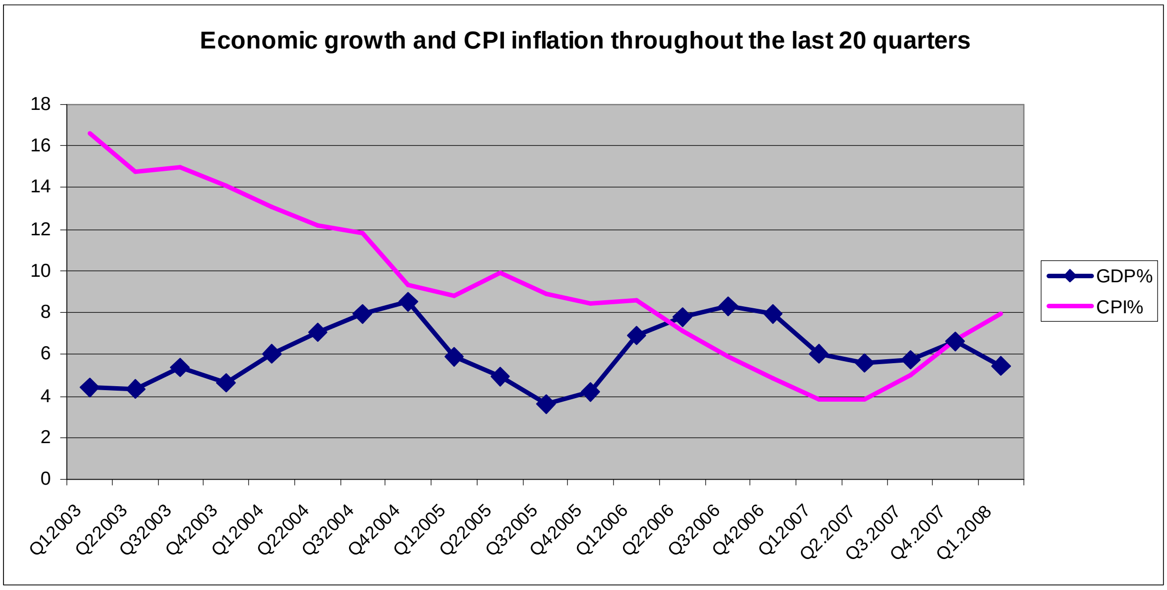
[Quarterly Report on Labor Market and Policies Developments – 1st quarter of 2008]

Outline of quarterly developments in labour market indicators and policies

The Romanian economy continued to grow throughout the first quarter of 2008 one would say in spite of the growing signs of gloom pervading the world scene. However, our forecast shows that GDP growth in the year to the first quarter of 2008, should not have exceeded something in between a 5.3-5.9%[1] range, with the trend being a downwards one and pointing towards a range of between 5.3.-5.6% for the end of the year, provided that no major derailments occur. Such a forecast would be in line with most of the forecasts that have bee circulated around, including the ones of major multilaterals, one of them being the IMF.

Chart No.1



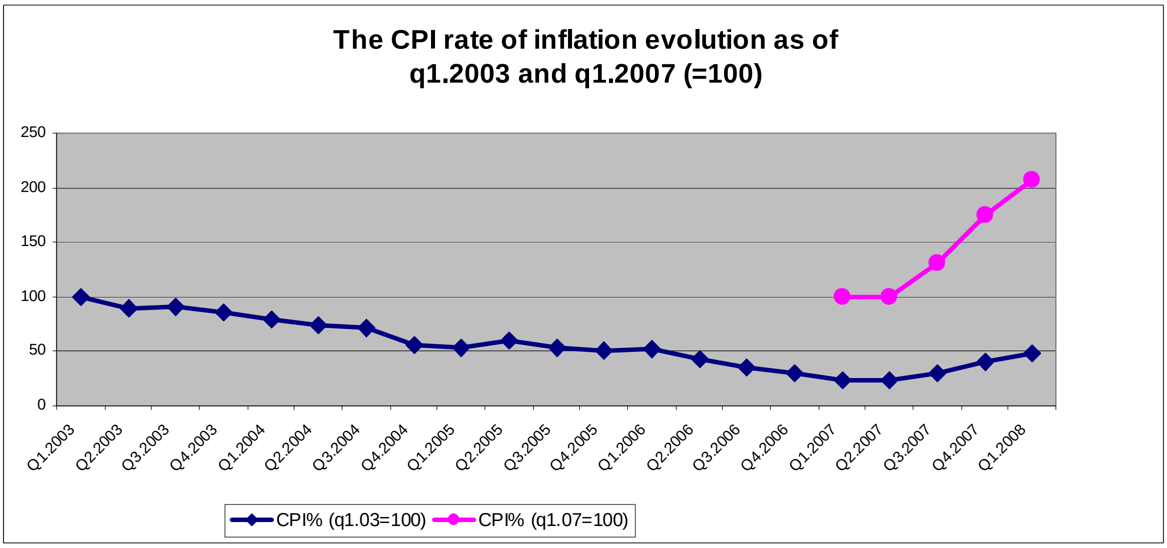
Source: NIS data processed by Dr. Catalin Ghinararu;

However, while this shows that Romania like all the other emerging markets has managed throughout the prolonged period o growth that has characterized the beginning of the decade, to build some degree of resilience so as to shield against the turbulences of the wider market, it is also clear that this resilience might not be strong enough. Evidence by now already mounts towards the fact that inflationary pressures which have been thought

[1] Figures provided in this report for GDP% in the year to the first quarter of 2008, are estimates of Dr. Catalin Ghinararu, derived from the outputs of the MITGEM model; Official/NIS data were not yet available when this report was elaborated (late Apr.2008);

at bay for quite while are commencing to surge again. The CPI rate of inflation for the year to the month of March, the last of the quarter for which we are currently reporting has been at an alarming 8.69%, leading thus the price increase for the entire quarter at a 7.97% as against the same period of the year earlier. As such, the rate of inflation for the first quarter of 2008 is practically more than 100% higher than the one registered for the same period of 2007, marking as such for a tremendous and certainly not well-boding surge in prices. Even when looking on the longer term things do not look rosy as from a low of 25% as against its levels recorded for the first quarter of 2001, in mid-2007, the rate of inflation is now at 50% of the levels recorded at the beginning of our analysis cycle (the same Q1 of 2003) a fact that marks a thorough and unmistakable surge of 25 percentage points (pp) in only a mere eight to nine months.

Chart No.2



Source: NIS data processed by Dr. Catalin Ghinararu;

It is by now clear and out analysis in the first paragraph of this current report will demonstrate it that the major culprit for this more than un-welcome development is the surging price of oil. This "commodity of commodities" is clearly the main driver of price increases with the depreciation of the national currency, the rise in wages and the effects of the last summer's droughts being merely side-shows, although their shares cannot be quite lightly dismissed.

In such a rough-ready landscape the relative performance of the labor market comes as more than pleasant surprise as preliminary figures released by the National Institute for Statistics of Romania (NIS) for the last quarter of

2007, display a higher than normally expected levels of total employment a well as of the employment and activity rates, showing thus that the economy still has enough steam to plough ahead. In this respect one might come aback to some earlier conclusions formulated in previous quarterly reports and which have stated that while an excessive growth in domestic demand is not without inflationary dangers these should not be exaggerated as a higher domestic demand helps in nurturing a domestic market on which one can rely in times of international turmoil. Also the unemployment rate, at least the national definition one for which date are available to the end of the month of March 20098, shows a remarkable resilience of the economy, as though at more than one full percentage point higher than at the peak of national economic exuberance in mind last year, shows that the labour market operates practically at what can be considered as “full employment” and that in spite of low employment and activity rates.

In the meantime, the Ministry of Labour and the public employment services, though already under the mounting pressure that characterizes a pre-election period seem to attempt a little bit more of an action than during the last year, when a mood of complacency seemed to have established itself. As such, two major job-furs aimed at easing the so-called deficits of labour, especially in the sector of construction have been organized by the Romanian Ministry of Labour and the National Agency of Employment, in Rome and Madrid, thus aiming to bring home Romanian migrants for employment abroad. The results have been so far more than modest as both of the events have been organized too early. The NAE could have well waited for a couple more months until the economic gloom would shave settled itself firmly both on the Spanish as well as on the Italian market and then it would have scored a full hit as migrants would have started and most probably will start to come back in larger numbers than any labour market intervention would manage and will ever manage to do.

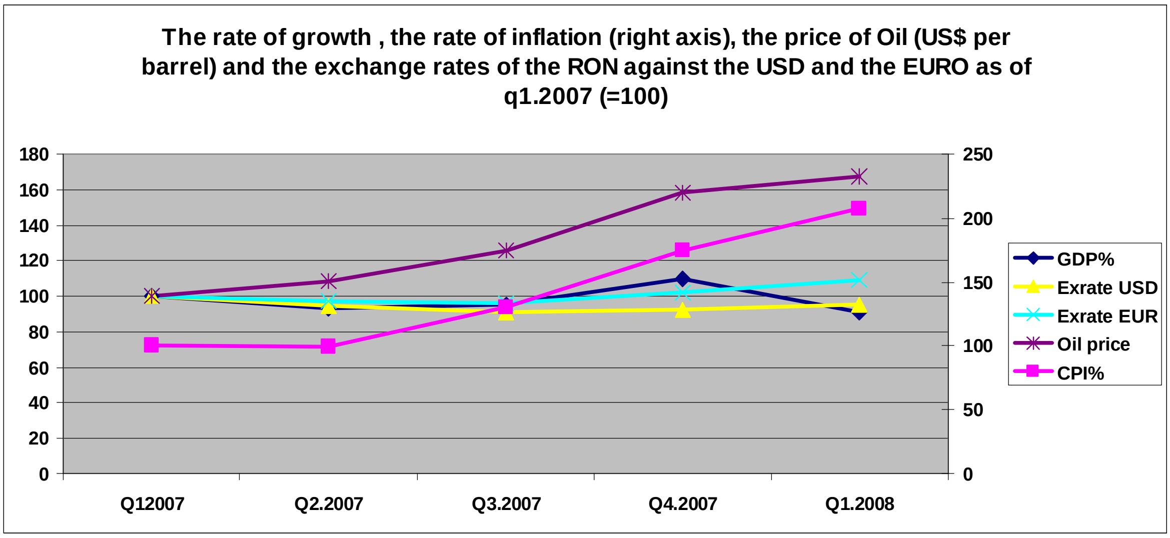
However, the temptation of an “active employment measure”, even if too early timed to have effects was hard to resist for an embattled minister of labour (the liberal Paul Pacuraru) who now openly faces charges of traffic of influence brought in by anti-corruption prosecutors.

In this climate of uncertainty, industrial action and not only in the public sector which generally tries to make as much as possible from pre-election periods, a fact that has been exemplified by the actions of teachers and even policeman, but also in the private sector has been quite intense for Romanian standards. A three-week long strike paralyzed the flagship company of DACIA-RENAULT in Pitesti causing apparently quite some financial loss for a car manufacturer that registered record sales during the last year and which expects even more this year given that its low cost models are exactly what is needed in times of recession, while in the meantime, a strike at the ARCELOR-MITTAL steel plant in the Lower-Danube city port of Galati has even degenerated in violent clashes reminiscent of last year's protests at the se industrial site when workers broke out into management offices. Needless to say that both actions have been about pay rises and at least in the case of DACIA the management has been forced to yield to it workers. It is however to be noted that these conflicts took place against a background of still strong growth and practically full employment when management has sometimes little choice but to yield to workers. Nonetheless, it is unclear what would have happened if all would have been taking place against a background of recession. Maybe unions should think twice when launching such actions in a year from now.

Update on key economic and labour market indicators

The Romanian economy as said before is still growing rather strongly a fact that can be only encouraging given the current more than gloomy mood of the markets. Our forecast shows that in the year to the first quarter of 2008, the GDP might be as well 5.9% higher than in the same period of the last year, a fact which by no means can be considered as negligible. If there is no major derailment throughout the year and if the weather conditions on which economic growth in Romania seems to be rather sensitive would look better than the last year a fact that might be as well true given the plentiful of snow witnessed by the winter months of the quarter then by the end of the of the year GDP% on the year early will still be in the range of 5.4-5.6%, which again is not negligible though it will clearly imply that a gentle slide is under way. Nonetheless, it has to be once again mentioned that this slide will not be yet a cyclical one as Romania's economy like all the others in the region has not yet reached that stage of market maturity at which economic and business cycles do develop. Therefore the slide would merely reflect a slower rate of investment and accumulation of assets, as enterprises and households alike are digesting so to say the spree of the last two or three years. The slowdown will also of course reflect the general slowdown of the world economy although, being an emergent market, Romania should perform far better than its mature counterparts in the Union. Of course there is scope for the slowdown to be more marked if the world economy firmly dips into recession. However, as of yet, given the uncertainty of the market is more difficult than ever to forecast what will happen till the end of the year and this especially as the price of sensitive commodities chief amongst these being oil, have long exceeded the threshold above which their influence induces more than a pinch into inflationary pressures.

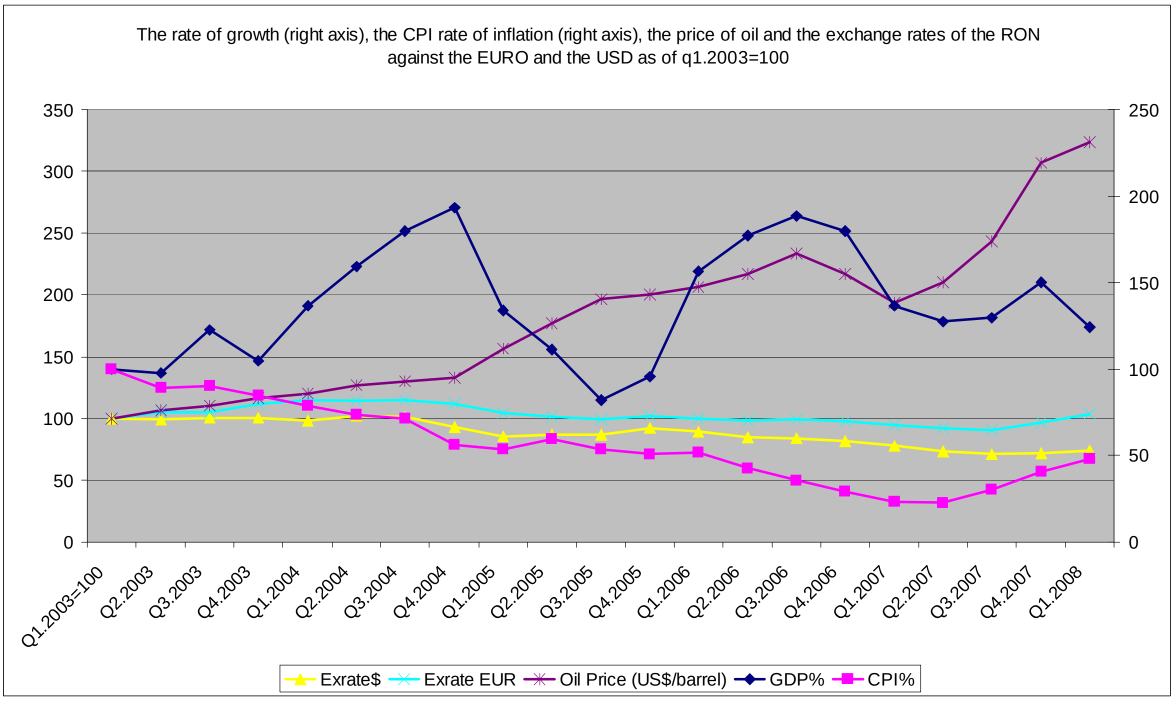
Chart No.3



Source: NIS and National Bank of Romania (NBR) data processed by Dr. Catalin Ghinararu;

Actually, what it is worrying as development is not the fact that growth might falter a little bit, although given the decades of missed development, Romania and its people need as much growth as they could possibly get and from whatever source it might come, but the renewed rise in inflation a beast which lately looked as having been tamed at last. The rate of inflation rose in the year to March to a high not seen for several years of 8.69%, thus practically reversing all gains in disinflation achieved by the National Bank throughout the last years.

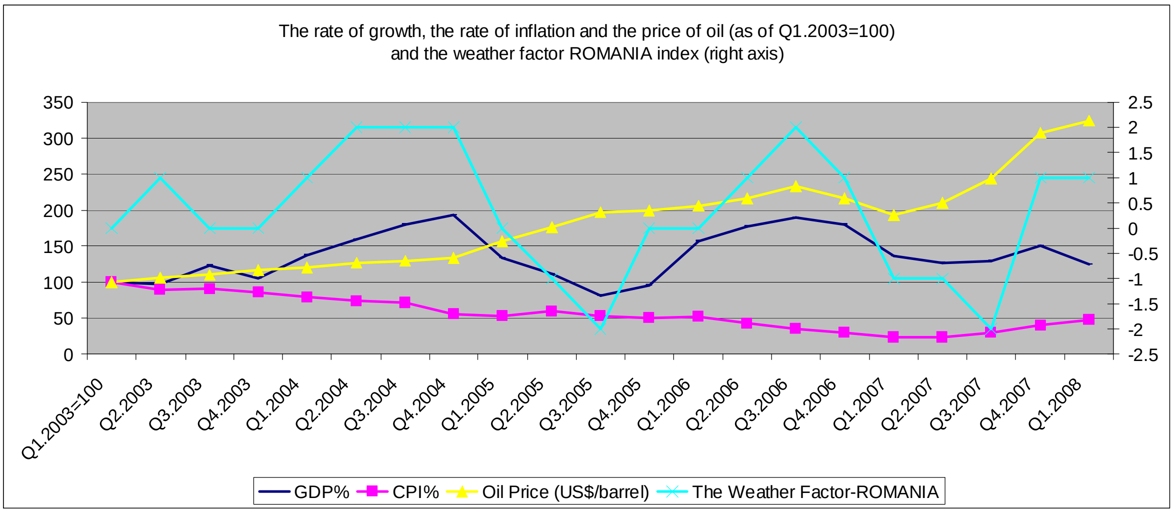
Chart No.4



Source: NIS and NBR data processed by Dr. Catalin Ghinararu;

Widely blamed for this surge in inflation have been the wild gyrations of the exchange rate which has plummeted by more than 10% in the ear to the first quarter of 2008, although one has to mention that before doing that it has rocketed by 9% in the first half of the 2007, so one could say that it has just given up what it has actually gain without just cause, due to a speculative attack on which the SYSDEM correspondent has given at the time the proper warning but to with the National Bank has been more than slow to respond, wrongly thinking that the appreciation of the currency was doing its job as guardian of price stability. As such, tracing the movements, no matter how apparently erratic and disturbing of the exchange rate over the last twelve months one cannot escape noting the fact that they have been actually no more than a storm in glass of water which while having for surely an impact on the rise in prices as reflected by the traditional measure of the CPI rate of inflation were by no means able to influence its upsurge which shows a staggering more than 100% gain as against its levels for the first quarter of 2007. Therefore, if the currency exchange rate, leaving apart its short-term gyrations does seem to be the man culprit for the surge in prices, then maybe wages and their rise can take the blame for it. True wages have been rising and fast throughout 2007, sometimes even at a pace higher than the Sum of Productivity and Inflation but when looking on rather longer term, viewing the evolutions of both aggregates for the last 20 quarters in row or therefore since Q1 of 2003, one would clearly see that the strong rise in wages which started with 2005, coincides actual with a more than sharp move of disinflation which therefore means that wages could not have triggered the current bout in inflation, as they have been rising from a very low base. Therefore, the rise wages cannot be ascribed as inflationary-inducing as it ha been just an expression of an increasing solvency and liquidity of a market that has been for far too long actually illiquid and insolvent. Therefore, the rise in wages, is just an effect of growth, actually a long-awaited on as it ha finally managed to kick-start the domestic market and the domestic demand which at the beginning of the current decade were all but dormant. Developing a domestic demand engine of growth for an economy, especially for an emerging one is no bad thing at all as it actually helps building in a shielding mechanism on which enterprise can rely when foreign markets start falter. Given the history of the Romanian economy, developing a domestic market was and is paramount and the only way to do it is fist by allowing consumption and imports as this actually allows for the accumulation that will afterwards induce production and exports. No other way ha been yet found so the ones that are searching for culprits of rising inflation in wages are wrong. They are also wrong if we take a look at the aggregates of the labour market which have only seen a slight improvement, starting actually since the moment wages have also started to rise. It is only since the late of 2005, throughout 2006 and most markedly throughout the last year of 2007 that employment and employment rats have seen the first significant upward movement in years while the unemployment rate witnessed, albeit trailing the movement of GDP growth by some months, a sharp decrease which cannot be solely ascribed to migration for employment abroad. Therefore, if the surge in wages can be associated with a rise in employment in squarely means that it has to be associated with a rise in productivity, as otherwise no employment generation can take place. As such, while of course any rise in wages as it triggers a rise in demand and if couple with a situation of very low unemployment, can be considered as potentially inflation generating, we do think that given the characteristics of the Romanian market, the inflation effect of this development should not be exaggerated.

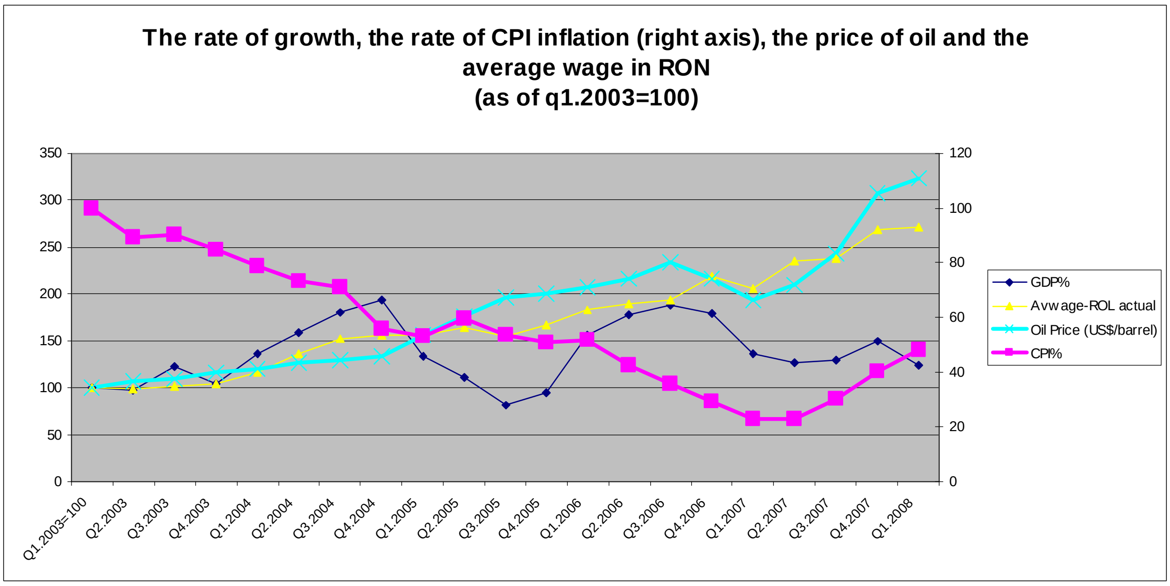
Chart No.5



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

If wages are either no to be blamed then maybe there are the adverse weather conditions at play and to blame for growing prices. Of course one cannot deny that the last year's drought caused some serious disruptions on the domestic market which have triggered of course a rise in prices but episodes of adverse weather have occurred throughout the decade in other instances like for example in the summer of 2005, when the country has been affected by severe floods. Prices have true witnessed a minor surge and growth has ebbed down for a quarter or so but in the end everything ha been ore than temporary and short lived.

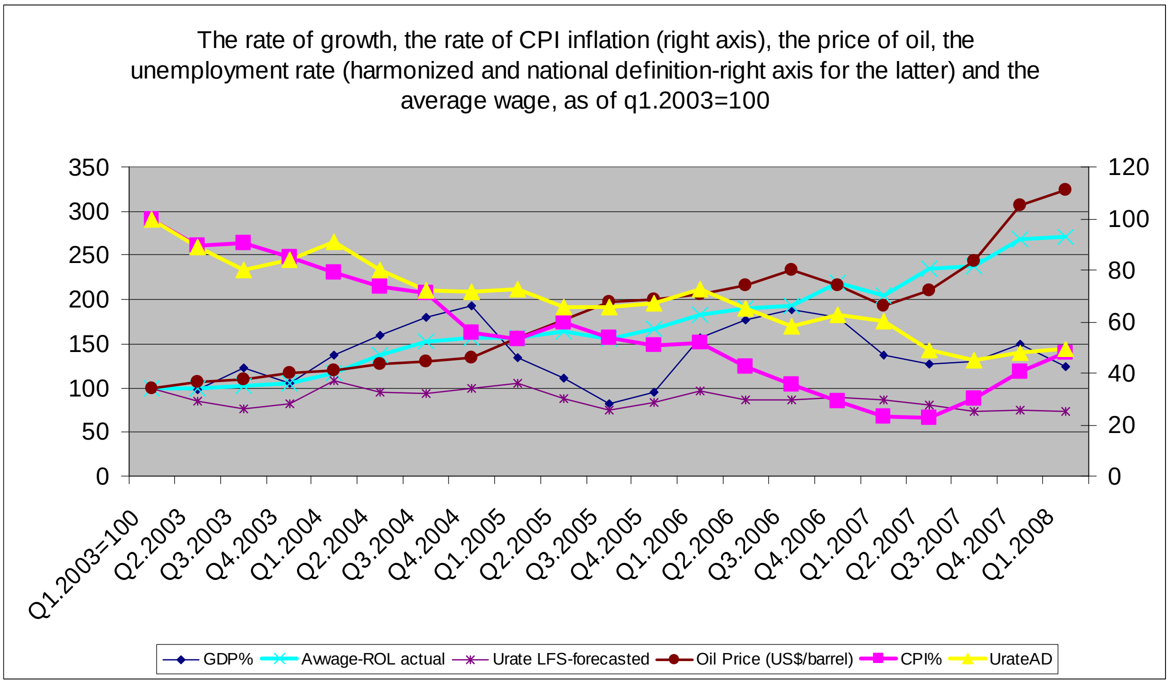
Chart No.6



Source: NIS data processed by Dr. Catalin Ghinararu;

Therefore there must be something more powerful at work and this something is a commodity called simply OIL. As the prices of crude have crossed firmly over the threshold of 75US$ per barrel beginning with the end of last summer and started to head rapidly towards 100US$, the Romanian economy was no longer able to cope with them and commenced o take like a sinking ship, water (i.e.: read inflation) on board. The rise in prices which the upward mode in the price of this particular commodity is triggering has been aided of course by the fact that it coincided with a bad agricultural season as well as by the fact that the currency has been hit hard by speculators and also to far much lesser extent by the fact that wages have been rising sometimes faster than productivity and inflation but in the end all these have been mere side-shows and the main factor of rising prices and of rising inflationary pressures is the rise in the price of oil, a factor that is actually located outside of the Romanian economy properly and against which this economy has little shielding to provide. If we o take a look on the evolution of both the price of oil and the rate of inflation or both the so to say longer term, which means since Q1.2003 as well as on the shorter term which means since the one year ago, we will see that the fast rise in the rate of inflation goes actually hand in hand with the acceleration in the rise of the price of crude. The two lines are actually climbing to ever new heights in parallel and at what can be called an almost equal pace. This last development is the most worrying. Therefore, if the price of crude does not come somewhere below the threshold of 100 US$ a fact which seems to be highly unlikely, with the forecasts actually showing a climb to heights of around 130-150 US$ towards the end of the year, possibly with some let-outs in between, then the rate of inflation will remain stuck at around 7-8%, possibly going even higher. In such circumstances all small gains made in employment in 2007 will be most probably lost or at the least no other gain will be possible for a while which might as well mean that the Lisbon targets will not be met in the three more years remaining until 2010.

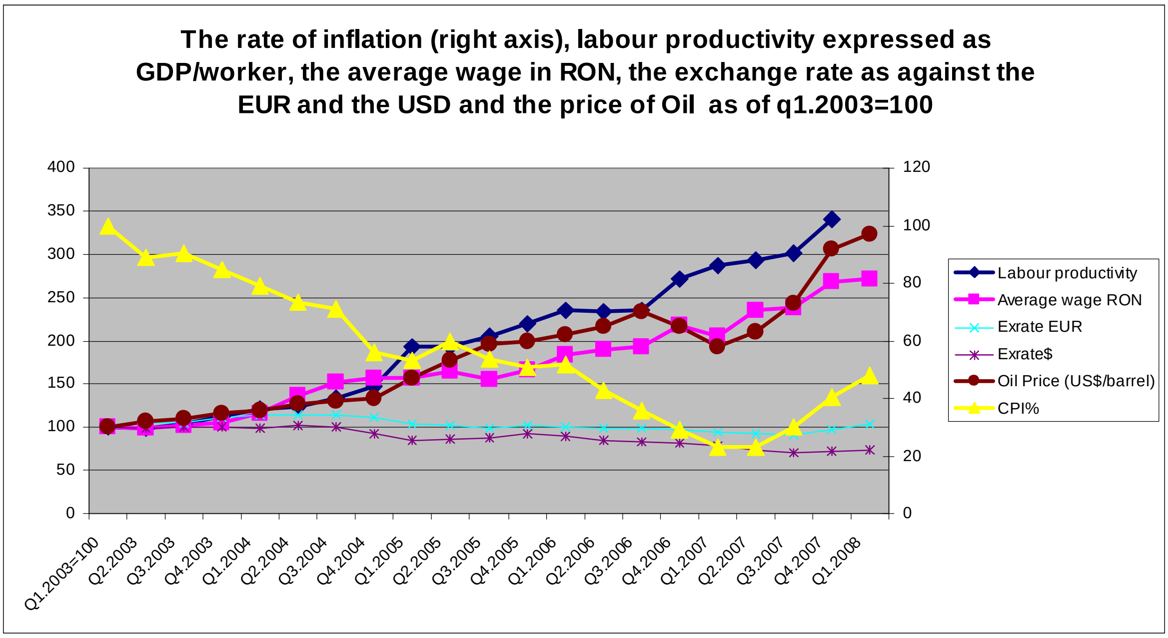
Chart No.7



Source: NIS and NAE data, processed by Dr. Catalin Ghinararu;

There will be, also probably, no major development with respect to the unemployment rate, though it will probably creep up slowly by slowly, heading towards the threshold of 5%, but this will do jus some good as it will loosen a little bit the labour market However, one has to say that soon enough the so-called deficit of labour will be a thing of the past as the slowdown of economic growth, the rising prices and the falling currency will put the brakes on the fast-growing construction sector, *the* place actually where the deficit was the most apparent. In the meantime if the gloom will continue and it is likely o be as such on markets which have been destinations for Romanian migrants (e.g.; Spain) then as well one might see, job-fairs or not, quite a number of returnees coming back on the domestic market and at that point the balance will tilt back. One cannot be certain when and how this will happen but it might as well be this year that we will see such a movement, which would confirm a development that the correspondent has been predicting ever since the first signs of turmoil have started hitting the developed economies of US and Western Europe.

Chart No.8



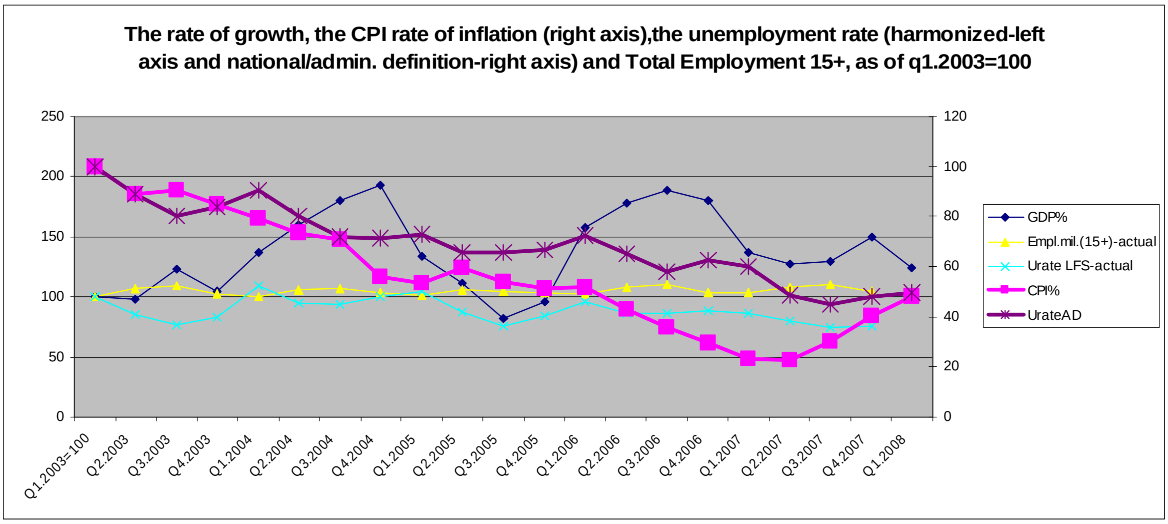
Source: NIS data processed by Dr. Catalin Ghinararu

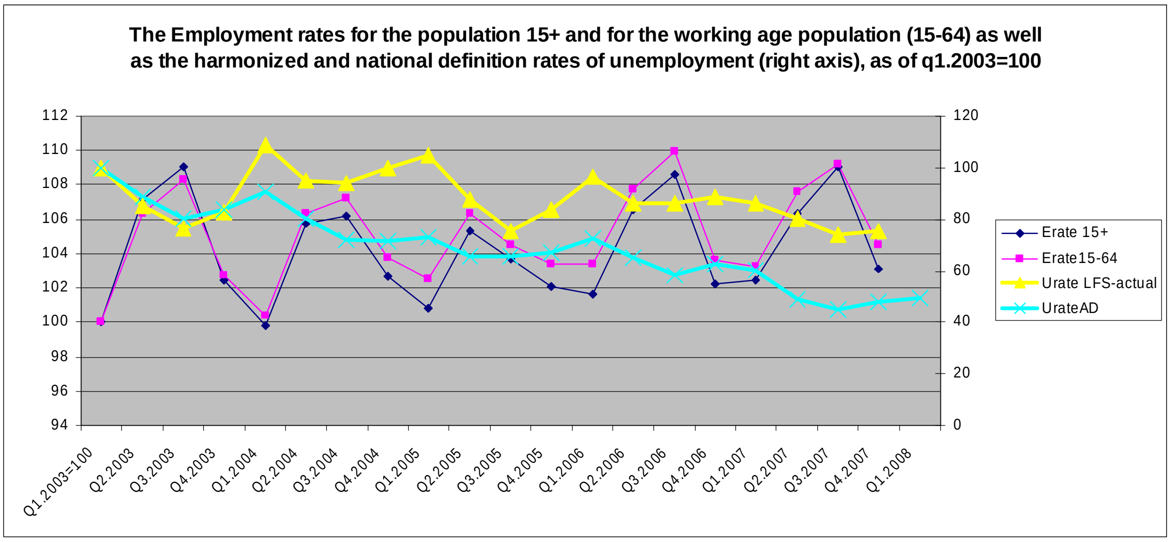
<u>Buttonwood</u> – On the liquidity crunch and ways to cope with in Small Open Economies

One has to be aware of the fact that currently there is a huge mass of liquidities on the world market which has been released by the ultra-loose policy of the US Federal Reserves at the beginning of the decade. The current weak dollar and the low interest rates in the US are re-enforcing this mass, <u>which is now adrift on the market and hits at random whatever asset it can find with oil and alimentary products denominated assets being prime targets.</u> These being volatiles they will continue for the quarters to come, at least up to the end of this current year, to push up inflationary pressures, which for Romania might as well mean going back into double-digit territory, a fact that has already happened in Bulgaria. Small economies like Romania, with no consolidated domestic market are at high risk as such and cannot defend themselves solely by means of monetary policy. The interest rate instrument is weak and ineffective to this respect for a country like Romania and might even create adverse effects by luring in speculators from time to time a it has been the case painfully enough during the first half of 2007. The prime instrument as such to fend against what is actually imported inflation is the budget balance and a policy in support of the domestic market and domestic producers and service providers, so as to insulate the economy against ***wider-markets imported volatility***, as much as it is possible and economically feasible. Maintaining a strict budgetary balance will also mean restricting at the minimum all kinds of labour market interventions (in other words ALMPs) and thus the necessity of a streamlining of the no less than 31 of them incorporated both in the Unemployment Insurance Act (Law No.76/2002) as well as in other acts so as to keep only those that are genuinely effective and show tangible results. Thus the necessity to revise the current act and incorporate evaluation as an integral component of the new, streamlined package of ALMPs.

From this point of view, any spending whatsoever during this year especially on wages or other benefits, has to be put on hold. One should even contemplate renouncing the second round of increase in the minimum wage which is due in lass tan two months and anyway give up any planned expansion of administration. In the meantime, taxes will have to be kept low so as to allow to economy to continue to grow but the December planned reduction in contribution rates especially the one aiming at further cutting the contribution rate for the unemployment fund by 0.5 pp. should be put at least postponed.

Chart No.9 & 10





Source: NIS and NAE data, processed by Dr. Catalin Ghinararu;

Leaving this territory aside one has to state that while there are no data released yet by the NIS with regard to the employment aggregates for the first quarter and basing just on the broad aggregates for the last quarter of 2007 released by the NIS so far, one can say that the performance for the last quarter of 2007 has been more than satisfactory as the employment rate for the 15-64 has kept itself in the vicinity of 60% therefore very close to the activity rates for the same age group, which shows that the economy has been growing stronger and productivity has been also on the rise. The fact total employment also kept high enough and on the average higher than in 2006 also showed that the economy went well and actually confirms the fact that the domestic fundamentals narrow and limited as they might be are solid enough, with the current bout in prices being almost entirely an imported and by this far more dangerous, simply by its sheer scale, in itself a fact that matters a lot in economy.

In the end of this chapter as we have used our readers and in spite we would say of the uncertainties of the market which make any forecast now a more than risky enterprise, we will provide our quarterly view on the quarters to come for this year for a number of selected macro-economic and labour market aggregates:

Estimates of selected macro-economic and labour market aggregates (q1.-q4.2008 - ROMANIA)

(Table No.1)

Variable	***Q1-2008***			***Q2-2008***			***Q3-2008***			***Q4-2008***		
	low	high	average	low	high	average	low	high	average	low	high	average
GDP%	5.46	6.51	5.98	4.97	6.76	5.86	5.35	6.75	6.05	5.37	6.82	6.09
CPI%			**7.95**	7.28	10.23	8.53	6.82	10.24	8.53	5.56	10.64	8.10
Exchange rate (RON/EUR)	-	-	**3.6892**	-	-	3.5728	-	-	3.5107	-	-	3.4433
Exchange rate (RON/USD)	-	-	**2.4617**	-	-	2.4638	-	-	2.3168	-	-	2.2234
Un-employment rate (LFS/ILO definition)*												
Exchange rate export competitive advantage	-	-	**-3.57**	-	-	2.14	-	-	-1.95	-	-	-3.34
Unemployment rate (national definition-NAE)	-	-	**4.26**	-	-	4.44	-	-	4.35	-	-	4.56

NOTE: Estimates are outputs of the MITGEM model constructed by the author at the National Scientific Research Institute in the field of Labour and Social Protection of Romania. Previous values where different from the current ones are shown in brackets. Validated data once available are shown with bold characters;

NOTE 1 (for this current report): It has to be noted that in spite of higher than expected inflation, the economy will grow even faster than forecasted here, with values of GDP% around 7% being still possible if weather conditions remain favourable. If weather conditions will prove adverse than worse than the low values of this forecast is also a possibility;

*Forecast rendered impossible due to high volatility of the market;

Policy Developments

There have been no major policy developments so far during the quarter as the embattled minority Government of Prime Minister Calin Popescu Tariceanu is struggling hard to maintain a semblance of normality ahead of an upcoming election year which, will see at its end a new Parliament elected this time on the basis of a combination between the simple proportional and simple majority vote.

The sole major development so to say, has been the botched attempt by the Ministry of Labour to broaden further the contribution base for pensions, by trying to include not only all salary type incomes but also fringe benefits employees actually receive, including here the monetary calculated equivalent of the use of company cars, mobile telephones and others as such. While of course the move has caused a storm of protests everywhere, in the end it has been abandoned as it lacked the practical institutional basis for implementation. The scandal that erupted subsequently forced the Prime Minister to send a powerful rebuke to the Minister of Labour, though it stopped short of asking him to resign as the recent past suggested that due to his personal row with the President, replacing ministers is a hard act to get around with.

Apart from the failed attempt to plug in the hole in the pension budget, a hole that is getting larger as around 4.1 million persons out of a total of around 5.8 million which means practically 69% roughly of the total number of the insured have made an option for a private pension fund, fact which by itself will mean that their contribution rates will be carved down by the mandatory 2 pp to go to the private funds and thus leave the contribution they give to the public scheme 20% lower, the Government and the Ministry of Labour has attempted to deal with the deficit of labour, especially manifest in construction, a fact that it has tried ever since the end of last year. In doing this, the Ministry and the National Agency for Employment (NAE) have organized two large Job Fairs destined to bring or actually to lure back Romanian construction workers in Italy and Spain, the two main destination countries of Romanian migration for employment abroad. The two events which took place in late February and respectively early March were not particularly successful as they were probably too early on. Would have the organizers been waiting for a few more months until the gloom would have settled over the beleaguered economies of both Italy and Spain they would have had for surely far more success. But, it is probable that given the dire state of the Spanish economy with the construction sector in full recession by the time this report is written, the migrants will be soon coming back by themselves as the recession entering economy will start rejecting surplus labour.

Apart from these, the NAE has organized its traditional General Spring Job-Fair, where in spite of claims that there is a shortage of labour supply queues of jobseekers have been forming themselves at the gates of the event venues quite some time in advance of the opening. Results of the Job-Fair are yet to be published.

It is important to note that all these have been taking place against a background of more intense than usual for the last years industrial action pressure with workers from several large enterprises, most of them in the hands of large multinationals demanding higher wages.

Also it is important to note the fact that finally in mid-February the Sector Operational Programme Human Resources Development (the SOP HRD) has become fully operational and has started to receive applications for funding or projects using the resources of the ESF. A first round of applications for Major has been held in March. It is important to know that the entire application can be made electronically, thereby drastically improving both effectiveness as well as transparency.