased by 1.5% compared to the similar period of 2007.

Romania needs a rapid economic growth, lower budget deficit and lower inflation, so as to recover the gap in the standard of living from the developed EU countries and to alleviate poverty. However, the rapid growth of the GDP based on consumption induces hazards for the medium-term economic stability.

In the second quarter, same as in the first quarter, on the side of the offer, the sector which pushed the economy upwards was the sector of constructions with a spectacular 33.9% increase. The whole economy developed very much in the direction of constructions so that it ended depending largely on the evolutions from this sector. This was, otherwise, the main market for all the branches of the national economy. We may therefore also think that a decline in this sector may cause a possible recession.

The services and the industry accelerated their annual dynamics. Thus, the contribution of the services to the economic growth was 7.6%. In industry, the annual rate of increase of the gross added value was 6.1%, compared to just 5.4% in the first quarter 2008.

The decline of agriculture slowed down substantially: 3.7% compared to -0.5% in the previous quarter.

On the side of demand, similarly to the first quarter 2008, in the second quarter the most dynamic component was the gross formation of fixed capital. This component and the final consumption displayed light reductions of increase.

The annual rate of increase of the actual end consumption of the population remained high (12.2%) slightly lower, however, compared to the previous quarter.

The actual end consumption of the public administration preserved its annual rate of increase compared to the previous quarter (4.1%) and the gross formation of fix capital maintained its strong increase.

In Romania, the GDP grew in the second quarter 2008, and in the first quarter 2008, not because the productivity increased, but because the end consumption increased. The foreign unbalance deepened as shown by the current account deficit which increased by 8.48% in the first quarter, to 7.98 billion euro; the increase was, however, much lower than in the first quarter of the previous year, when the value of the indicator doubled.

In conclusion, we may say that in the second quarter of 2008 the economic growth of Romania was unsustainable, with high risks of rough landing.

The main determinants of the advance were volatile sectors such as constructions and agriculture. Commerce played an important role in the economic growth, the dynamics of the exports being much stronger than the dynamics of the imports. The record growth of the GDP in the second quarter (9.3%) was much over the potential of the economy.

Taking into calculation the hypothesis of economic overheating, such an economic growth determined NBR to increase the monetary policy interest rate.

Romania didn't yet regained the production capacity which to meet the domestic demand. Therefore, the problem of the current account deficit is a structural problem.

The strong economic growth, the higher current account deficit, a higher inflation and the significant increase of the wages are the main characteristics of the first half 2008.

Romania couldn't demonstrate up to that moment that it may have economic growth by reducing the current account deficit.

It is known that a potential economic growth which doesn't create inflationist pressure is somewhere around 6%. If we look at the situation of the other states in the region, a 9% growth of the economy is very much for Romania and it shows that the economy overheated putting pressure on the inflation and on the foreign deficit.

The drives of the economic growth in the *third quarter* 2008 were two volatile sectors: agriculture and constructions. Agriculture had a record production after the 2007 drought.

The GDP growth in the third quarter (9.1% in real terms) relied on a conjectural increase of the agriculture and consumption, whose adjustment was unavoidable.

The industry proved in this quarter too, that it is not the drive of a long-term sustainable economic growth, being affected by the reduction of the demand for imports from the EU, by the restrictive interest rates and by the reticence of the banks to give loans.

The services slowed down significantly, mainly the financial intermediations and the business, rental and real estate services.

The gross formation of fixed capital slowed down its advancement in this quarter from 30% in the second quarter to 24.3%.

The economic growth during this quarter was not sustainable, under the conditions in which it relied on volatile sectors such as agriculture and constructions.

GDP growth in this quarter took place on the background of EU economy contraction.

In the *fourth quarter* of 2008, the economic indicators deteriorated rapidly. The recoil of the economic activity during this quarter was anticipated by most forecasts.

The effects of the international financial and economic crisis became increasingly manifest: the exports and the foreign financing decreased; the currency market became very volatile in correlation with the regional trends; the foreign investors showed a lack of appetite towards the risk.

The propagation of these effects reflected in the slower crediting for the private sector, which slowed down the economic growth.

The industrial production decreased by 3% in the first month of the fourth quarter compared to the first month of the third quarter 2008, which was the most marked decline of the previous three years, after it decreased by 1.5% in August 2008. We presented just this indicator which is the most important for the overall situation of the economy, being strongly correlated with GDP growth.

2. One of the economic problems of Romania on its way to integration within the European structures was the high *inflation* rate. The annual inflation rate increased to 8.63% in March, from 6.6% in December 2007. This is outside the ± 1 percent point interval of variation according to the target set for 2008. This inflation level is the result of the conjugated influence of several factors.

The increase was caused both by the persistence and amplitude of the internal and external shocks on the side of the offer, and by the higher pressure on the side of the excess of demand (the inflationist impact was heightened by the consistent accelerated expansion of the credit for the private sector and by the consistent pressure generated by the substantial increase of the incomes). The depreciation of the national currency and the poorer forecasts on inflation also contributed to the increase of inflation during the first quarter 2008.

The correction of the exchange rate from 3.1 EUR/RON, during the entire last year (totally unsustainable level) came on the background of the international crisis, of the increased aversion of investors towards risk and on the background of the foreign unbalance of the Romanian economy.

The depreciation of the national currency simply inflated constantly, for instance, the bills for fixed and mobile phones.

All CORE indicators measuring inflation (CORE 1,¹ CORE 2,² CORE 3) offered by NSI and agreed by NBR had unfavourable evolutions in this quarter. We can speak, for instance, of the higher inflationist impact of the administered prices (8.5% annual variation). We can also remind the price increase for heating (5.9%) and natural gases (12.4%) as well as the manifestation of an unfavourable basic effect or the maintenance of significant pressures from the volatile food prices (the category of goods with volatile prices includes the vegetables, fruits, eggs, fuels).

All these pushings ahead (short-term shocks) must not become permanent and be included in population's expectations. CORE 3 has shown a 6.8% increase during the past 12 months, which is very worrying for the future.

All these aspects show that inflation will continue. Deflation must be a sustainable process, not a forced one, but it is difficult to accomplish because of the structural components of the inflation and because of the high inflationist pressures.

The increasing inflationist pressures reflected in the higher gap of the average annual rate of HICP in Romania compared to the EU27 average: 3.2% in March 2008 compared to 2.5% in December 2007.

¹ CORE 1: IPC – administered prices

² CORE 2: CORE 1 – volatile prices

Therefore, within the context of a sustained economic advance, when NBR had just to be concerned with price stability, the implementation of the inflation targeting regimen remains a challenge.

Price stability must not be solved at the expense of the financial stability.

In the *second quarter* 2008, in most countries worldwide, inflation remained high. The East European states showed high values of this indicator within the context of the high prices of the raw materials worldwide.

In Romania, the annual inflation rate during this period continued to be outside the ± 1 percent range of variation, corresponding to the target of 3.8% set for 2008.

By end of June, the annual inflation rate was 8.61%, similarly to the rate of the late first quarter 2007.

During April-June 2008, the factors of influence included, similarly with the previous year, the rising trend worldwide of oil price, the tensions on the food market and the unfavourable basic effect generated by the low inflation of the first half 2007.

At the end of the *third quarter*, the annual inflation rate (7.30%) remained outside the ± 1 percent interval of variation corresponding to the target of 3.8% set for 2008. However, this level was 1.31% lower than in June (8.61%), which confirmed NBR forecasts that deflation will resume in the third quarter.

After the 9.2% peak generated in July by the 12.53% increase of gas price and 4.51% increase of electrical power price and by the higher excises, inflation decreased throughout the third quarter.

The third quarter 2008 marked the discontinuation of the ascending trend of the CORE 2 inflation, in the interval August 2007 – July 2008, supported by the vegetal agricultural production.

The annual inflation rate didn't exceed 9% since July 2005, when NSI reported an annual inflation rate of 9.3%. This made plausible the revised NBR prognosis for inflation at the end of 2008: 6.6%.

In July 2008, the inflation rate was 4.1% in the euro zone. Throughout the third quarter 2008, the annual inflation rate remained over the level compatible with price stability.

At the end of June 2008, Romania ranked fifth in EU according to the harmonized inflation rate, being preceded by Estonia (11.2%), Lithuania (12.4%), Bulgaria (14.4%) and Latvia (18.5%).

The East European states had the highest values across Europe in July within the context of the high worldwide prices for raw materials. Inflation was high in most of countries worldwide.

The average inflation is the indicator function of which will be judged the request of Romania to adopt the euro. Until the end of the third quarter it increased because the increase of the administered prices and because of international factors of influence such as the higher prices for food and oil.

At the end of 2008, the annual inflation rate was 6.3%, lower than the peak of July 2008 and than at the end of 2007. It was, however, above the upper limit of the interval of variation associated to the target.

The resuming of deflation and its consolidation were produced due to the monetary policy and of the favourable dynamics of the volatile prices (fuel and food). The relaxation of the fiscal and wage policies during this year and the depreciation of the national currency because of investor's risk aversion maintained the inflationist pressures.

3. In the first quarter of 2008, *unemployment rate* was around 4%. This shows that the surplus of labour force offer was at a minimal level and that the possibilities of the employers to hire staff from the domestic market become increasingly limited.

In May-July 2008, unemployment rate was 3.8% and in November it was 4.1%.

In the same month, unemployment rate was 7.8% in the euro zone according to Eurostat. Due to the aggravating world crisis, 12.18 million persons were jobless, 1.06 million more than in November 2007.

The countries worst affected by unemployment were Spain (13.4%), Slovakia (9.1%) and Latvia (9%), while the lowest unemployment rates were in the Netherlands (2.7%), Austria (3.8%) and Cyprus (3.9%).

Within the context of increasing unemployment, the trust in the economy of the euro zone reached its lowest level after 1990.

4. The currency reserves of NBR consist of assets denominated in euro, US dollars, Sterling pounds and other foreign currencies.

At the end of June 2008, they were of 24.915 billion euro and 25.92 billion euro in August. The increase came from inflows, representing changes in the foreign exchange reserve requirements

of the credit institutions, inflows in the European Commission's account, income from the management of foreign exchange reserves.

The evolution has also been influenced by outflows, representing changes in the foreign exchange reserve requirements of the credit institutions, interest and principal payments on public and publicly guaranteed foreign debt, payments to the European Commission etc.

In September 2008, the foreign exchange reserve of NBR increased by 101 million euro. The *gold reserve* remained at the end of September at 103.7 tons. Due to the evolution of the international price of gold its value increased to 2.08 billion euro, which brought the international reserves of Romania (foreign exchange and gold) to over 28 billion euro.

In October 2008, the foreign exchange reserves of NBR amounted to 27.3 billion euro. Because the structure of the foreign exchange reserve follows the structure of the public debt and of the commercial relations, it has a large US dollar component.

At December 31 2008, the foreign exchange reserves of NBR consisted of assets denominated in euro (63%), in US dollars (32.55%), Sterling pounds (4%) and in other currencies (0.45%).

By the end of December 2008, the foreign exchange reserves of NBR amounted to 26.2 billion euro compared to 27.3 billion euro at November 30 2008 and 25.3 billion euro at December 31 2007. This was due both to the depreciation of the US dollar and Sterling pound compared to the euro and to the intervention of NBR on the foreign exchange market.

The appreciation of the euro versus the US dollar and Sterling pound during this month decreased the US dollar and Sterling pound component of the foreign exchange reserve by the equivalent of 974 million euro.

While changing from the fall of 2008 the way of foreign exchange administration after the financial crisis burst out, NBR didn't abdicate from the conservatory line of administration. The foreign exchange reserve was large enough for interventions on the foreign exchange market.

On December 31 2008, the gold reserve remained at 103.7 tons, with the value of 2.049 billion euro.

The international reserves of Romania (foreign exchange and gold) amounted to 28.269 billion euro at the end of 2008, compared to 29.340 billion euro on November 30, 2008.

Conclusions

In 2008 the surveyed macroeconomic factors displayed, at the first sight, a positive evolution.

Thus, the *economic growth* was high during the first nine months when the international crisis had already begun to push the western economies towards recession. The slowing demand became visible only in the late months.

The economic increase relied preponderantly on the consumption, especially on the consumption of imported goods. The rate of economic growth exceeded the estimated potential of the economy. This caused an excess of demand in the economy, which fuelled the deepening current account deficit and the inflationist pressures. A growth at the expense of and based on a higher foreign deficit can only be unhealthy.

The economic growth relied on volatile branches such as agriculture, constructions and services.

2008 was the peak of an economic cycle, which entered its descending stage in 2009. The economic crisis only hurried its stopping.

The question is what are the advantages of Romania after a decade of economic growth?

This growth based on consumption, which increased the foreign balance unbalance and economy overheating made Romania vulnerable to the impact of the international financial crisis.

Inflation seems to revert to a descending trend due to the very restrictive monetary policy, to a good agricultural year and to the decreasing oil prices on the international market.

The criterion concerning the inflation rate was not attained, Romania meeting just two of the five criteria for adopting euro: public debt and budget deficit.

Deflation can be continued through a mix of more balanced economic policies, with more restrictive fiscal-budgetary policy and income policy.

One of the main indicators of trust evaluated by the foreign rating agencies is the *foreign exchange reserve* of the National Bank of Romania, which was about one billion euro higher in December 2008 than in December 2007.

Throughout 2008, NBR showed prudence and consistence in the administration of the foreign exchange reserve. The central bank didn't have toxic assets, only prime (AAA) placements. The accounts

where the foreign exchange reserve of Romania is kept are opened in large central banks.

One of the major goals of NBR for the subsequent period is the protection of the foreign exchange reserve.

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