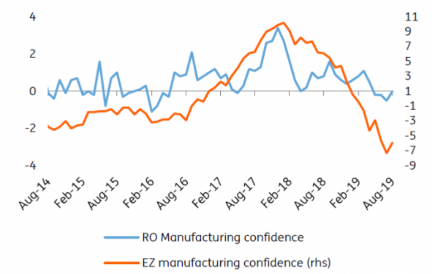
Romania's industrial contraction deepens

Romanian industrial production shrinks by -6.4% year-on-year in July. These are the worst figures in more than eight years and there's no light at the end of the tunnel

Car bodies on the production line at a Ford factory in Craiova, Romania

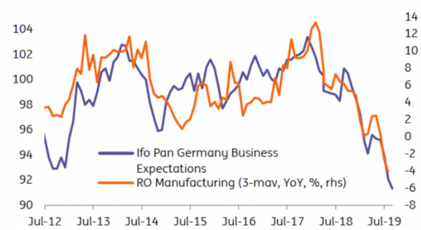
January-July industrial production contracted by -1.4% versus the similar period last year. For the first time since the great recession, high frequency data offers hard evidence of trouble in the tradable sector of the economy. Today's industrial data show annual contraction on all fronts: mining (-7.4%), energy (-4.7%) and most important – manufacturing (-4.4%). To add insult to injury, the previous month's data was revised lower. The manufacturing sector posted a monthly contraction in each of the last three months.

Fig 1 Catching-up with the West ... in a bad way ...



Source: EC, ING

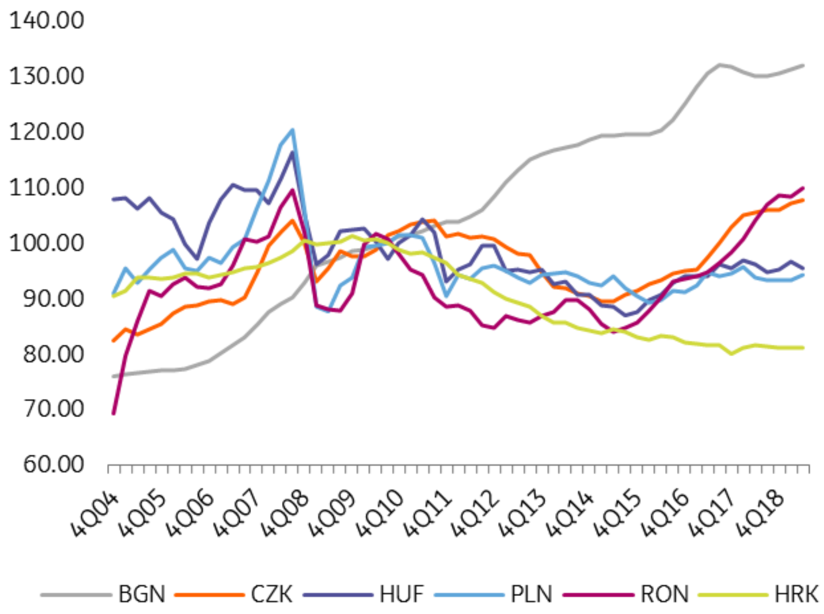
Fig 2 ... as German sentiment sets the trend



Source: IFO Institute, NIS, ING

The external environment can be blamed for the contraction in the manufacturing sector which is well integrated into continental value chains. Given the relative position of Romanian companies on that value chain, their bargaining power in price setting is limited. Add to this the accelerated wage hikes. They increased by 39.8% versus three years ago, mainly driven by minimum wage hikes. That's bitten into the profit margins and outdated public infrastructure affecting efficiency and it all means you end up with a pretty bleak outlook for Romanian manufacturers. To make things worse, the Romanian leu has been incredibly stable against the euro over the last three years, which in real terms meant some competitiveness losses. Unit labour costs (ULC) based real effective exchange rate (REER) strengthened even more during the last few years.

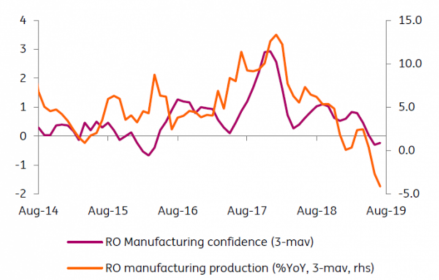
Fig 3 ULC deflated REER: RON getting out of the pack



Source: EC

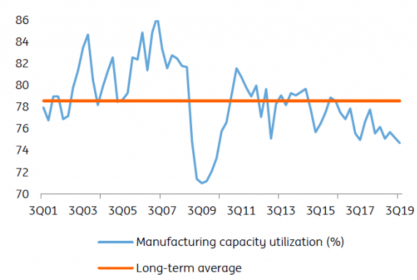
The high-frequency industrial data has been somewhat departing from the confidence data lately. Only in very recent months, producers started to report headwinds coming from the demand side and decreasing new orders. At the same time, shrinking orders are visible in declining capacity utilisation. The ugly picture is completed by employment in manufacturing which decreased by -2.1% YoY in Jun-19 equivalent to some 25 thousands jobs shed by the manufacturers.

Fig 4 Hard data getting ahead of soft one ...



Source: EC, NIS, ING

Fig 5 ... while capacity utilisation declines



Source: EC, ING

We still think that the lagged contagion from softer demand in Romania's main trading partner countries is just starting to show up, as a likely build-up in inventories kept things afloat for a while. Still, we keep our 3.7% GDP growth forecast for the full year as the 4.7% YoY growth in the first half of the year weighs in.

Weaker external demand should be offset by domestic consumption which is still holding up well, though the latest print on consumer confidences is a bit worrying. Net exports' drag on growth is likely to increase. Booming investments in the construction sector, though helped by low base effect and fiscal facilities, have been the main driver of 2Q18 GDP growth. Once the favourable base effect drops out, its incremental contribution from construction to growth is likely to diminish.

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