

FINANCIAL CRISIS AND ROMANIA'S ECONOMY

Cristina Alina NĂFTĂNĂILĂ, Assistant lecturer Ph.D. student
Faculty of Accounting and Finance Câmpulung
Spiru Haret University

Abstract

The effects of the international financial crisis also have spread on the Romanian economy.

In terms of the direct impact, the banking system was less affected by not being exposed to the toxic assets, and because of prudential and administrative measures adopted over the time by the National Bank of Romania. Indirectly, the international financial crisis is expanding on the Romanian economy on the multiple channels.

The evolution of the financial crisis will lead economies into a deflationary spiral in the next year or even a longer lasting, as deficit reduction efforts will take large, and probably we shall assist an output of some euro area of weaker states.

Key-words: *financial crisis effects, economic policy, measures on economic growth, external financial agreement, the euro area, Greece*

JEL Classification: G28

Introduction

This article sheds light on issues of financial crisis on the Romanian economy and challenges for the economy in Romania.

We considered necessary the analysis of the issues related to the revitalization of the economy of our country (out of recession, budgetary correction, high dependence on foreign loans) and also the presentation of the measures taken by the Government in the Government Programme 2009-2012.

What do we need? In essence, it is necessary a significant strengthening of the fiscal and salary policies. In addition to this, the government can help improve the perception of the foreign investors through measures such as improving the capacity of absorbing EU funds and thus replacing the private external financing with the public external financing or by creating new jobs in the insufficiently exploited areas, which can gradually take over the role of engine of the economic growth.

Literature review

According to economic speciality literature (Fischer 1999), the financial crisis is a phenomenon which is in the spotlight of worldwide economists as a

result of the impact on their economies. Specialists of every country try to find solutions for overcoming the economic crisis by adopting an optimal combination of all policies: budgetary, salary, monetary in order to move the business towards work and productivity.

Even if the ongoing economic adjustment process cannot be accurately planned, however, the promotion of the coherent and credible economic policies could avoid a disorderly adjustment (hard landing).

Theoretical background

For this article we have studied the speciality literature, articles and studies recently published on this topic.

In our research we have examined the components of gross domestic product to show that, in Romania, economic growth in 2009 remained in the positive territory. For this we have consulted the national and international macroeconomic context, the Government Programme 2009-2012 and the official site of the National Bank of Romania.

Intern and international macroeconomic context in 2009-2010

The effects of the international financial crisis have also spread on the Romanian economy.

However, in terms of the direct impact, the banking system was less affected by not being exposed to the toxic assets, and because of prudential and administrative measures adopted in time by the National Bank of Romania. Indirectly, however, the international financial crisis and especially its obvious consequence – the recession in the developed countries – are expanding on the Romanian economy on multiple channels.

On the commercial the channel, slows or even reduces the export growth. On the financial channel, limits the access to the external financing, and thus restrict, the volume of lending, and creates difficulties in the private external debt service.

On the exchange rate channel, reducing the external financing reflected in the national currency depreciation.

On the confidence channel, there was a withdrawal of investors from the Eastern Europe countries. This as the effect the manifestation on the monetary currency market of some moments of panic and speculative attacks, such as the one in October 2009 in Romania, which made necessary the intervention of NBR, the central bank.

Finally, on the channel of wealth and balance sheet effects, the damage of the net assets of people and the companies occurs, due to the high proportion of loans in the foreign currency (related to the national currency depreciation) and the drop of the asset prices and capital values at unsustainable values (the propagation of these effects determines that the degree of uncertainty regarding the evolution of the economic variables be extremely high).

This contributes, in its turn, to the accentuation of the crisis through the negative effects it has on the expectations and by increasing the degree of cautious consumers and traders.

In Romania, the response to the adverse effects of the crisis cannot be similar to that made by some European countries or the U.S. There are several differences between the Romanian economy and these economies, which do not allow copying the package of measures developed there.

In essence, we talk about the fact that the Romanian economy has a large current account deficit, which indicates its dependence on the external financing. We have to choose between the orderly reductions of this deficit or its reduction by the market in the current conditions of tension and chosen mistrust, with dramatic consequences for the exchange rate and the economic growth.

Even if the ongoing economic adjustment process cannot be accurately planned, however, the promotion of the *coherent and credible economic policies* could avoid a disorderly adjustment (*hard landing*). Thus, the government should avoid an emotional crisis approach under the unions and employers pressure, which should lead to some measures to stimulate the internal demand, complicating the reduction of the current account deficit at a sustainable level. Only a concentration of the macroeconomic policies combination on the process of the adjusting external imbalances (the current account deficit) and of the internal one (the budget deficit) may lead to the support of the soft landing of the economy and to improving the perception of the foreign investors.

What do we need? In essence, it is required a significant strengthening of the fiscal and salary policies (in the broad sense, including bonuses and awards of the quasi-wage nature). In this sense, the 2009 budget was an approvable first step, especially because of the relatively high allocation of funds for investment.

In addition to this, the government can also help improve the perception of the foreign investors through measures such as improving the capacity of absorbing EU funds and thus replacing the private external financing with the public external financing or by creating new jobs in the insufficiently exploited areas (infrastructure, tourism, agribusiness), which can take over gradually the role of the engine of the economic growth.

Generally, financing agreements with the international organizations, starting with the European Commission and the European Investment Bank are needed, in order to compensate for the reduction of sensitive private capital inflows are welcome.

As for the National Bank of Romania it remains consequent in its economic growth projection for 2010, with the following arguments:

- lower share of exports in GDP compared to other Central and East European countries, which still have projected a positive growth in 2010;

- the low level of the financial intermediation (nongovernmental credit as a share of GDP), which implies a smaller contraction of the economy due to the financial channel;

- the exchange-rate flexibility, which allows some exogenous shocks to dissipate over the nominal variables (exchange rate), rather than to affect the real economy.

Another set of arguments for maintaining the economic growth in the positive territory is based on the analysis of GDP components (consumption, investment and the net exports):

– as for as the consumption is regarded, in the 2nd trimester of 2010 it is highlighted an increase of the final consumption with 0,4% compared to the 1st trimester of the same year, mainly as a result of the increase in the expences volume for the final consumption of the population (+ 0,8%);

– a negative effect on the GDP had the evolution of the net export as a result of the accentuate glowth of the imported goods and services (+ 24,5%) compared to the exports' volume (21,4%);

– direct net investment show an increase of 1.773 mil. Euros in the 2nd trimester, compared to the first trimester of 2010, when their value reached only 839 mil. Euros.

In the first of 2010, the net GDP's decline continued, but its annual rate reached –2,6%, as compared to – 6,5% in the last trimester of 2009. In the second trimester of 2010, the gross GDP increased by 0,3% according to the datas extracted from the CEB's annuel buletine published in september.

It is expected that at the same time with the resumption of the economic growth, the private sector will record the deficits again. In order for Romania's current account deficit to remain within sustainable limits it is necessary to restrict the budget deficit below the 7.3% of GDP, the entire year.

The government promises to reduce the budgetary deficite from 6,8% of GDP in 2010 to 4,4% of GDP in 2011, to 3% in 2012, and 2,5% in 2013.

In early of 2009, the completing of a multilateral external financial agreement with the International Monetary Fund, the European Union, the World Bank and other international financial institutions took place in the following context:

- a high volatility of the financial markets, characterized by an increased risk of the investment abandon and withdrawal of the foreign investors' capital, especially from the emerging economies;

- combining the effect of the international financial crisis with the following specific macroeconomic imbalances of the Romanian economy:

- share of high current account deficit in GDP (7.3% in 2009) and funding in an increasing proportion of it by accumulating short-term external debt;

- accumulation of short-term debt, mostly private, which has fuelled unsustainable growth rates for increasing the nongovernment credit and the risk of inability of the debt rolling at the moment of amplifying the international crisis and reducing the liquidity on the international level.

From the perspective of the Romanian authorities, the motivations of such an agreement have been and remain the following:

- limiting the impact, of otherwise greater than originally anticipated, of the international crisis over the Romanian economy. Thus, were avoided adjustments that could become unsupported by the population and the economic agencies;

- improving the prospects for development of Romanian economy, sustainability and coherence in the public policies through the commitment to implement some reforms in the areas agreed with the international financial institutions in a given time frame;

- access with relatively low cost to funds for replacing any major reduction in the capital flows towards the Romanian economy.

The agreement with international financial institutions induced a number of immediate positive effects, namely:

- providing resources on attracting external funding through both gradual borrowed resources and through the “Initiative of coordination in the banking field in Romania”, in which parent banks of major credit institutions with foreign capital from Romania have undertaken in the maintain exposure of such groups from Romania and to increase the capital of these institutions to deal with the possible negative effects of economic crisis. Besides, in the first half of this year, the rolling degree for the external dept was approximately 82% above the projections from the initial program signed with the international financing institutions;

- mitigating volatility of the national currency exchange rate, at the same time with the reduction of risks related to the external financing;

- reducing the risk premium charged by the foreign investors in Romania.

Internationally, a number of economic indicators tend to suggest a stabilization of activity. There are, however, a number of potential risks that may slow the current trend:

- revitalizing the U.S. economy and of some economies of the euro area was caused mainly by a temporary measure. The perspective of the very high public debt in many developed countries will put increasing pressure on the interest rates. Thus, the speed of the return of savings could be slowed;

- the effects of the fiscal stimulus in these countries and of the provided financial aid given to the financial sector will diminish during 2010;

- lending will continue to be limited to a medium time horizon. It is expected that the economies in Europe will be the most, affected because the crediting through the banking system is predominant;

- slow-absorption of the unemployed can generate social tensions;

- the regional context is uncertain. The possibility of contagion due to the devaluation of the currencies of the Baltic countries is still relatively high.

Romania’s economy is highly integrated in the EU economy, so any external negative shock will spread quickly internally.

The evolution of the financial crisis

The evolution of the financial crisis will lead developed economies towards a deflationary spiral in the next year or even for a longer period, as deficit reduction efforts will take large, and probably we shall assist to the withdrawal of some weaker states from the euro area.

The growth in U.S. and the euro area was based largely on the consumption and debt over the last two, three decades and everytime the economy has tried to eliminate the excesses and errors resulting from excessive growth of the credit, the

interest rates were low and the debt burden became even greater, notes the analyst. This type of model succeeds on a short term, but in time needs more and more substantial stimulants as to avoid a collapse – “which would actually be just a return to the balance”.

This evolution was facilitated by an “irresponsible approach” of the debt and speculation problem, evident in the ease with which they were saved from insolvency imprudent countries and private companies from Mexico and countries from the Southeast Asia to the fund Long Term Capital Management in 1998. This has contributed to an overall increase in debt burden, accumulated during the credits offered too cheaply. “And now it would be too simplistic and naïve, for the West to believe that can easily escape the sins of excess crediting in the past 20 years” (Nick Beecroft). The major transformation of the private debt into public debt “seemed until now as a panacea”, but cracks in this edifice are beginning to appear, as one can see for the example of Greece.

In the euro zone we could witness the secession of some of the weakest members, which is probably the desire of Germany, as suggested by the German analyst Wolfgang Munch in a commentary from the Financial Times (“Narrow the euro area and established a European fiscal union”).

Conclusions

Romania could face to the economic crisis and succeed on the medium and the long-term in the European Union if it will focus on areas that bring added value, where we are competitive.

The faith of Romania on the medium-term depends on its capacity to support these strategic areas, which bring added value, competitiveness, external orders, and not least, new jobs.

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