

THE FINANCIAL CRISIS AND THE IMPACT OVER THE SECTORS OF ECONOMY

Nistor Ioan

“Babeş-Bolyai” University, Faculty of Economics and Business Administration, ioan.nistor@econ.ubbcluj.ro, 0744574067

Ulici¹⁸⁸ Maria

“Babeş-Bolyai” University, Faculty of Economics and Business Administration, ulici_maria@yahoo.com, 0741278084

The financial crisis is perceived as a tsunami wave started in July in the United States and which is presented on all countries in Europe and around the world. Mortgage crisis has affected indirectly the Romanian economy. The main factor which affected the business environment in Romania is the declining of demand. Banking and financial sector is probably the most affected by economic crisis, being negative influenced by all the negative factors of crisis. This study investigates the impact of the financial crisis on the sectors of economy, because there is ample evidence that the economy is now slowing sharply.

Keywords: financial crisis, economy, interest rate

Code JEL G01 J01 E58

Introduction

The crisis is perceived as a tsunami wave started in the United States and which is presented on all countries in Europe and around the world. "When the crisis arrives in Romania" or "the crisis will be on top in month X" are phrases without value, but we hear every day on television. A closer look can see that economic disturbances started from subprime crisis in United State are only one side of a more complex reality that combine external economic factors with others, related exclusively to the Romanian environment.

Lending with identity card or in very easy conditions was aggressively promoted in the local financial environment, despite repeated warnings of the Nationale Bank. Unstable policy about the first registration fee which has affected the automotive industry in Romania is purely Romanian origin. Irresponsible spending of public money in 2008, leading now to increase taxes on labor (CAS), is again the result of political populism of our politicians. So what is myth and what is reality in the crisis from Romania?

Globally, losses recorded by commercial banks in the world rises, until now, at over 150 euro billion, of which 127.5 euro billion in U.S. only. It is expected that the financial industry to record total losses of more than 705 euro billion. "This crisis has become the new bird flu, that has infected absolutely everything". (Goldman Sach Investment Bank, 2008)

The impact of crisis on the sectors of economy

The main factor which affected the business environment in Romania is the declining of demand. This however must be seen as part of a complex and interdependent set of factors, among which the most important are: the availability of credit, exchange rate volatility, the occurrence of arrears and liquidity problems, etc. All these are the effects of public policy little calculated at the time of their adoption, and a voluntary restriction of private consumption as a mean of protection against the effects of the crisis. The credit strengths for Romania include: increasing EU economic and financial integration that supports investment and microeconomic restructuring, low government debt and support from EU/IMF mitigate vulnerabilities posed by macro imbalances. The credit challenges for Romania include: controlling the budget deficit in the context of an economic recession and limited financing, risks to macro stability posed by

188 Investing in people! PhD scholarship, Project co-financed by the European Social Fund, SECTORAL OPERATIONAL PROGRAMME HUMAN RESOURCES DEVELOPMENT 2007 – 2013

Babeş-Bolyai University, Cluj-Napoca, Romania

deteriorating economy, high external debt and large current account deficit, stalled structural reform process. (Moody's Romania, 2009)

Problems of availability of lending are coming mainly from lack of cash existing on the global financial market. In Romania, the Central Bank increased the interest of reference and reserve requirements for banks to discourage the granting of too much easy credit. The result is a high cost for working capital and to fund investments for institutional clients. For individuals have been tightening credit conditions. 44% of managers in the metallurgical industry, metal constructions and metal products and 40% of chemical industry consider lending availability one of a key issues leading to declining demand in their sectors.

One unknown in the equation of economic crisis is the exchange rate level. In December 2007 the leu / euro was 3.53 to reach 3.92 in December 2008 and then jump to 4.23 in January. Some analysts forecast an average a rate of 4.4 leu / euro for the end of 2009, but the spreading of predictions is very high, which reflects the current state of volatility. In the situation analysis of the NBR in January 2009 show that the evolution of the exchange rate affects 36-45% of companies in the metallurgical industry, textile industry and calculation centres.

"Financial holds" a favorite phrase from the beginning of the past decade, reappears. In 1995, the economy was stuck in huge outstanding amounts to pay between and from the arrears and colosii from unstructured industrials, which spread throughout the economy. Fifteen years later, the forgotten problem of arrears becomes again topical. NBR mentioned in the report from January 2009 that have already appeared difficulties cashing the value of products sold to companies in the chemical industry, construction materials industry, the extractive industry, technical centres of computing industry, machinery industry, equipment and electronic devices (in percent between 29 up to 100%) and 25% of companies in the construction sector. The government included in the anticrisis plan several measures that will help the traffic flow of money, such as TVA's compensation payment and recovered. These measures are beneficial, but might not be sufficient for the market at the moment.

Possible effects of the consumption decline of the Romanian economy were discussed more time. During the years of economic growth, have been told countless times that this growth is unhealthy, unsustainable, based on consumer credit on imported goods. That is why today we have a current account deficit of 13% of GDP. But the problem is a structural and old. There would be no problem if we temporary import more than export, with the conditions that we import also supply of investment that allows a qualitative improvement of goods that we produce (for internal consumption and export) and to attract foreign direct investment in productive activities. Unfortunately, we bought more consumer goods, which we funded from speculative capital (attracted here only by high interest rates and that leave as soon as they are needed in the mother countries) or from the money that have been sent home Romanian workers from EU. Increased consumption until this year did not occur in parallel with a similar increase of domestic supply. Our problem is that this year we don't have from what we fund the consumption: speculative capital leaves, Romanian workers from outside will not easily find work and to export will be something more difficult, because demand has fallen dramatically in countries where our products were selling before (EU). Domestic demand (not only the consumption, but also investment) will drop dramatically to the level which can be funded. In turn, the internal supply will be affected by the difficulty of financing of capital goods.

Investment in fixed capital has formed the second major component behind Romania's rapid rate of expansion after consumption, driven by a mixture of spending on construction activity and capital goods purchases in the industrial sector. It has been supported by the significant net inflows of foreign direct investment into Romania, access to relatively affordable credit prior to recent turmoil in global capital markets, and governmental capital expenditures to upgrade infrastructure. It has also been aided by the recent liberalization of the capital account and the upgrading of Romania's sovereign medium- and long-term foreign-currency securities to

investment-grade (which has now been reversed by several ratings agencies in light of global financial turmoil). Capital spending rose 28.0% in the fourth quarter of 2007 and 28.9% for the year, compared with 19.3% growth achieved in 2006. Higher domestic interest rates in 2008, motivated by the resurgence of inflation, will dampen capital investment growth however, especially coupled with very tight credit conditions on global financial markets. In the first three quarters of 2008, though, gross fixed capital formation was still growing at a very robust 27.7% year-on-year. The industrial sector has benefited from the influx of foreign investment capital, which has driven rapid growth in output and supported considerable investment in new machinery. While this has contributed to the deterioration of the current account in the short term, it should bring about longer-term export potential and is already driving significant improvement in productivity that will support rising real wages and help to keep Romanian exports competitive in what is certain to be a difficult global market. The flow of foreign capital for portfolio investment reached a net US\$1.694 billion in 2005, while direct investment reached a record US \$ 6.373 billion. This covered the current-account deficit almost entirely. In 2006, direct investment capital reached a new record high of 9.1 billion euro and covered around 91% of the current-account shortfall. Increases in the volume and volatility of inflows and outflows of portfolio capital reflect the development of the Romanian capital market. FDI, which does not typically flow in smoothly over the course of the year, was comparatively sluggish in 2007 at 9.06 billion euro, covering a lesser 41.9% of the burgeoning current-account deficit in that period. Foreign direct investment in the first 10 months of 2008 amounted to 8.157 billion euro and was equivalent to 56.5% of the deficit on the current account.

Key Economic Figures	2006	2007	2008	2009*	2010*	2011*	2012*	2013*
Real GDP (% yoy)	7.9	6	7.8	0.4	3	4.9	4.8	4.1
Consumer Price Index (% yoy)	6.6	4.8	7.9	5.3	4.1	3.6	3.2	2.6
Industrial Production Index (%)	7.1	5.3	3.2	3.2	4.3	4.2	3.8	3.4
Foreign Direct Investment (% of GDP)	9.6	5.7	4.4	4.5	4	3.3	3.1	
Foreign Direct Investment (US\$ bil.)	11.8	9.4	8.8	9.2	9.7	9.2	9.3	
Unemployment rate (% yoy)	5.2	5	4.9	4.7	4.6	4.5	4.3	4.2
Trade balance (% yoy of GDP)	-12	-14.6	-13.4	-13.2	-10.6	-8.7	-8.4	-8.6
Trade balance (US\$ bil.)	-14.8	-24.2	-26.7	-24.3	-23.1	-22.2	-24	-26.2
Budget balance (% of GDP)	-1.7	-2.57	-2.9	-2.53	-2.36	-2.2	-1.9	-1.7
Policy Interest Rate (%)	8.75	7.5	10	6.5	6.25	5	4.5	4.25

Source: www.globalinsight.com

Decrease demand has reached historic levels, according to the perception of managers. The bulletin of conjuncture of NBR from January 2009 states that 51% of surveyed managers consider the low demand as the main cause of limitation of production, almost two times more than at the beginning of the fourth quarter of 2008. The crisis is affecting the selective areas of activity. Most affected are firms in metallurgical industry, metal constructions and metal products (about 87% of companies surveyed) and transport industry, building materials, chemical industry. In a lesser extent is affected telecommunications market, where demand remains relatively constant, but it forecast a year with little growth. Voice services market has matured with penetration rate estimated between 90% and 130% and the market competition has become fierce, therefore we see rather optimization of costs, freezing employments and productivity growth. Hope comes from the area data services where there is still a high growth potential, but the development of broadband infrastructure will depend on the allocation of public funds and the capacity to spend for the development of metropolitan networks. Difficulties NetCity underground network in Bucharest are not auspicious, even in circumstances in which the project was granted to a private investor. In the IT area, expect a slow increase of the level of 25% estimated for 2008 to 5-6% in 2009, which will be reflected in postpone the development of new projects and in a slow wage increases in the area.

Companies large of retail / distribution estimates only a cap of demand, but a more important negative impact it would also have high costs of working capital due to interest rate. The retail of electronics products or IT is faced with a more pronounced decrease in demand, plus an unfavorable exchange rate. It is possible that these pressures will lead to disappearance from the market of some companies with smaller turnover. We will see the retail market postpone investments in new stores, although some large retails have announced that they will continue the plans. Greater attention will be given to various performance shops, so those who do not reach a level set will be closed or relocate.

In 2008 the automotive industry was bad, and the prospects for 2009 are still sombre. Association of Car Producers and Importers APIA (quoted by Intellinews) estimates that new car sales fell by 12% in 2008 compared to the previous year with large decreases in the last quarter and will continue to fall with another 50% in 2009. So at the end of 2008 and the beginning of 2009, Dacia (part of the group Renault) was forced to stay. The reduction of working time was necessary in the conditions in which in January 2009 sales fell by about 70% compared to the same period of the earlier year. Dacia announced that it will give up one third of staff if the rhythm is maintained. Auto market situation in Romania is not much different from other EU states. The answer of European governments ranged between subsidies, tax incentives and programs of auto park renewal using the program type "rabla". Romanian government using the first registration tax policy has managed to distort the market with frequent and unpredictable changes. In the crisis program, it included the allocation of additional funds for the Romanian program of renovation of car park. Voices from the area considered that the decrease of benchmark interest rate could have a greater impact as long as 70% of purchases of new cars are made by credit.

Textile industry is also affected by lower demand, especially on foreign markets, against the background of a still unfavorable climate in this sector, for which Romania has become before the crisis a business environment with larger costs. On domestic market, the consumption per capita was very low compared with Western Europe, even before the start of the crisis. Light industry, especially the lohn, was on the downward slope already in previous years, which marked a delocation of production to eastwards, where costs of labor were lower. Increasing taxes on the workforce will accelerate this delocation negating the potential positive effects of a favorable euro course for exports.

Metallurgical industry is also strongly affected by lower domestic and external demand. ArcelorMittal will reduce production in the next period by about 30% and the scheme of personnel will be diminished by one third. Alro has already closed one of the halls of electrolysis and about 30% of staff has leaving voluntarily with compensatory payments or have retiring in 2008. Cuprom has initiated insolvency proceedings and is expected important disposal of personal.

Economic crisis, lack of lending in particular, has severely affected affected the construction sector. For 2009 it is estimated a growth rate of 10-15%, less than 28%, the forecast for 2008. The expectations of entrepreneurs are going to work for infrastructure and industrial construction. The ability of state to use European funds for infrastructure will have a clear impact on the sector, but the speed with which it operates in complex procedures for these programs is not encouraging. Industrial buildings are under questionable sign as long as the main policy of firms in the period crisis is to postpone development and investments plans. In addition investors access to sources of financing will be difficult or very costly in terms of lack of liquidity in the financial system and for individuals the access to credits is more heavy than before, with interests and criteria less encouraging. In these conditions, the situation of the construction and building materials sector is not encouraging. Trends analyzed by INS in a survey of the situation in January 2009 based on the views of managers indicate a decrease in the volume of production and contracts stock for the first three months of 2009 (short-sold 33%, respective -26%) and

reducing number of employees (short-sold 28%). Also it forecast a stagnation of prices of construction works (short of the NBR report) or even an increase of prices of construction works (sold short 24% according to INS).

Banking and financial sector is probably the most affected by economic crisis, being negative influenced by all the negative factors of crisis. Reference interest rate increased from 7.5% in January 2008 to 10.25% in September 2008, being held up at present. In addition, there have increase the obligatory reserves both in lei and foreign currency. The loans had a spectacular fall since November 2008 when for the first time in recent years the volume of granted loans has decreased in terms of the grant of new loans has almost totally frozen. The forecast regarding lending for 2009 is not her best against the backdrop of lack of liquidity and the perception of managers is not positive for either the second part of the year. With regard to savings, develop an increase in deposit-type instruments in December, reflecting an increased attention to the economies of inflation protection, but voluntary restriction of consumption as a way to face the crisis. The level of remaining credit is low, but the upward trend from 1.12% (dec.2007) at 2.23% (dec.2008) of total loans in foreign currency. At the end of January the signals appeared as percentage debtors could dramatically increase in the near future.

In the energy sector, the situation is complicated by the large number of state-owned companies in the sector who play by other rules than the market. In the last quarter did not felt the crisis, but it expect a reduction of activity by about 10% in first half of 2009 (mainly due to low demand from the energy industry), and that in the second half of the year the situation is stabilize. Some of the existing contracts will be renegotiated because of arrears: some of large energy consumers would be unable to pay their debts on time. Available staff are partly caused by other factors, even to a greater extent than the crisis (eg, reducing the number of employees as a result of a restructuring plan for the post-privatization of Petrom, CEZ, ENEL or DistriGaz). Availability of credit market is a problem that will lead to postpone development plans. In the electricity sector up to the end of 2008 is discussed fairly serious about investment projects of up to 20 billion euros until 2016. As a result of uncertainties related to the crisis is now estimating that the total investment in production will not exceed 8 billion on the same time horizont. Exchange rate significantly affects the acquisition of capital goods and raw material (eg gas). Even the state companies make plans to reduce the operational costs by increasing production efficiency.

The transport sector is differentiated affected, depending on the mode. Road transport is most a private sector, it secures most transport services on the market and is full of striking crisis that affects clients. It is expected a large number of bankruptcies, especially among small firms and clients with specialized clients and consolidations to large firms. It is estimated that nearly 10% of the total number of carriers have already bankrupt until February and by the end of 2009 will stop work for 60% of those on the market in mid of 2008. Already the visible reduction of the intensity road traffic in January in Bucharest and other major cities, or around them, before the press and observers, is an important proof (though anecdotal) for what happens in the depth of the economy.

Railway operators, in contrast, faced with poor quality of infrastructure (where maintenance and investment, even the state risk to work worst than before because of efforts to reduce the budget deficit) and the arrears, very likely, from customers, the state-owned companies (mining companies, etc.). Rail freight carriers, unlike the road is not expected to drastically reduce their staff. The evolution of the exchange rate affects everyone and the impact on excise duties (in Euro). Reducing the possibilities of credit on the market strikes on investments in new means of transport - buses, trucks and train cars. Solution seen by operators, especially the road, consists in diversifying customers to reduce the risk of bankruptcy by arrears. Regarding the transport of persons, it is affected differently by road and air: while the coaches have lost customers and from the development of low-cost flights, both operators will be affected by the evolution of demand and fluctuations in fuel prices.

Market value of an investment is by definition oriented to future. It represents the price that someone would be willing to pay for the right over the future economic benefits associated with that investment. And now there is a consensus over the fact that accelerated decline will affect the real economy.

Conclusions

There is ample evidence that the economy is now slowing sharply. Export-oriented sectors are reducing production and the construction industry is faltering. Domestic liquidity has eased somewhat since February but the central bank is still maintaining high rates to support the currency. Analysts expect that Romania to experience a difficult recession in 2009, but the economy should avoid a major collapse due to relatively low private sector debt and less reliance on foreign trade.

The government signed an agreement for almost EUR 20 billion in extraordinary support from the IMF and EU in March following concerns about a rapidly worsening budget balance and reduced external liquidity. The programme should stabilise the government's financial position for the next two years. IMF funds are being used to reduce foreign currency reserve requirements to boost FX liquidity. As inflation subsides, the additional funds should also allow the central bank to gradually reduce interest rates to support an economic recovery.

Bibliography

1. IHS Global Insight Report: Romania (Country Intelligence), 13 January 2009
2. Moody's Romania, Global Credit Research, Credit Opinion, the 6-th of April 2009
3. Estimations of Goldman Sach Investment Bank, 2008
4. www.anti-criza.ro
5. www.bnr.ro
6. www.globalinsights.com
7. www.wallstreet.com
8. www.deloitte.com