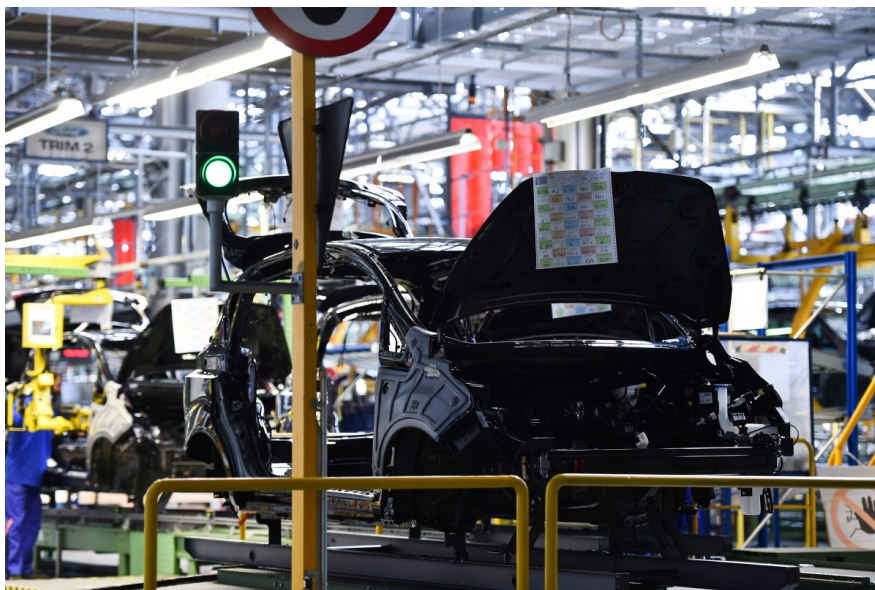


# Romania's industrial contraction deepens

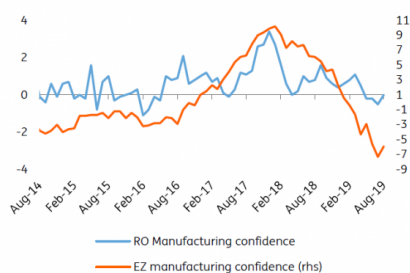
Romanian industrial production shrinks by -6.4% year-on-year in July. These are the worst figures in more than eight years and there's no light at the end of the tunnel



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

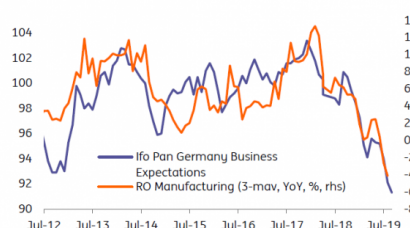
January-July industrial production contracted by -1.4% versus the similar period last year. For the first time since the great recession, high frequency data offers hard evidence of trouble in the tradable sector of the economy. Today's industrial data show annual contraction on all fronts: mining (-7.4%), 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

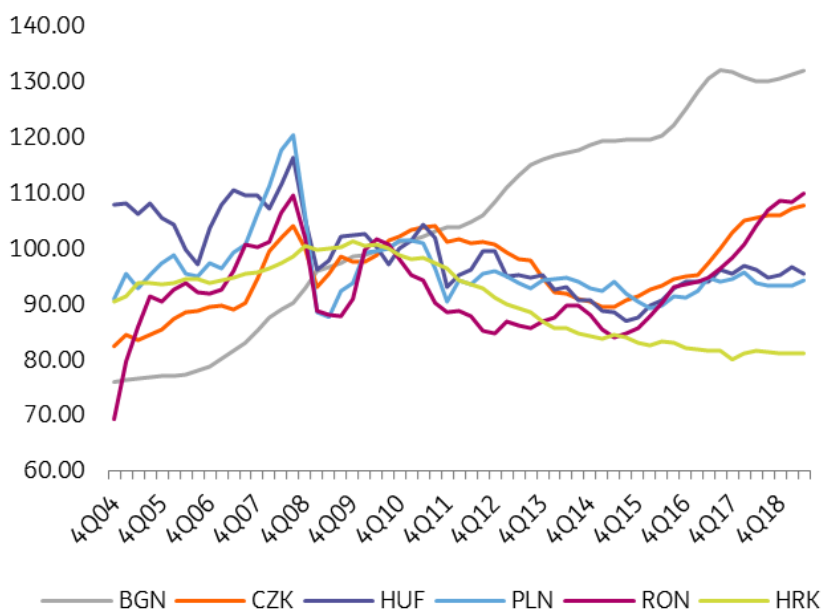
Fig 2 ... as German sentiment sets the trend



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 That's bitten into the profit margins and outdated public infrastructure affecting efficiency and it all means you end up with a pretty bleak outlook for Romanian manufacturers.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.

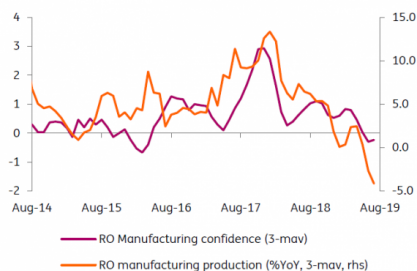
**Fig 3 ULC deflated REER: RON getting out of the pack**



Source: EC

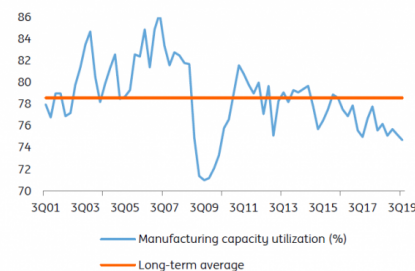
The high-frequency industrial data has been somewhat departing from the confidence data lately. Only in very recent months, producers started to report headwinds coming from the demand side and decreasing new orders. At the same time, shrinking orders are visible in declining capacity utilisation. The 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.

## Author

### Valentin Tataru

Chief Economist, Romania

[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.