Quarterly Report on Labor Market Development and Policies – 3rd quarter of 2008

Outline of quarterly developments in labour market indicators and policies

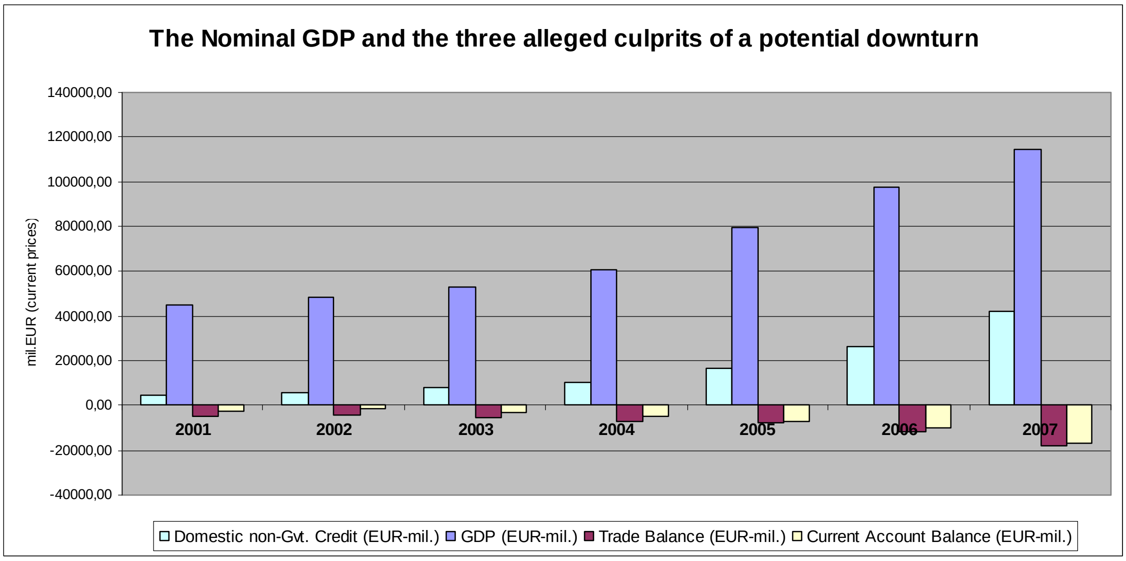
The Romanian economy continued its growth throughout the third quarter of this year, as symptoms of the sharp economic downturn that were to engulf the world economy had not yet shown their bite throughout the summer months.
As the National Institute for Statistics (NIS) has revealed in its early-September press conference and in valediction to the statements made by the SYSDEM correspondent in his previous report, the rat of growth for the second quarter for which now validated date are available, have actually shown a record expansion of the GDP, the largest ever-recorded since such data have commenced their publishing in 1990 of 9.3% on the year early. This is squarely as pointed out during the above-mentioned event, the highest expansion rate in the year to this quarter of 2008, recorded in the whole of the EU, placing thus Romania 7.3 pp. above the average rate of growth for the same period for the whole of the EU-27 and a staggering 664% above the average for the EURO area (=100) which by all counts was already teetering on the brink of the recession to come.
However, inflation driven strongly by the effects of the price of oil, which at the time was barely past a historic height, also ran high, averaging a 8.12% in the year to the quarter with a spark at slightly across the 9% threshold in the year to July, thereby in the just-aftermath of the record levels reached by crude in June, thus coming as yet another confirmation of the imported and largely oil-fired character of the bout in inflation registered since the month of September 2007, suggested by our former Reports to date.
Nonetheless, it was more than clear that the “eye of the storm” was closing by and that the main front was coming to hit, as by the end of September, the exchange rate of the national currency (RON) started to get jittery thus acting as a carrier agent of the economic turmoil, which for crude economic machineries such as the Romanian economy, espouses itself mainly via a run on their national currencies. Therefore, after a period of slight appreciation that accompanied the summer months, the depreciation trend set itself in once again though a true turbulence on the currency markets only came by in early October.
Employment aggregates have shown no significant movement although a slight increase in the National Agency of Employment (NAE) calculated rate of unemployment, which witnessed a constant, incremental increase (3.7% in July, 3.8% on August and 3.9% in September) might signal something of unusual for a quarter that was generally characterised by more-than-depressed rates of unemployment. It is however to be noted that employment and labour market aggregates are lagging variables that trail the cycle. If one of our earlier assumptions made in a quarterly report exactly one year ago, would prove to be true than a slowdown in pace of growth, which would or actually might set-in somewhere in the first six months of the next year will after it bring what I could be a significant bout in the rate of unemployment, maybe even of proportions not seen since the beginning of the current decade.
Nonetheless, it would be too early for us to make any straightforward pronouncements for the truth and the only REAL ECONOMIC truth is that **we do not know** how these economies that barely came out of their Plan to Market Transition would fare in the face of what is for them a “random exogenous shock” of unprecedented magnitude. There are

no data and no evidences upon which to look as early recessions seen by mature capitalist economies during the last half of the twentieth century do not have here, in Central and Eastern Europe any correspondent so to put it. Therefore the most recent evidence of crisis-performance is the one for the Great Depression of 1929-33 and even for this we just have the benefit of works written in its immediate aftermath (1930-1940) and of no comprehensive and analytical work afterwards (i.e.: post-1945). Therefore there are to our best of knowledge 50% chances for either of the two most extreme of scenarios, namely either a complete meltdown of an economic structure that is simply too fragile and too crude to withstand a shock (more fragile actually than in 1929-33 when it had behind at least had a century of capitalist development while now it has a mere of two decades, therefore half the amount of time it *then* had) or that, simply in defiance of the cycle, so to put it, to continue growing, probably at less impressive rates though, simply due to its very low starting point and lack of sophistication. The latter can be considered as a measure of the degree of "insulation" of the economy. Inside therefore such a framework of analysis one should consider the responses that would given in a more elaborate form in the last, additional, section of this Report.
Finally from the policy point of view one has to mention that the Romanian Government has continued its program of pension-readjustment, thus bringing forward the last and final phase of the process of PENSIONS RECALCULATION, including now in the process the so-called "work groups" or the special provisions relating to contribution period and statutory retirement age that were applicable under the pension regime previous to April 1st 2001 (the date when the current Public Pension Act-Law no.19/2000 entered application) to workers in arduous and very-arduous working conditions. In the meantime, it has concluded a pact with both employers' representatives and trade unions for a measured-step increase of the minimum statutory wage, which has not only been hiked starting with Oct.1st this year to RON 540 (EUR 151 at an average market exchange rate for the second quarter) but will also see a constant increase throughout the years to come, with the stated objective of reaching a ratio of 50% to the average gross wage in 2013, a move that would mark a 19 pp. increase from the current ratio of 31%, or in other words a yearly average gain of 3.8 pp. over the coming five years. To what extent such a move will be sustainable remains of course to be seen, but all the odds are squarely against it, to say the least.
As an end of a debilitating saga for an exhausted minority Government heading towards the Parliamentary elections scheduled for Nov.30th, came the resignation of the Minister of Labour, the liberal Paul Pacuraru, which from the beginning of October has been replaced by his party colleague Mariana Campeanu, for the remaining of the Government's term in office.

Update on key economic and labour market indicators

Economic Growth: The Romanian economy expanded by more than 9% (www.insse.ro/cms/files/conferinte/septembrie%202008_Total-presa.ppt) in the year to the second quarter of 2008, its best ever performance since the indicator is as such calculated or in other words since 1990. While this start performance might otherwise have been boding well for the rest of the year, given the current situation it rather gives shivers. It is of course more than rational to expect a strong performance of around the same magnitude in the year to the third quarter, as the crisis was not yet present though some industries especially steel producer were already feeling the pinch of the downturn settling on Western markets but, with domestic demand still strong, the effect must have been minor. However, it is more than apparent than with the end of September this will come to an end. It is hard to tell now by how much will the economy still grow in the year to the last quarter of the year, usually its throughout the year as shown by recent records, but one would be probably more than pessimistic to assume a sharp downturn at once.

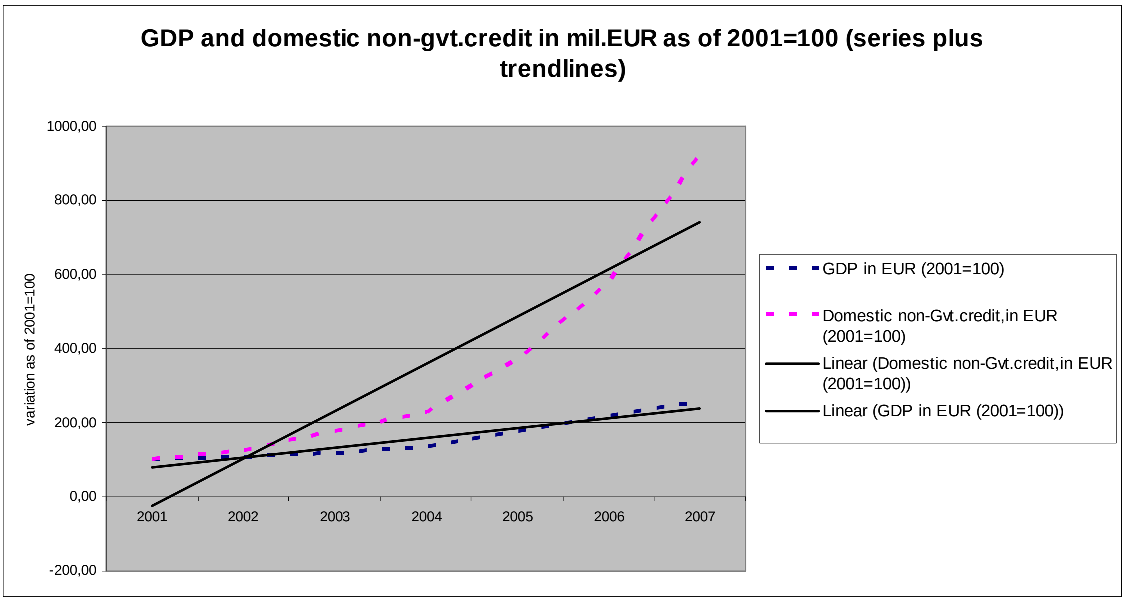
Chart No.1



Source: National Institute of Statistics data processed by Dr. Catalin Ghinararu;

However, in order to give the true picture and also attempt at looking at what most economic analysts have pointed as the systemic risks apparently embedded in the Romanian growth process one would have to look at the several variables that have underpinned the more than strong growth that has characterized the first eight years of the current decade.

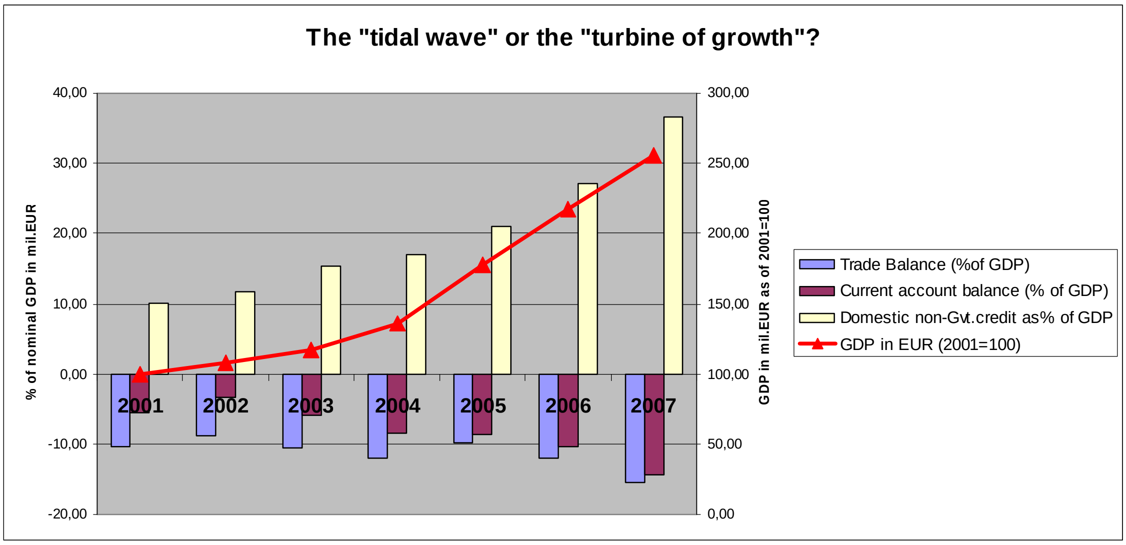
Chart No.2



Source: National Institute of Statistics and National Bank of Romania data, processed by Dr. Catalin Ghinararu;

First and foremost one would have to look as we have more than once said, at the starting point which, in 2000, when GDP expansion resumed after a prolonged Plan to Market Transition, was at such a low that the only reasonable course to expect was growth. The deficit of development, the long-repressed needs all combined with several other inherent advantages of an emergent economy, at which one can of course add the more than favourable international environment with a wealth of cheap capital available, have attracted investors into the Romanian economy, the largest majority of them being direct, strategic ones. This explains the large current account deficit, which is given in the case of Romania, not by some fancy portfolio investments, which anyway would not have been able to found their way into a primitive and poorly developed capital market, but by these very direct, strategic investments. Although the expansion the current account deficit has been substantial, in absolute numbers it is still not large and what is most important, it is given actually not by the flows of capital but by the flows of goods and services. Strategic investors have started modernizing and updating ailing enterprises and installations and thereby, only natural, a flow of capital goods, by al means not to be found and not being produced by the primitive Romanian production apparatus, had to come on the market. This has led to higher productivity, which more than sufficiently explains the expansion of nominal GDP. The fact that economic growth throughout practically the whole of the last eight years has been more than non-inflationary in its character is reflected by the disinflation process that accompanies it all around until the moment when crude prices start their sky-high ascent that has marked the last year and a half. In other words, so much non-inflationary has been the growth process, that until the price of crude did not reach and cross the threshold of 70-75 US$/barrel, the disinflation process has continued unabated. Higher productivity ahs given a boost to incomes, though not that much to employment, which in turn meant that a market that has been long considered as being illiquid started to become attractive for retailers, thereby creating a second engine and most powerful engine of growth, actually one that can help, of course only to a certain limited extent shield against a global downturn, which would hit really bad if the economy would have been over-dependent on exports on markets already depressed. Only unavoidably, the increase in domestic consumption, which has received yet an additional boost from the introduction of the flat-rate income tax in early 2005 (the Government, especially the one that would result from this November's election, would do well to preserve it, as lower taxes are one of the best known and effective instruments of maintaining growth, especially when recession or God forbid even Depression settles in all around!) has triggered the development of credit, an industry largely unknown in pre-2001 Romania but without which a modern economy cannot simply function. The surge in credit has been huge but looking with ore care at the figures we realize that we are worrying about a storm in glass of water. Total domestic non-Governmental credit was at around 10% of the GDP in 2001 and reached around 36% of the GDP in 2007. Short-term credit which is generally associated with consumerism and which is a part of the former was at 1% of the GDP in 2004 and reached 26% of the GDP in 2007. Therefore, while the pace of growth might look indeed scary, the relative numbers show that we are not talking even by far of the scary stories of over-indebtness plaguing the developed economies in the West of Europe or across the pond. We are actually talking of a normal fast-developing economy that needs both some degree of credit as well as capital and goods, which obvious enough it cannot find domestically, in order to overcome its huge development deficit.

Chart No.3



Source: National Institute of Statistics, National Bank of Romania data, processed by Dr. Catalin Ghinararu;

However, while the fundamentals look rather strong, we do necessarily know that investors that have committed their capital into the Romanian economy are dependent in their operations on developments unfolding in the larger and now recession-stricken economies of Western Europe and North America. From hereon, our analysis will have to distinguish in between three major categories:

- investors that are overwhelmingly dependent in their Romanian operations of foreign markets (e.g.: the case of the steel producers);

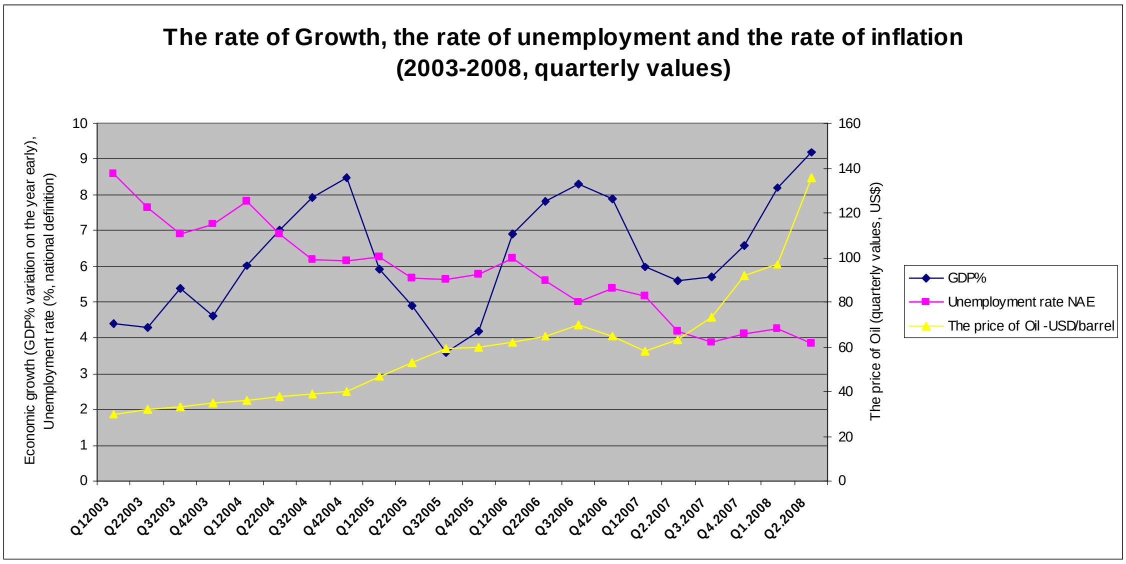
- investors that have a strong dependency on foreign markets but also have either managed to carve or have maintained/taken over lucrative shares of the domestic market (e.g.: the automotive industry);
- The Oil industry.

For the first category of investors effects are already dramatic and some of them have even announced spells of temporary unemployment for their workforce, even starting with the end of September. More such disturbing news followed, especially from ARCELOR-MITTAL, the owner of SIDEX-Galati, in early October. This will squarely mean that GDP growth will falter in the year to the last quarter even presuming still strong domestic demand and unemployment might pick up again.

The second category will also see rather significant losses but if domestic demand is kept in shape via low taxes (the flat-rate income tax) they might whether the storm somewhat better and might shed less labour.

Finally there is Oil and its related industry which in the case of Romania practically represents the largest of the industrial conglomerates the country possesses at he moment. The importance of Oil has been rising constantly and strongly throughout the last years and the rise in its price has affected the Romanian economy in at least two major ways. First when looking at the exports of oil and derivates we cannot help witnessing that in money terms, they are now at almost 300% as against their beginning of the decade levels, while the imports, also in money terms, though of course strongly up as against the commencement of the decade, have taken only 250%. In the share of Romania's total exports from a meagre share of 6% at the onset of the decade oil and derivates have reached now around 10%. Imports in the meantime, grew les impressively from around 12% to only around 13% of the total. This shows only one thing. The Romanian economy has gained more than it has lost from the constant and strong hike in the price of crude. Actually data published recently by the NIS show that for the first six months of 2008, oil and derivates have been ranking top among Romania export's, although in compensation they have been ranking also top in its imports. But while higher oil prices have been feeding into inflation, which not surprisingly has peaked at the beginning of the quarter under analysis as prices of crude topped at 140US$ a barrel, they also and strongly pumped into the revenues of the oil companies, the true majors of Romanian economy and therefore, one can no longer count as a coincidence the fact that GDP expansion peaked, again in conjunction with the price of oil.

Chart No.4



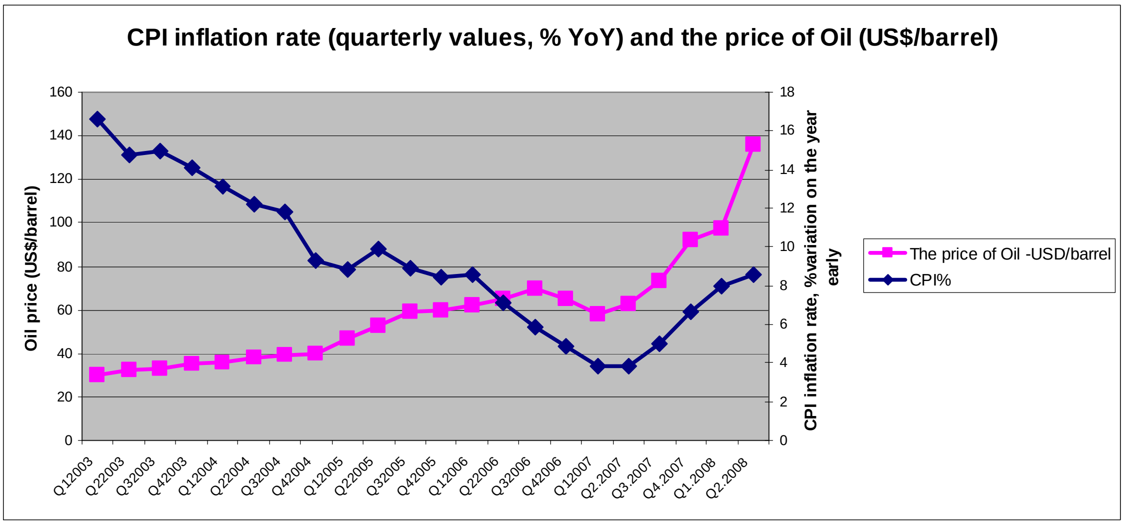
Source: National Institute of Statistics, National Agency of Employment and *The Economist (EIU)* data, processed by Dr. Catalin Ghinararu;

As such and currently, the price of crude acts as the axis of a gearbox pushing the two levers of economic growth and inflation in tow opposite directions according to its gyrations. If the price of crude descends too much (say below 70US$/barrel and stays there for a longer time) then of course inflationary pressures will somewhat ease (they might nonetheless creep in strongly via the exchange rate, yet another thing that oil helped prop!) but, in reverse, growth will begin to falter and falter strongly. Therefore, given the circumstances, one can say that a precondition for the Romanian economy to keep growing, apart from maintaining the strong pro-growth policy of the flat-rate income tax, is that oil price hover around 70US$ a barrel, as it seems that this might be a "*sui-generis*" level of equilibrium (the remark has though to be taken with the necessary reserve as data we do possess are far too limited to consolidate such a statement) at which both inflationary pressures can be reasonably kept in check and growth kept from faltering or falling actually, too much.

So as to end the argumentation we come hereby to one of the few evidences that we do possess with regard to the behaviour of the Romanian economy in times of unprecedented world turmoil (i.e.: with the reservations necessary, the fourth phase of the cycle and the most unknown - *Depression*?) and which dates back to the Great Depression of 1929-33. In 1940, Prof. Virgil Madgearu, one of the few Romanian economic scholars to devote a consistent opus to the behaviour of the Romanian economy during this major slump of the world capitalist development, mentions one for us striking piece of evidence, Oil exports and Oil price! (Madgearu 1940, Slavescu 1935). Then as apparently also now, Romanian economy managed to whether somehow through the maelstrom, anyway better than many other and fair enough to say larger, economies did (e.g.: Germany), also thanks to Oil. Based on such a irrefutable evidence it can be only fair for us to say that the chances of avoiding a recession and even a meltdown *might as well be* pinned again for Romania on one single factor: Oil.
To Watch: Rate of growth in the year to the third quarter of 2008, the price of Oil ad the exchange rate of the national currency

Inflation: Inflation peaked during the third quarter of the year with its preferred measure the CPI index being at all-high for the last more than four years, slightly edging above 9%(www.insse.ro) in the year to July. However, in August and September price increases receded a bit, exactly as oil price started to dip from its all time-high of 140US$ in late June. Although there are also other factors at work, the mere fact that immediately as the price of crude started its downtrend so did consumer price inflation, only serves as to show that the main culprit for the bout in inflation during the first half of the year has been oil price. Of course the fact that the Romanian currency appreciated itself slightly during the quarter under analysis helped also to a certain limited extent but, the sudden bent that practically mirrored the one in the price of oil clearly exposed the root cause.

Chart No.5



Source: National Institute of Statistics data (NIS) and EIU data, processed by Dr. Catalin Ghinararu;

However, conditions will more than change for the last quarter of the year. Prices of crude have fallen sharply to levels half the ones in mid-summer, in the meantime however the currency has taken a brutal brunt in early October which necessitated the intervention of the National Bank. Although it is hard to ascribe the brutal jumps to the contagion that spread through the markets following the meltdown on Wall Street, this ***random exogenous shock*** had nevertheless a significant contribution as the Romanian currency started losing the ground gained during the summer months just as news of more and more losses on the world financial markets was driving investors out of emergent market assets such as the Romanian currency. Nonetheless, what spelled the crisis in early October was the largesse or rather should we say the irresponsibility with which the Romanian Parliament hastily approved a 50% hike of the salaries of teachers, by far the largest and vocal category of public employees. If the measure is pursued to its end, the effects might as well be devastating. It would be therefore for the first time when salaries and their rise could be squarely carry the blame for a surge in inflation that would come both via domestic prices as well as via the powerful channel of the exchange rate which, in the brief history of Romania’s capitalist rebirth after 1989 has proven the most dangerous.

Actually there is quite some analysis that should go around the issues of depreciation of the national currency. In itself, a slight and orderly so to say depreciation that would leave the currency at around or slightly below the threshold of 4RON/EUR would no be totally bad as it will actually act like a sort of a brake on the inflationary pressures simply by making the price of imports look dearer and therefore arresting excessive consumption. In this respect a depreciation against the US$, accompanied by a fall in the price of oil below the threshold of 70US$ would do the trick, as it would also increase the prices for raw materials and fuels, thereby quite significantly dampening demand. Of course this would mean also that economic activity will slow down but so will the rise in prices. Therefore, such a so to say benign depreciation that would actually leave the inflation rate move into a narrow variation band of 6-8% monthly variation on the year early will not do much harm to the Romanian economy on the contrary it might even do some good. One could even say that it might do a lot of good as exports will get cheaper and the trade deficit, which makes for the most of the current account deficit, will narrow, as imports will slow down.

However, it is not such inflation and such depreciation that it is to fear. What might likely happen is a general fleeing of the capital as investors either will, perceive Romanian as a risky, unstable destination, a fact that might well come in if the Government does not attempt a last-ditch defence against unjustified salary claims coming basically from the public sector, or simply as a result of more markets turmoil that will make investors liquidate most of their emergent market positions, with Romania among them. Such a depreciation which would be rather more sharp and disorderly might as well lead to a bout that would send inflation firmly above the threshold of 10% and keep it there. This would seriously harm growth as most of the inputs will become much too expensive and therefore a significant share of the production capacities might either choose to close or to reduce production.

Finally, the most dangerous scenario will be the one where the exchange rate will simply enter into free-fall fact which might as well happen if budgetary largess combines itself with investor panic on a huge scale. Such a ***run on the currency*** is a danger commonly faced by all emergent economies (www.economist.com) and might as well drive the inflation close to 20%. In such a scenario, which might be as well called a doomsday one, unemployment will go sharply on the rise and as said before, the structure of the economy will start dissolving itself. One has to say that given the current political uncertainty and the climate generated by the general election campaign, the latter alternative is not wholly impossible.

To Watch: Budgetary largesse (i.e.: salaries in the public sector) and the exchange rate;

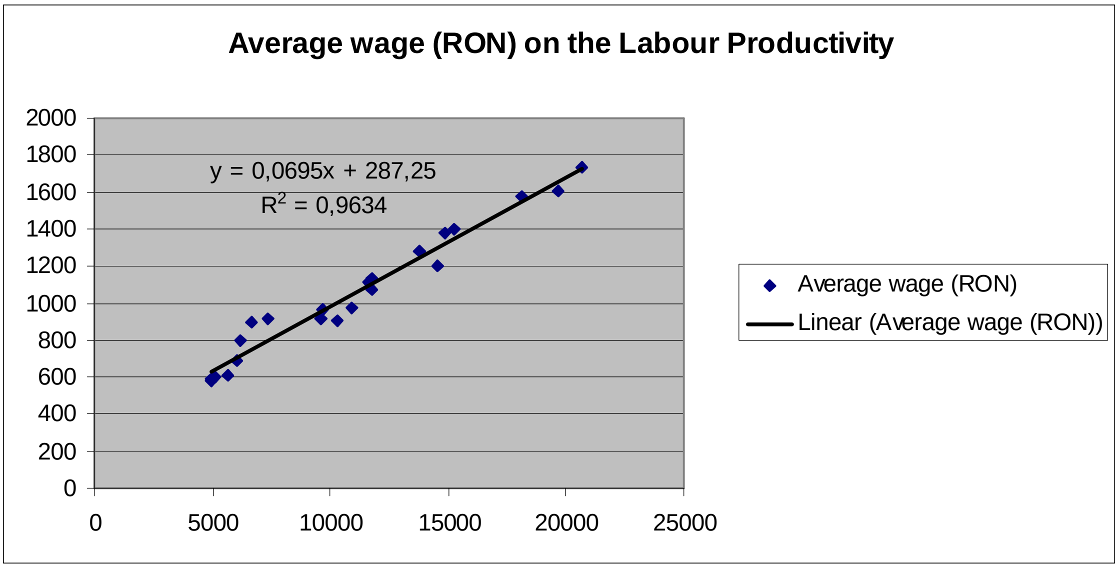
Exchange rate: The RON recorded what could be the last period of appreciation for a maybe long period to come from now on during the summer quarter. Buoyed by revenues including from oil, underpinned by a rather high interest rate o the National Bank and with an image polished by an economy that looked like beating the odds, the national currency appreciated itself both against the EURO as well as against the UD during the three months of the third quarter. However, towards the end of September as investors were trying to shield against losses registered on bourses worldwide, the exchange rate entered a prolonged slump. In three weeks, from late September to mid-October, the RON lost against the EURO a staggering 14%, inching strong towards the dangerous threshold of 4RON/EUR, which would have marked, if reached, a full U-turn to the exchange rate of 2004, thus reversing the whole of the appreciating an thus disinflationary trend of the last years. Perilously enough, the RON also lost ground against the greenback but the effects of this move were more than mitigated by the slump in the price of oil.

However, this move although halted short of the critical threshold of 4 RON/EUR by a massive intervention of the National Bank of Romania (NBR) is hallmark of the developments to come, especially at it was not triggered necessarily by market contagion. On the contrary, its peak was reached when the Parliament actually voted for a 50% hike in the salaries of the teachers. Therefore and as said before, if irrationality will continue, no strength of the fundamentals, which to a certain extent does exist and is embedded in the very crudeness of the Romanian economy and not even a rather favourable evolution of the price of oil will manage to save Romania from what is going to be a ***self-induced*** inflationary meltdown. It has to be understood that a strong depreciation of the national currency is not going to lead just to an increase of consumer prices, with this being the lesser-most of evils to be unleashed as such, but it will make inputs so expensive for productive activities inside the economy, which are preciously few, that most of them will be forced to close down. Therefore, depreciation would run the risk of both re-igniting inflation and fuelling into unemployment on a scale not before seen, even in the nineties. The mere fact that following such a meltdown, inflationary pressures will finally get subdued (the sheer contraction of the demand will make its effects visible) will prove of little consolation for at that moment there will little left from the Romanian economy, except probably its subsistence agriculture.

To Watch: ***Again*** budgetary largesse and ***again*** the price of Oil! The evolution of the exchange rate throughout the month of November, when elections are due will be offer crucial leads into the shape of the things to come.

Wages and productivity: Wages have been for long blamed for being one of the feeders of inflation. However, it is to be mentioned that a simple look on he figures will prove such a statement more than wrong. The actual wages have, at least for the last 23 quarters, placed themselves below what would have been their trend-line growth, admittedly a strongly ascending one. Only for the last three of four quarters in a row did the actual values for the average gross wage, the preferred measure, surpassed the trend-line. In the meantime, productivity, as expressed by the consecrated measure of GDP/worker has been for the same period with its actual values mostly above its trend-line. Of course one could and would surely add that the same data for the same period of 23 quarters starting with quarter 1 of 2003 shows that for most of the time the increases in salaries have more than exceed the conventional benchmark of the Sum or Productivity and Inflation, the mere fact of which would prove that indeed salaries and their growth is inflation-generating. Nevertheless one would have to compound all these with a third element which is the constant trend of disinflation which has marked practically the whole of the interval, until the very moment when the price of crude has hit an bypassed at a speed what we have called the critical threshold of 75-76US$ per barrel.

Chart No.5



Source: NIS data plus the calculations of Dr. Catalin Ghinararu;

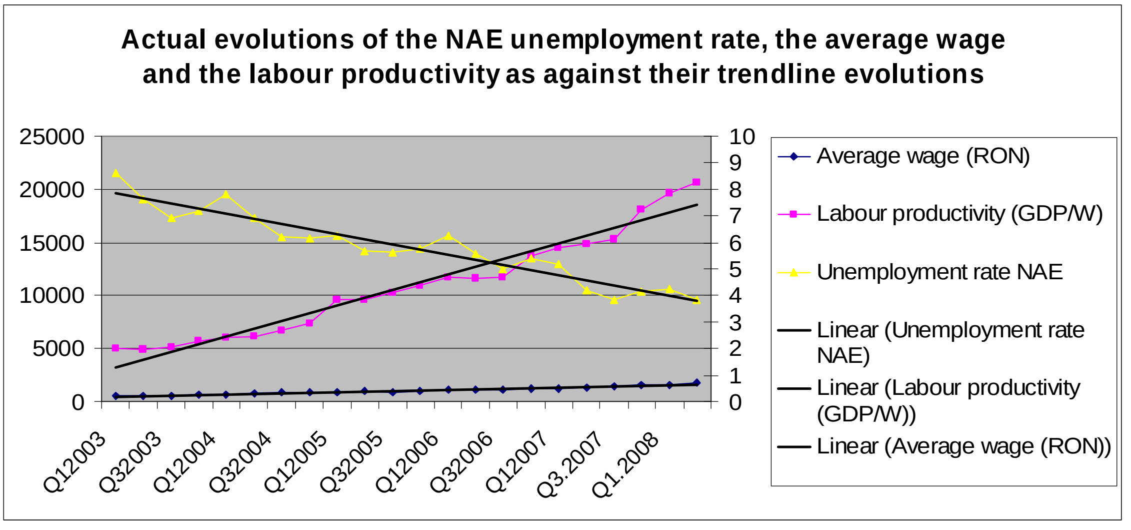
As such, it is clear that salaries cannot be hold culpable for the bout in inflation. The rather marked increases surpassing constantly the benchmark of the Sum of Productivity and inflation have been more than offset by the meagre values of the salaries in absolute terms. Thereby even if relative increases have been looking as substantial, the absolute amounts were still nimble and therefore more than possible to finance from the gains in productivity, even if, by contrast and in relative terms of course, the latter were looking as the pauper of the process.

However and in a thoroughly unexpected U-turn for the worst, the landscape changed dramatically during the third and beginning of the fourth quarter of this year. Romania's minority Government, encroached ever more strongly as elections are looming closer has yielded to the pressure of the Unions. In July this year it has made a binding pledge (formalized by Government Decision) to raise the national statutory minimum gross salary from a ratio of 31% to the average wage at the time (i.e.: July 2008), to a ratio of 50% to the average wage in 2014. This would call for an average yearly hike over the next five years of 3.8-4 pp. It is even for a neophyte hard to imagine where from with a world economy in tatters, a currency hanging from a thread and an economy that was never tested in times of crisis and of the behaviour of which in such times nobody knows anything practically, will any of Romania's future Government find the resources to abide such a pledge. In the short term of course this has meant that starting with Oct.1st 2008, the minimum wage has been increased to RON 540 (EUR 154 at market exchange rate when the pledge was made and EUR 138 also at market exchange rate, therefore already **11% less(!)**, when the pledge had to be and was duly and unfortunately honoured).

As a or actually *in continuation* to what can be called a true debacle in terms of salary policies, the Parliament has adopted the (in)famous law that increased the salaries of

teachers in the public education system by 50% thereby laying the foundations for more inflation and depreciation to come.
To watch: If the future Government will not renege upon the first pledge and will not reverse the second and even more dangerous one, inflationary meltdown will settle starting with the first quarter of next year or even possibly earlier. In such a case not much would remain to do. As said before, inflationary meltdown will trigger economic downturn, even possibly a collapse of economic activity and thereby all gains in productivity, which to date are real and significant, will be nullified. Needless to say so will be the apparent gains on the paycheque.
Unemployment rate: The Unemployment rate by both of its measures, the national definition one and the LFS one is low. Actually, by the national definition rate one can talk as well of a historic low of no more than 3.8% as an average for the quarter (www.anofm.ro).
Nonetheless, one has to say that while in the third quarter of 2006, the national definition unemployment rate was displaying a monotonous decrease, during the somewhat stable while during the third quarter of this year it has recorded an increase although an incremental one. However, it is to be noted that the increase has been constant for the three months under analysis. This might as well be a signal of the things to come. It is therefore likely that given the stoppages announced by a host of large employers among them being the DACIA-Renault and the SIDEX-ARCELOR-MITTAL, which true have stopped short of lay off now but might as well be forced if the downturn continues to actually lay off workers as well as considering the general slow down that will for surely affect the dynamic sector of construction, that the fourth and last quarter of the year will bring a continuation of the rising trend in unemployment.

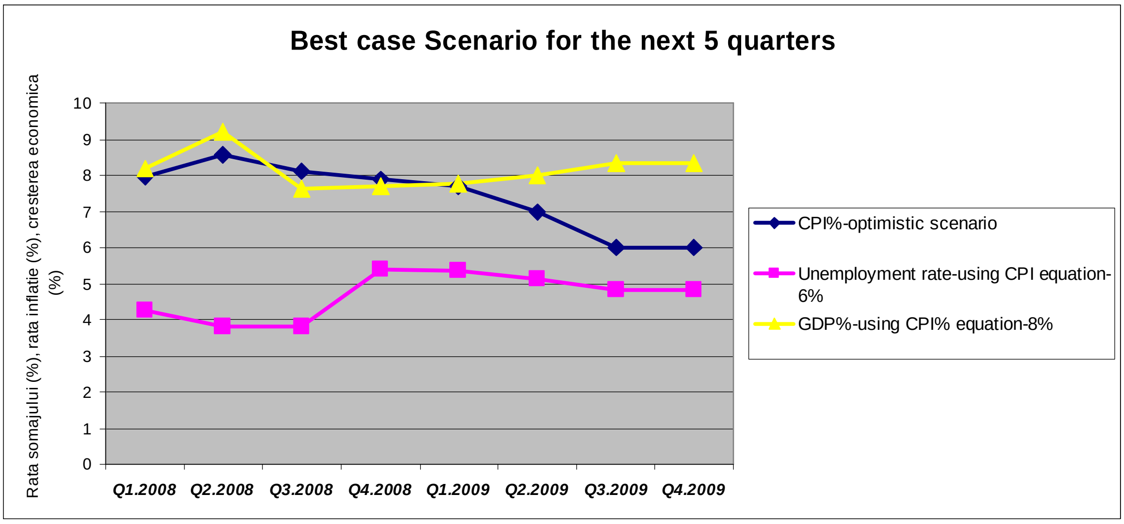
Chart No.6



Source: NIS data processed by Dr. Catalin Ghinararu;
However and as said before the great danger for the Romanian economy comes from instability and unpredictability which might as ell force the investors to take drastic moves and leave a place where returns are diminishing and inputs, crucially among them labour, are becoming too expensive to cope with on a global market gripped by recession. Therefore and taking from the analysis done in the paragraph on inflation one might with respect to unemployment outline three scenarios:

1. Depreciation will not get out of hand and thereby inflation will not go too much on the rise thereby signalling investors that the market is still safe and stable and therefore it is worth staying here and providing jobs. In this case unemployment rate might as well be stable and its measure by the national definition will not go over 5%, at its most and that even taking into account an unavoidable slowdown due to global recession.

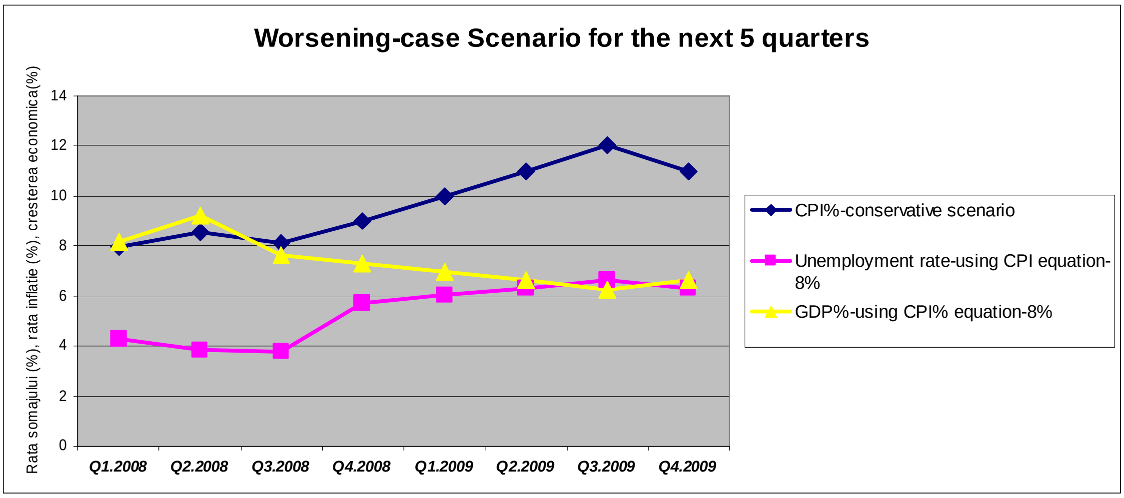
Chart No.7



Source: calculations of Dr. Catalin Ghinararu;

2. Depreciation will accelerate as a result of world market turmoil and even if conditions domestically will not deteriorate that much, still some large investors will be obliged either to partially shut down or to drastically reduce output due to a general contraction of demand. Such a scenario which would entail a rate of unemployment well over 6% would be rather more dramatic but given the fact that already some large companies have announced partial closures, not totally impossible. A slowdown in construction might as well worsen the prospect as already the real state market shows marked signs of weakening.

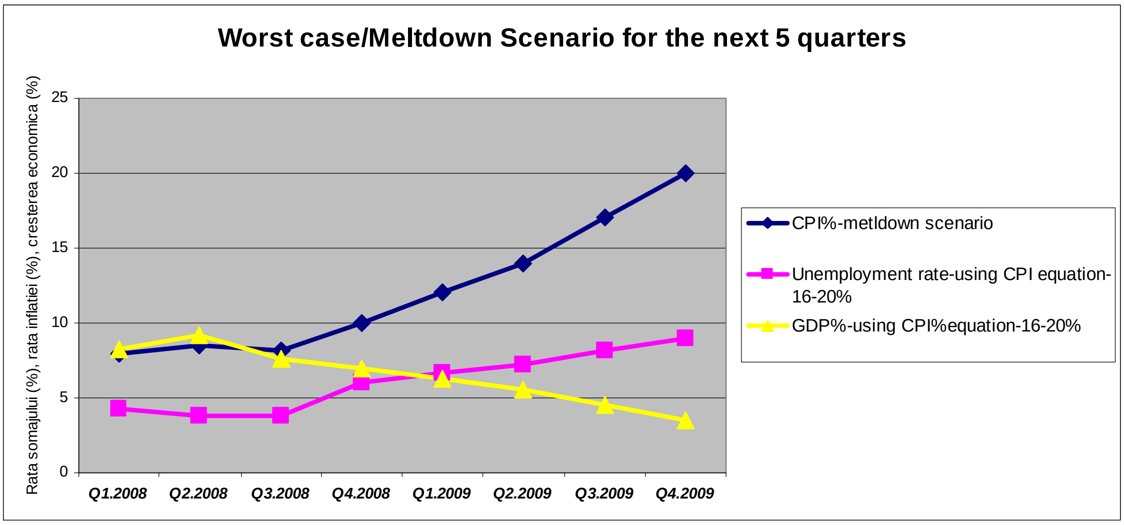
Chart No.8



Source: calculations of Dr. Catalin Ghinararu;

3. The final scenario which might emerge if salary increases get out of hand and a run on the national currency is precipitated by worried investors, is GDP growth sagging to as low as 3% towards the mid of the next year and as a consequence unemployment rate, even by the national definition measure, surge towards 9-10%, therefore to values not witnessed since the massive lay-offs of the last wave of Transition restructuring in the late nineties.

Chart No.8



Calculations of Dr. Catalin Ghinararu;

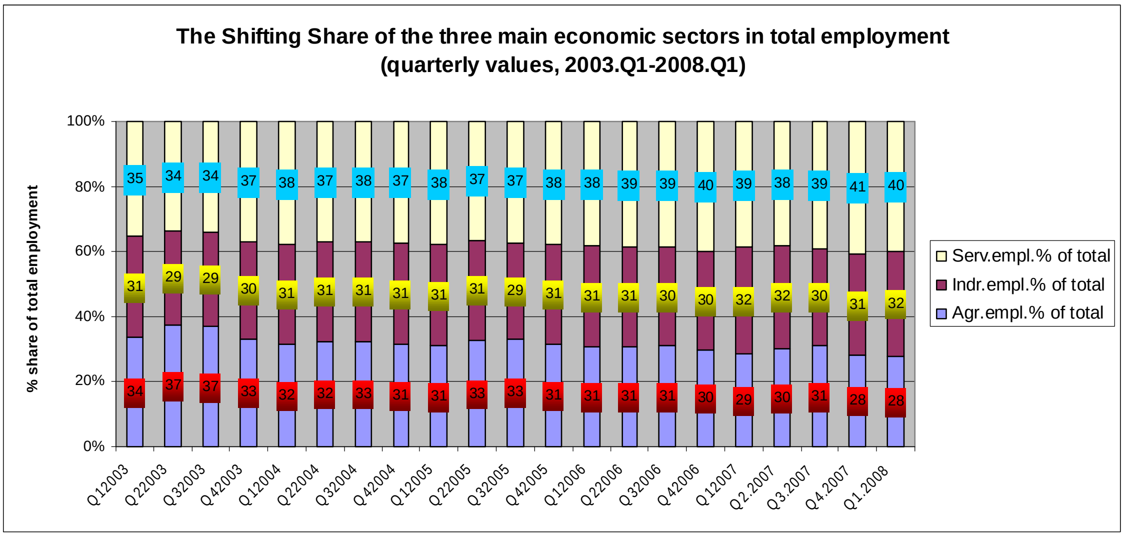
One has to say that the National Agency for Employment is ill equipped to face such an eventuality. Even as we are writing these lines and as some large companies are announcing partial stoppages due to shrinking demand, the National Agency for Employment is witnessing a massive reduction of its staff, by a few hundred employees, which are redistributed towards other services and agencies of the Ministry of Labour.

Moreover, as already planned, starting with the 1st of December, the contribution rate for the unemployment insurance fund will be slated to a combined (employer + employee) 1%, a fact which in itself might mean that when funds will be badly needed they will not be actually there. It will be therefore more than difficult for any Government facing recession and therefore a need to come out with a stimulus package for embattled enterprise while in the meantime facing the also-pressing need of coming with some active labour market policies for the growing number of unemployed to actually start raising again contribution rates. It will only send the economy deeper into recession and unemployment rising. It is thus another effect of the pro-cycle policies of excessively reducing the contribution rates when there was no need for that and about which the SYSDEM correspondent has been warning for some time already.

To Watch: Growth throughout the third and fourth quarter of the year and the exchange rate of the national currency;

Participation and Employment rates: Participation and employment rats did not practically budge throughout the second quarter of the year for which we do have now validated data of the LSF provided by the NIS. Practically all the aggregates are hovering around the levels they are registering already for a couple of years in a row, although the shift in the structure is more and ore visible with the services sector becoming the leading employer, the agriculture on the downslide and the industry consolidating its position, even becoming for the first quarter of the year for which we do have also detailed data, the main driving force behind the growth in employment on a quarterly basis. The only aggregate that has shown a more marked move has been the unemployment rat which has fallen by almost a full percentage point to what is so far its lowest of levels in 23 quarters in a row that is since the first quarter of 2003. Of course one has to take into account that these are data for the second quarter of the year when the economy grew by an astounding 9.3%. It might be of course that figures for the third quarter will be still looking pretty much the same as the crisis was not biting yet but as said earlier, the fact that registered unemployment, usually at its lowest during the summer quarter witnessed an increase, although from a historic low, means that also the LFS aggregates might as well point towards, though, one has to take into account that these are strongly lagging variables.

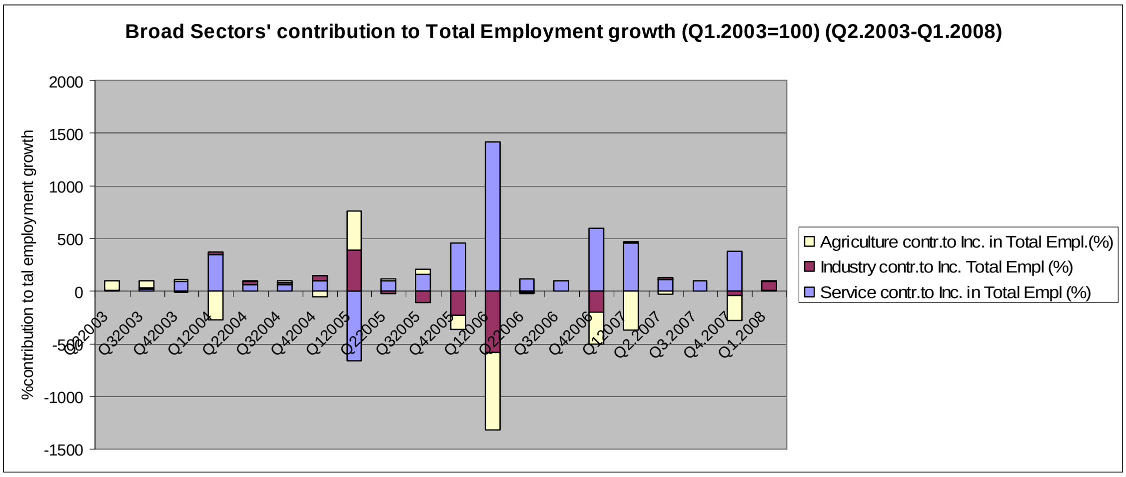
Chart No.9



Source: NIS data processed by Dr. Catalin Ghinararu;

The very fact that figures for employment and labour market participation practically do not budge show actually that at the current levels of productivity the maximum of employment generation capacity has been reached. The strong correlation between the rise in labour productivity and the deficit of the current account for the last of the 23 quarters, given also the fact that the latter is made up largely of foreign direct investment and only to a lesser extent of portfolio investment, is an illustration of the fact that investors have poured money into the productive ventures they have either acquired or built from scratch in Romania. This is also reflected by the deficit of the trade balance, yet another variable which also more than sufficiently explains the surge in productivity, thereby confirming that large quantities of modern equipment and technology have been brought to Romania. This not only had an effect on salaries, which also for the last of the 23 quarters in a row have seen their surge more than sufficiently underpinned by the rise in productivity but also on total employment, where, overall figures have been maintained at the same level of around 9 million reached after the end of transition restructuring, while the structure has dramatically changed, with the agriculture being replaced starting from the beginning of 2004, by services as the main provider of jobs. As such, although expansion demand has not been strong, replacement demand more than made the difference. Accordingly, it is more than reasonable to assume that given the tremendous amount of investment committed during a short period, investors will try now to reap the benefits or to get a return on investment which is just another normal law of capitalist production. Consequently, even in the absence of an economic downturn the flow of investment would have been expected to falter as investors were concentrating on getting the most out of what they have put in. Therefore, it would have not been anyway expected to register anymore increases in total employment, just maybe a continuation of the shaft in structure as the subsistence agriculture would have continued to release labour towards the growing sectors and recently more and more towards the resurgent industry. However, this thoroughly positive trend which would have led maybe in a few years even to the emergence of a significant expansion demand might be thoroughly interrupted by the financial crisis. This expected downturn which might as well last quite a significant period of time, will for sure see if not necessarily a renewed surge in unemployment, though one has to understand that unemployment will be on the rise with the only question being the pace of the rise and its expected duration in time, for surely a thorough stagnation in employment generation. This would mean that even the replacement demand that has so far sustained employment and especially has been responsible for the shift in the structure in employment which in itself has signalled a thorough modernization of the Romanian economic apparatus, might slow to a crawl. In the meantime, as our correlations shows, high or rather higher unemployment might be as well accompanied by a resurgence of the agricultural subsistence employment, which once and again will act as a last resort buffer of the labour market, thereby withstanding for the shock, in the same manner as did during the peak of the Plan to Market Transition restructuring. Such an evolution if confirmed of course by the events, will allow again Romania to weather better an eventual prolonged downturn of the world economy, thus showing that the existence of such a sector is not necessarily just a drag on the economy or like in most of the instances in economics, not one in absolute terms.

Chart No.10



Source: NIS data plus the calculations of Dr. Catalin Ghinararu;

To Watch: Evolutions of employment aggregates during the third quarter and the pace as well as the magnitude of lay-offs during the final quarter of the year when the crisis already started to show its grim face.

Vacancy rates: Vacancy rates for the second quarter of the year, have shown, according to the NIS, a slight decrease as against their level during the first quarter, being now at 2.02, down from 2.14 for the first quarter of this year and what is more down rather more sharply from its all-time since the indicator is being calculated by the NIS (Q1.2005), reached during the second and third quarters of last year when the indicator has been at 2.12-2.19 and when talks regarding the deficit, always thought by the SYSDEM correspondent as of poor substance or rather shallow to user a term of the markets, were at their peak. Now this all might as well enter a full reverse.

To watch: The value of the indicator for the third and especially for the fourth quarter!