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on EU-10 and CIS

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The ICEG European Center issues its monthly publication, which includes 2-4 brief analyses on macroeconomic and microeconomic issues. The publication focuses on two groups of countries: **Commonwealth of Independent States - CIS** (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan) and the ten post-soviet New Member States of the European Union **– EU-10** (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

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About us

ICEG European Center is an independent economic research institute based in Budapest, Hungary. The Center was founded by Dr. Pál Gáspár in 2001.

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Romania – New government, new IMF credit line?

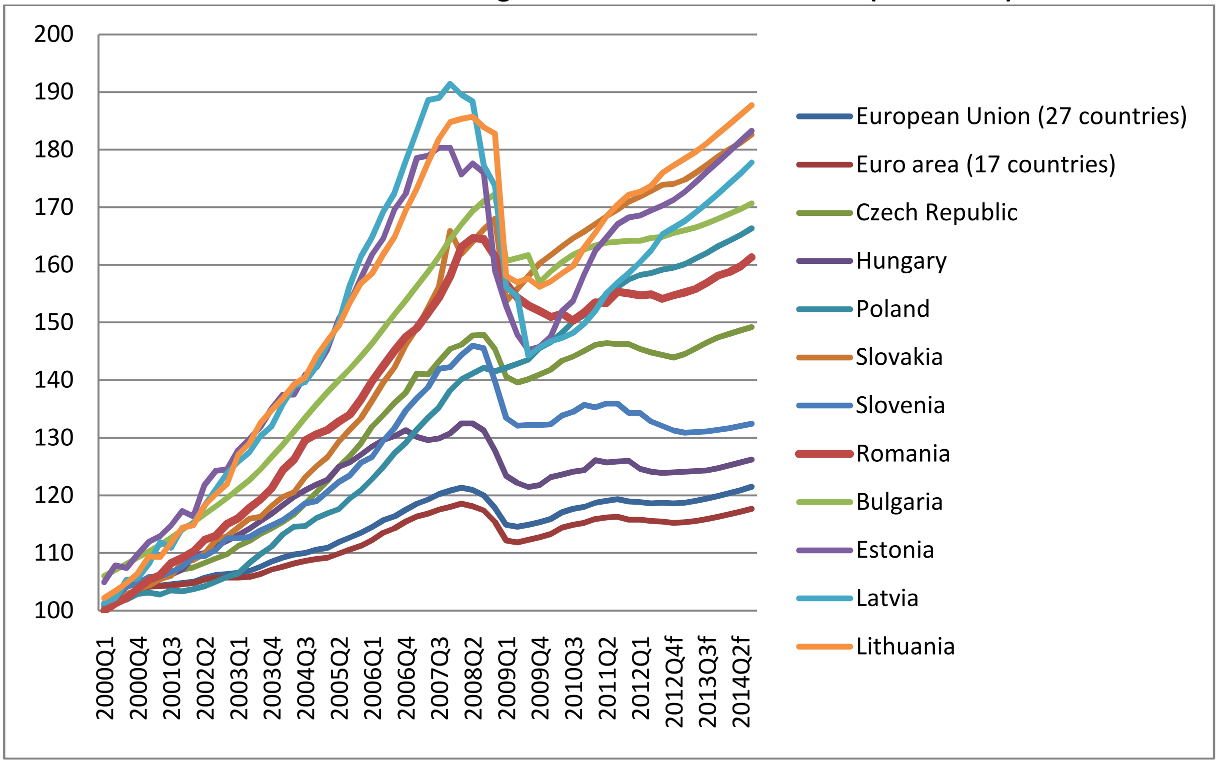
Péter Sulán

At the end of March 2009 Romania signed a two-year deal for 20 billion EUR of which 12.95 billion was financed by the IMF to support the country's economic programme. After 2 years in 2011 the government signed another, but precautionary standby agreement for 5 billion EUR which expires in the spring of 2013.

On 9th December 2012 general elections were held in Romania. The vast majority of the voters supported the opposition and its leader, Mr. Victor Ponta (USL). Before the elections several officials stated that Romania wants to extend the expiring standby loan agreement for another 1 or 2 years. The question is that what Mr. Ponta plans to do and how necessary it is for Romania considering that the country has not yet fulfilled all the requirements of the previous IMF loan.

The country's economy declined by almost 9% during the crisis, but slow recovery started, and according to the European Commission, it is forecasted to grow by 2.2% in 2013 and 2.7% in 2014. Domestic demand is surprisingly strong and gross fixed capital formation amounted to 24.6% of GDP in 2011, which was one of the highest rates in Europe.

Chart 1. Cumulated GDP growth in selected economies (2000-2014)



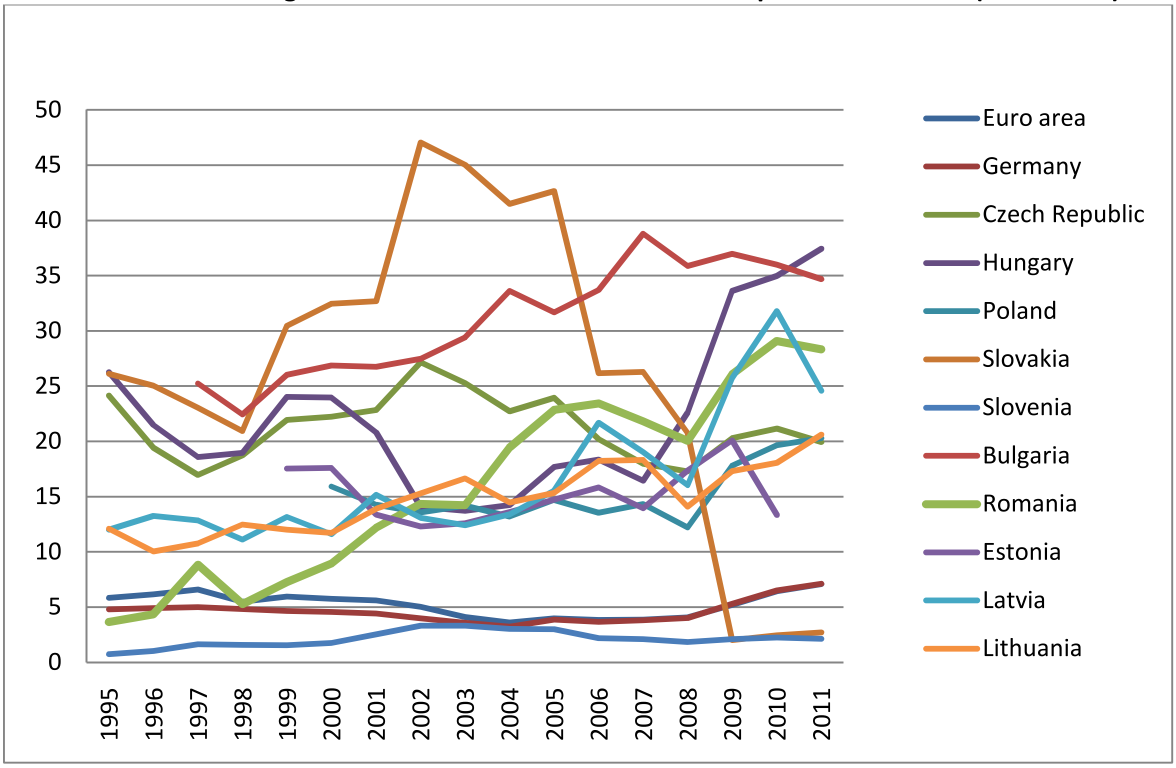
Source: Eurostat, f: forecast by the European Commission

The total government debt rate is among the lowest ones in Europe, it levels around 35% of the GDP. Currently the general budget deficit is forecasted to be 2.8% for 2012, 2.4% for 2013 and 2.0% for 2014, while the National Bank's CPI projection for 2014 is around 3%. If these row numbers are considered, the Romanian public debt is highly sustainable.

Market developments also confirm that. Just after the elections on the 20th December, Romanian authorities offered three-year bonds. The demand was 20 times higher than the previously offered amount, thus the government accepted 11 times more, nearly 770 million EUR. Strong market demand for local bonds is a regional phenomenon however, as on the following day Hungarian ten-year bond yields hit their lowest rate for the past 7 years, while Polish bond yields hit all time lowest rates.

From November 2011 the National Bank of Romania decreased its reference rate (policy rate) from 6.25% to 5.25%. During this period, the nominal RON/EUR rate depreciated by only 4.2%, which shows that this policy is also sustainable. However the strict fiscal policy and the sustainable debt level currently provides comfortable position to the country; the international financial circumstances still represent some risks. In this respect, the level of international foreign reserves is important as well. There are several ways to measure the optimal level of reserves. To compare it to the GDP shows the tendencies and the differences in the selected economies below (*Chart 2*).

Chart 2. Total foreign reserves in selected economies compared to the GDP (1995-2011)

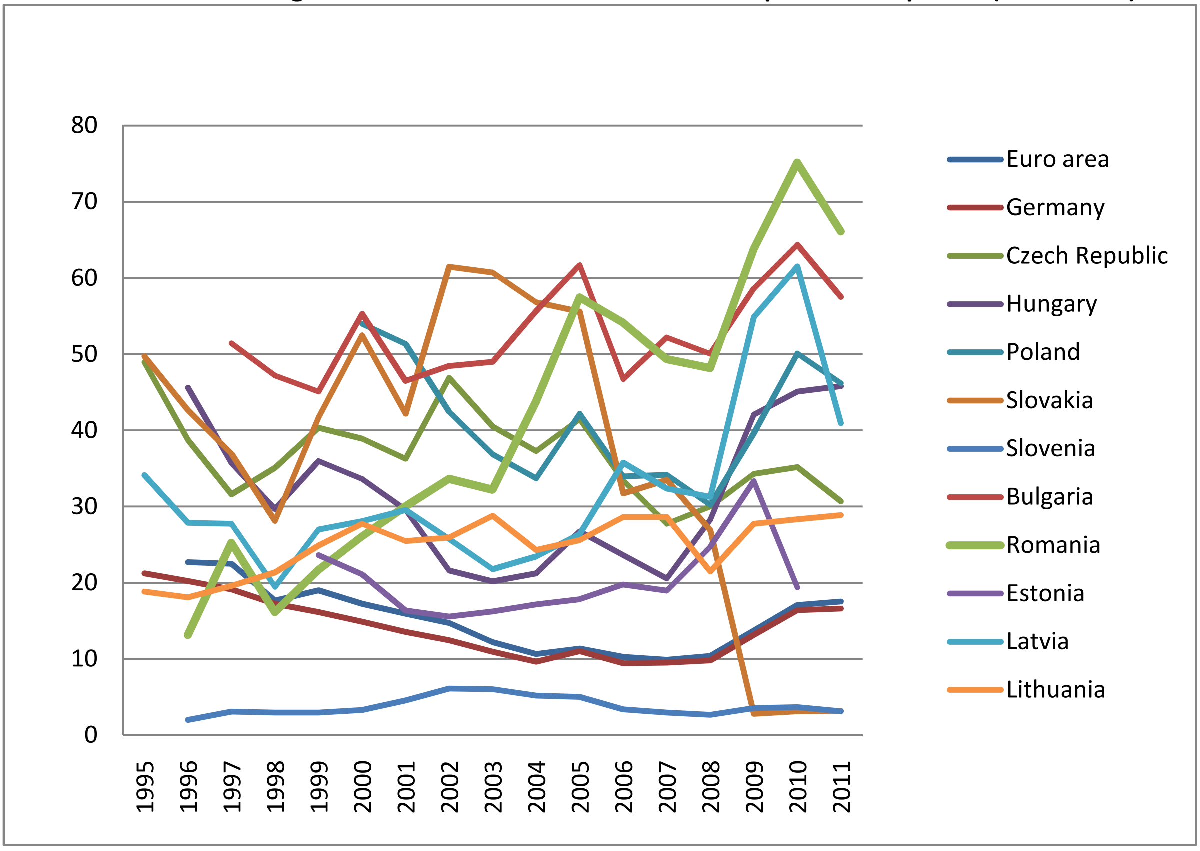


Source: Eurostat

Romania continuously increased its reserves in the last 15 years. By the end of 2011 only Hungary and Bulgaria had greater amount compared to the GDP. Considered that Hungary has to cope with high indebtedness, while Bulgaria operates currency board regime, Romania's reserve position looks secure.

To measure reserves up to the total amount of yearly imports, the comparison to the other countries is even more convincing (*Chart 3*).

Chart 3. Total foreign reserves in selected economies compared to Imports* (1995-2011)



Source: Eurostat; *: Total sum of yearly imports

Concerning the negotiations with the IMF there are some questions. First, the new government will only prepare the 2013 budget in January. Second, there are still incomplete structural reforms required by the IMF for the previous agreement. And third, the European Commission's budget deficit forecast might easily be too optimistic regarding to the new government's yet unknown aims and plans.

All things considered, despite of the pre-election statements, it would not be a surprise if Victor Ponta's new government would not make all efforts in order to get the IMF standby facility for another 2 years shortly.

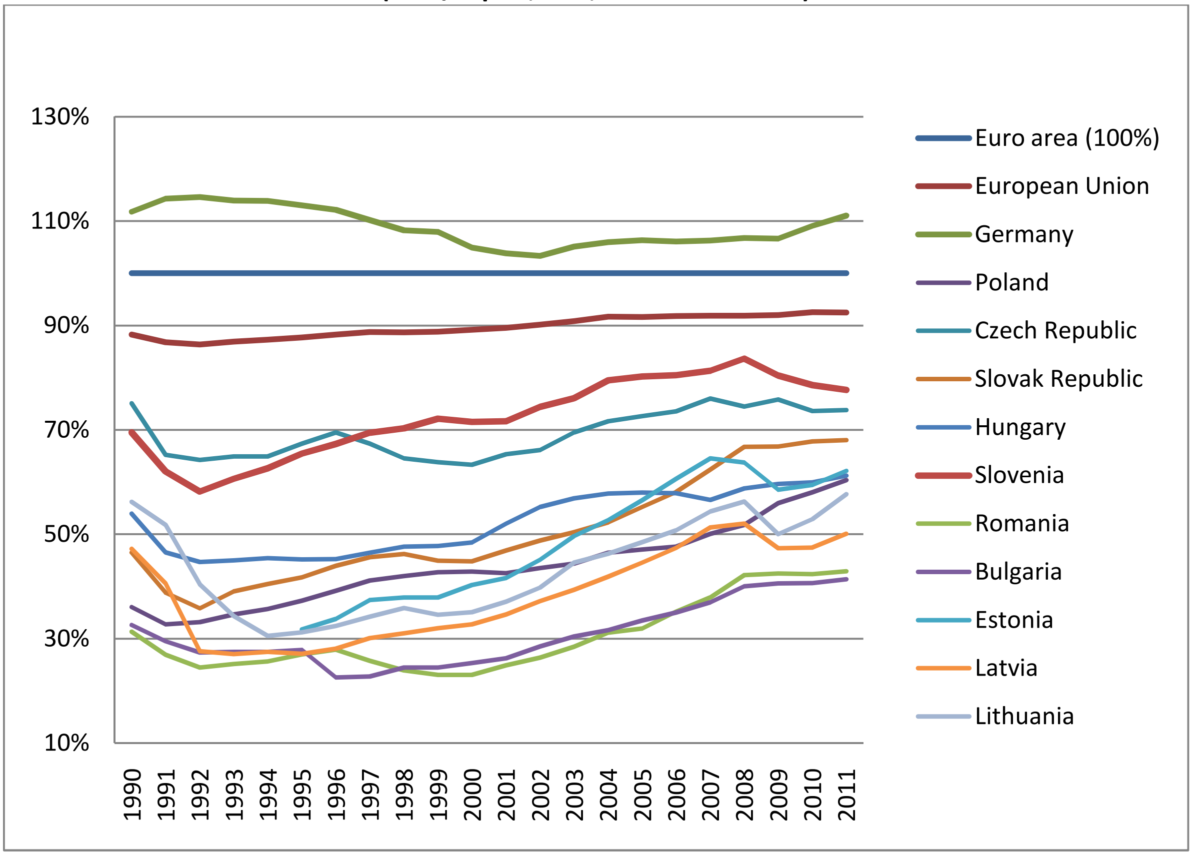
Recession, downgrades and politics – what is the problem with Slovenia?

Péter Sulán

In August 2012, both S&P and Moody's downgraded Slovenia, while S&P placed the country to credit watch just before the first round of the presidential election in November. In the second round on 2 December 2012 Borut Pahor won by more than 67% over the incumbent Danilo Türk. Borut Pahor formerly headed the government from 2008, but he failed to carry out the necessary reforms until the current Prime Minister Janez Janša's coalition overcame in early general elections at the end of 2011.

The country's economic situation is difficult. After 16 years of convergence Slovenia is almost the only country which could not recover from 2008 and still shows sharp divergence form the European Union.

Chart 1. GDP convergence in Central European and Baltic economies (1990-2011)
(GDP/capita, PPP, Euro area=100%)



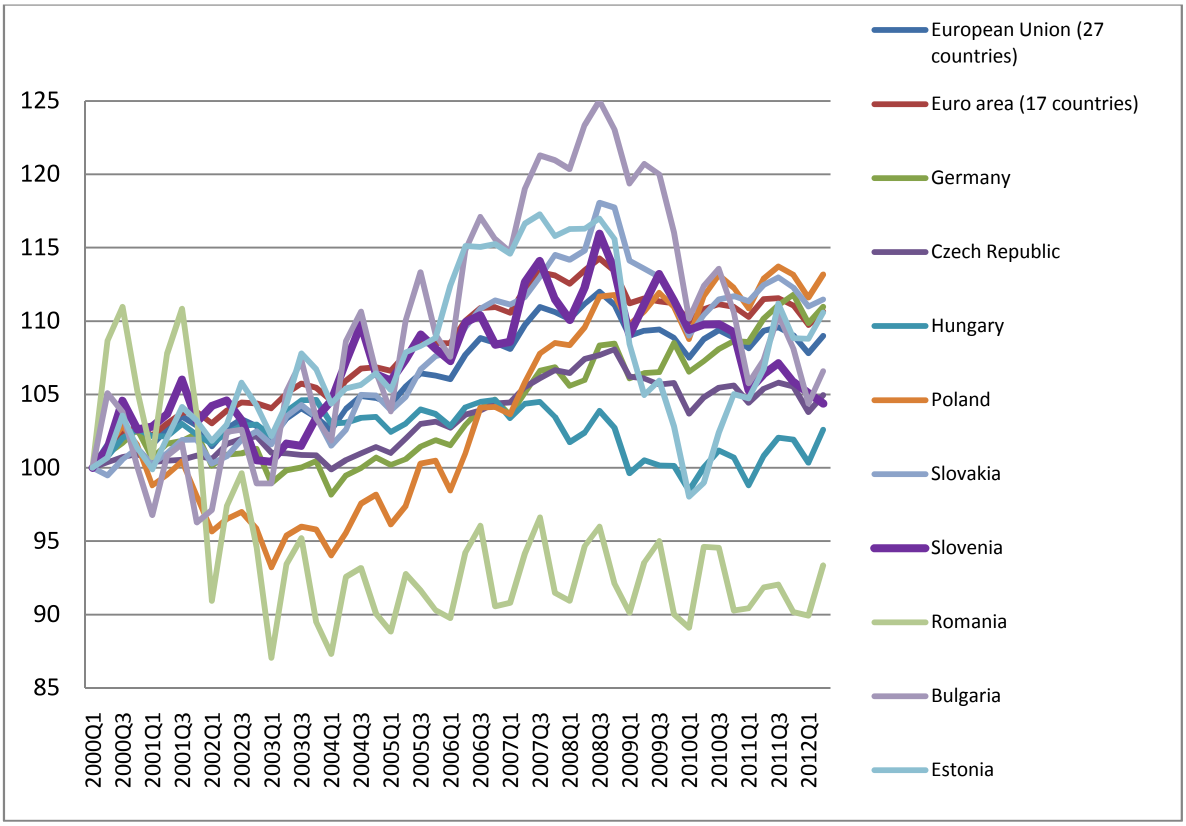
Source: World Bank

The disappointing process is a result of the following factors. Total gross fixed capital formation forecasted to drop from 28.8% of the GDP (2008) to 17.1% by 2012. On the other hand the average rate of Hungary, Czech Republic, Poland, Slovenia and Slovakia in 2012 is 19.9%, thus the difference is only 2.8 percentage point. The picture is a bit even brighter if we look at the details. Investments in dwellings and other buildings hit their peak just before the crisis, while investments in machinery declined much less than the average in Central Europe, and from 2010 to 2011 the rate could even grow. All these considered, the rate of investments in Slovenia is low, but the core problem is not with that.

As in all Central European country, international trade is very important in Slovenia too. The total export of goods and services reached 72.4% of the GDP in 2011. External trade of goods and services has always been balanced during the past 10 years, the biggest deficit was 3.22% of the GDP in 2008, while the highest surplus was 1.44% in 2009. On 1st January 2007 the country has introduced the Euro. In the following 3 years there has been a 10% real appreciation in real effective exchange rate deflated by the unit labour cost, but from 2009 it remained in the same level securing the economy's competitiveness.

Although the unit labour cost stayed in the same level, domestic demand could not swing back after the main shock in 2009, as in other economies it could be experienced. In fact, domestic demand in Slovenia constantly decreases from 2009. In 2012 it forecasted to reach the same level as it was in 2006. The reason behind this is most probably the shrinking number of employed people (*Chart 2*).

Chart 2. Total employment in selected European economies (2000-2012)



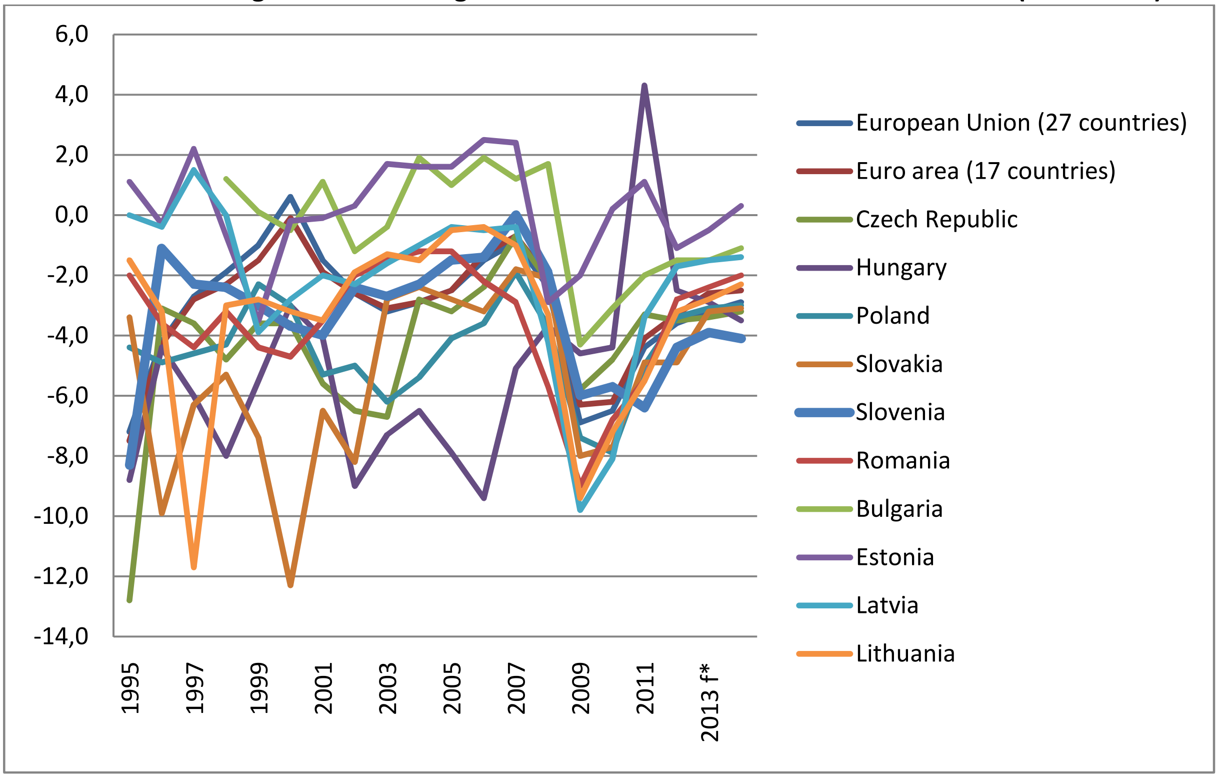
Source: Eurostat; *: Resident population concept - LFS

The rate of unemployment stands at 8.1% which is still far from the worst figures in Europe, but taking into account that Slovenia had one of the lowest rates before the crisis (4.2%), 8.1% is high. The fact that the rate of activity is continuously shrinking (now it stands at the same level as it was in 2004 last time) shows that some things have to be changed in the labour market.

Conforming required by the crisis is hard for the public sector as well. Before the crisis the country was successful in lowering the total government expenditure to 42.5% of the GDP (2007), but it grew back over 50% in the past years. In the same time the total debt of the general government jumped sharply from 22% of the GDP (2008) to more than 50% (!) by 2012. Furthermore, the European Commission forecasts the debt to be over 62% by 2014. The structure of the debt is also unfavourable, over 62% belongs to external creditors. In addition, gross external debt position (including public and private debt) grew significantly from around 60% of the GDP (2003) to over 100% by 2011.

The general government budget deficit is still over 4% of the GDP. As *Chart 3* shows, Slovenia is one of the slowest in Europe in reducing budget deficit.

Chart 3. General government budget balance to the GDP in selected economies (1995-2014)



Source: Eurostat; *: forecast by the European Commission

Thus in general, there are the following core problems in Slovenia.

- Lagging reforms or fiscal consolidation;
- Rapidly growing debt (both public and private);
- Unfavourable debt structure, growing indebtedness to external creditors;
- The country does not seem to be able to stop the growing public indebtedness;
- Shrinking domestic demand is a result of the lacking labour market reforms;

The significant divergence in per capita GDP to other countries shows that the country could not handle the crisis well, and its politicians failed to carry out the necessary reforms. Lagging deficit reduction and indeterminate reform steps make uncertainties stronger.

The newly elected president Borut Pahor's approach is exactly represents what Slovenia needs. He said "There is almost no problem that we cannot solve together" and "It is my proposal that we reach a political agreement of all parliamentary parties".

After 4-5 years of struggle, by now all political groups could experience at least once how difficult is to introduce the necessary measures without the support of different civil groups and the opposition. Cooperation among political powers might be able to make the necessity of the reforms understood to the public and other leading groups. This, and the fast and definite steps are the only hope for Slovenia otherwise uncertainties and economic divergence continues.