

Quarterly Report on Labor Market Development and Policies – 2nd quarter of 2008

Outline of quarterly developments in labour market indicators and policies

The central event of the second quarter of 2008, have obviously been the local elections, held at the end of May and mid-June in tow rounds of voting, they have confirmed both a visible decline of the pro-presidential PD-L party, which has lost the prized position of Mayor of Bucharest to the left-leaning, former PSD leader Sorin Oprescu, this time running on an independent ticket, as well as the continuous, albeit not spectacular comeback of the opposition social democrats. The Liberals, currently, alone in Government for more than one year have done unexpectedly well, coming in third but nonetheless failing to make their mark in the flash-point Bucharest elections, where they only managed to win a single sector city hall, however, the one of the country's richest of communities, that of sector no.1. Worth to mention that for the first time ever, citizens have been voting directly for the president's of the "judet" (i.e.: county) councils, in a single-majority, single-round, truly "first past the post" system. Currently all the major political forces are re-aligning themselves while using the brief summer holiday period to prepare for the autumn general elections. As a result, the Government is coming under increasing pressure and criticism, with the former coming from the union's side which are by now in a habit of trying to gain an advantage during pre-election periods and the latter from both the pro-presidential PD-L as well as from the opposition PSD, which are thus trying both to squeeze-in the margin that might bring them victory in the incoming parliamentary elections.

Good news however that in spite of the strong depreciation of the currency during both the final quarter of 2007 and the first quarter of 2008, the economy simply boomed, with GDP growing in the year to the first quarter of 2008 by an astonishing 8.2% (See also at www.insse.ro/cms/files/conferinte/iunie%202008_Total-presa.ppt). Car sales and fuel sales have been on the up and that in spite of surging oil prices and up-picking inflation, signs that the Romanian economy might as well star-perform this year, especially as the omens for agriculture also look right. Although this record growth far outpaced the expectations of all analysts it is to the credit of the SYSDEM correspondent that in his last report at least he hinted to the fact that growth might reach into 7-8% territory, given the right conditions and they were right.

This also meant nonetheless that inflation picked up again, driven both by the depreciation of the national currency, which continued unabated during the first quarter though it stabilized and even re-entered appreciation during the second one as well as, like worldwide, by soaring fuel prices. The CPI rate of inflation reached 8.6% , as an average for the year to the second quarter, thereby making it more than hard for the National Bank to attain its target (See at www.bnr.ro – Report on inflation-May 2008) , although given the inflation spike, the target has been hiked to 6% for the end of the year on the year early. High inflation however did not seem to deter growth, therefore confirming the SYSDEM correspondent's opinion that given the current characteristics of the Romanian economy growth can go unabated even with rather high inflation, for the surge in both prices and demand only attracts investors.

Unemployment remains low, with the national definition rate at 3.8% and the harmonized rate at 6.3% for the first quarter according to recently released NIS data, which thus mark a convergence trend of the two rates, on a descending path, which only testifies to high growth.

The so-called labour deficit, though not apparent from vacancy rate data published by the NIS, has been the constant preoccupation in the realm of employment policies of the Government, with several Job-Fairs being organized by the Ministry of Labour in both Spain and Italy in the hope of brining back migrant workers. Employers are however sceptical about the initiative continuing to blame high taxes, although the country runs a flat rate income tax of 16%, which the opposition social democrats blame for inflation and want to reverse if re-gaining majority in the autumn general elections, and, contribution rates have been constantly coming back during the last years.

As the quarter ended, the Ministry of Labour went under strong pressure from the unions to increase the statutory minimum salary, currently at RON 500 (EUR 142 at market exchange rate) to the promised at the onset of the year RON 540. The Government however seems to be more tempted to renege on its pledge as inflationary pressures are mounting and with salaries rising by 20% (See at www.euractiv.ro – 08.05.2008) as against their 2007 level, it is more than tempting to consider them as the main culprit for inflation, although and sadly, this is not quite the case.

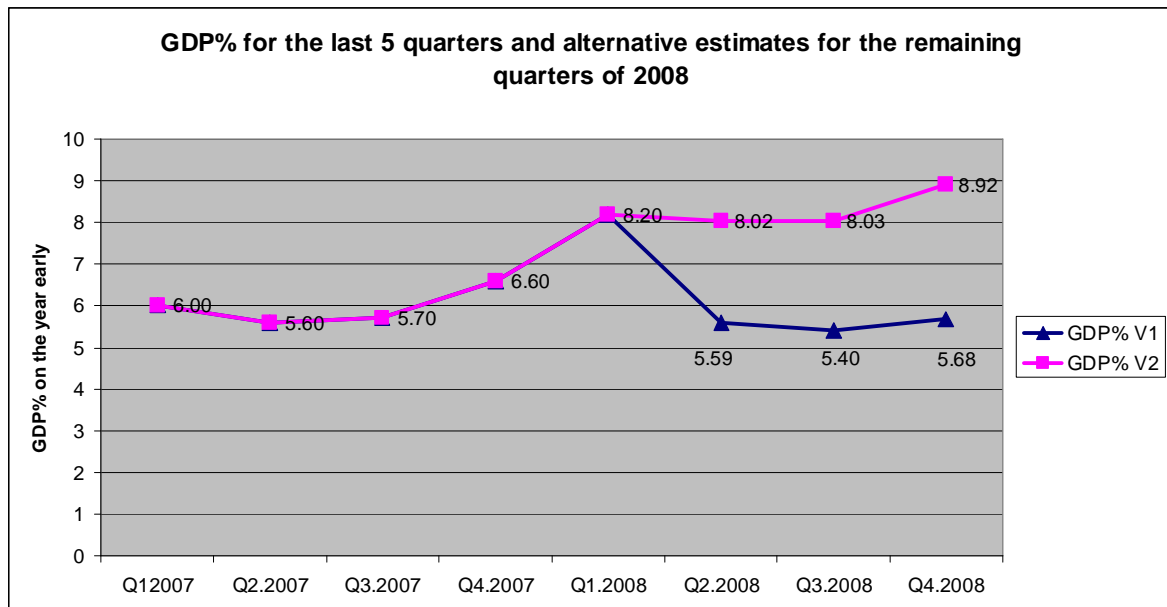
Worth also to mention that the minister of labour himself Mr.Paul Pacuraru is dogged by an on-going criminal investigation, on allegations of trafficking influence and corruption.

Update on key economic and labour market indicators

Economic Growth: Romania's GDP witnessed an 8.8% rise in the year to the first quarter of 2008, in defiance of all forecasts and analysis and in spite of the increasing turmoil in the global economy, rising oil prices, a depreciating currency and a spike in inflation. While this comes as a good news, heralding, if conditions for agriculture will also prove good and both the first and second quarter have been from this point if view more than auspicious, one of Romania's best years in terms of growth, with GDP growth estimated now to maintain itself between 7-8% for all of the four quarters of the year.

To Watch: This year might be one of the best for the Romanian economy and that would be in spite of the worldwide and European gloom. If the agricultural year will also be a good one then it might as well be that on the average for the year the GDP will grow by 8%, a fact that would clearly outpace the performance in 2004, when GDP growth rates have been at around 8% only for the last quarter when compared to the year early.

Chart No.1



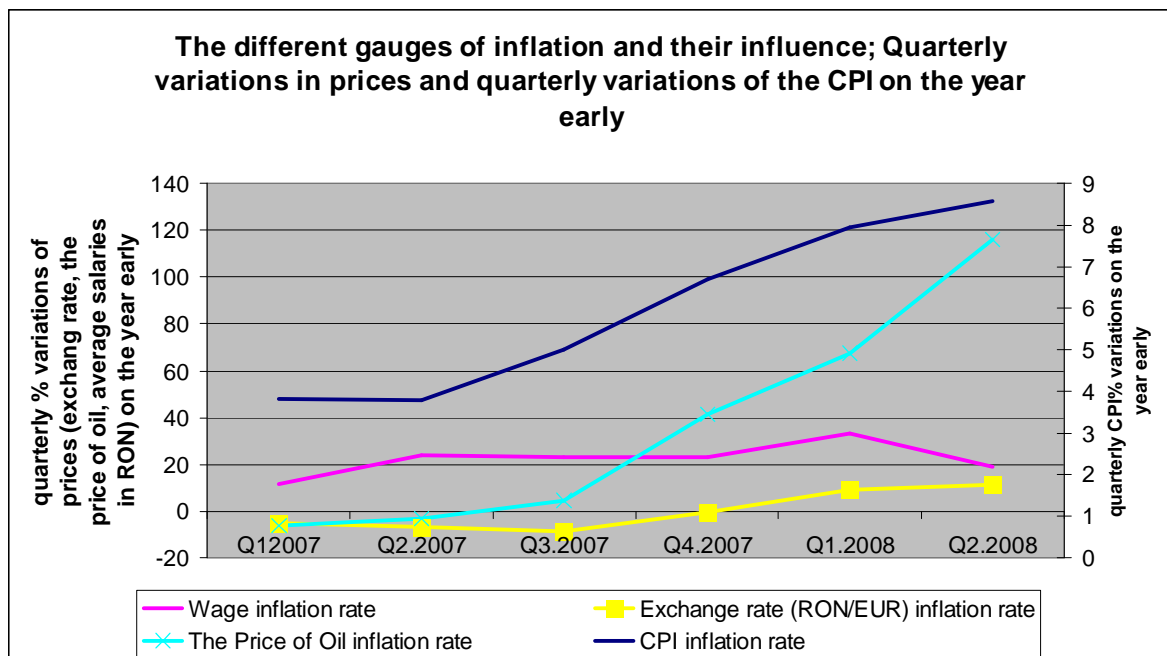
Source: NIS data plus calculations of Dr. C. Ghinararu

Inflation: Inflation has nonetheless been on the rise and continues to be with the inflation target being revised for the end of the year by the National Bank to 6%. Average CPI % variation on the same quarter of the last year shows a 8.65 increase in consumer prices, which can be largely attributed to inflation imported via the price of commodities (i.e.: oil and gas) but also to

a certain extent to wage rises that have outpaced productivity. Depreciation of the national currency has also contributed to that especially during the last quarter of 2007 and first quarter of 2008. Nonetheless, the latter did less damage during the second quarter of 2008.

To Watch: High inflation might be the rule throughout the year, though it will not dampen growth necessarily. The target of the central bank will be hard to reach but one could bet for a landing on the upper-end of the variation band, therefore somewhere around 7% for the year to December, provided that the agricultural year will be a good one, which until now seems to be the case.

Chart No.2



Source: NIS and NBR data plus the data and calculations of Dr. C. Ghinararu;

Exchange rate: The exchange rate of the RON stabilized against the EURO throughout the second quarter of 2008 reaching an average value of 3.65 RON/EURO, which marks an appreciation by almost 2% as against previous quarter values (Q1.2008) although, when comparing with the same quarter of 2007, the current rate marks a 10% depreciation against the single currency. The value against the green back (US\$), in free fall all round the

world, has been an average of 2.34 RON/US\$, climbing 5% as against the previous quarter of the year and only a 4% appreciation against the same quarter of the last year, marking thus the depreciation of the national currency as against both of the international reserve currencies in late 2007 and early 2008. The rebound of the exchange rate which is good news for inflation fighting comes as news regarding the Romanian economy, have been better than ever especially given the worldwide gloom, while in the meantime inflows of capital have been brought back by the key interest rate of the National Bank which has put now its foremost monetary policy instrument at 10%, marking a tightening of the monetary policy. The effects are visible as regards to the exchange rate, which thus blocks a channel of inflation but less visible with regard to credit, where the value of consumer credit has reached at the end of the last year the equivalent of 26% of the country's GDP, thus marking a 2600% increase as against 2004 for example, when as expressed as share of the GDP, consumer credit was accounting for just a meagre 1.4%;

To Watch: Possible gyrations of the exchange rate as investors wind and unwind of the market. If the central bank decides that it wants to keep the interest rate real-positive than it would attract speculative inflows, risk another spree of appreciation followed yet by another sudden depreciation when investors would lock into their gains. This coupled with growing deficits created by a stronger currency that would again encourage imports would not bode well for inflation, Actually the disinflation effect achieved via appreciation would be more than matched by the re-inflation effect that would come via increased demand for imported goods. The estimated effect o restrain on credits might be slow to materialize as banks are still eager to tap on the Romanian market and Romanians are equally eager to meet long repressed needs!

Wages and productivity: Average wage for the second quarter rose to an estimated average of 1727 RON (EUR: 473 at market exchange rate) thus marking a 20% increase against the last year's level and making it the prime culprit for inflationary pressures that are mounting in the economy. However, while wages inflation is definitely higher than price inflation on the whole, it has to be noted that it cannot be held responsible for the general rise in prices, which as we have thoroughly pointed in previous reports had more to do with the soaring fuels costs which above the threshold of 75-80US\$ per barrel start to hit the Romanian economy on this aspect as well with depreciation of the currency which has raged for two quarters in a row as investors were selling their RON denominated assets either to lock in

their gains or to flee from an emergent market with not such a good past record. As this record seemed to be a bad guide for the future with growth coming stronger than expected, they rushed back, a fact which fully explains the current re-appreciation trend of the currency. However, the damage with respect to prices, as inflicted simultaneously with soaring fuel prices, is harder to unwind. From here thus the reluctance of the Government to go for a promised rise in the minimum salary as it fears both higher inflation as well as an emptying of the coffers as to the minimum salary are tied a string of social protection benefits not to mention the impact on public sector salaries.

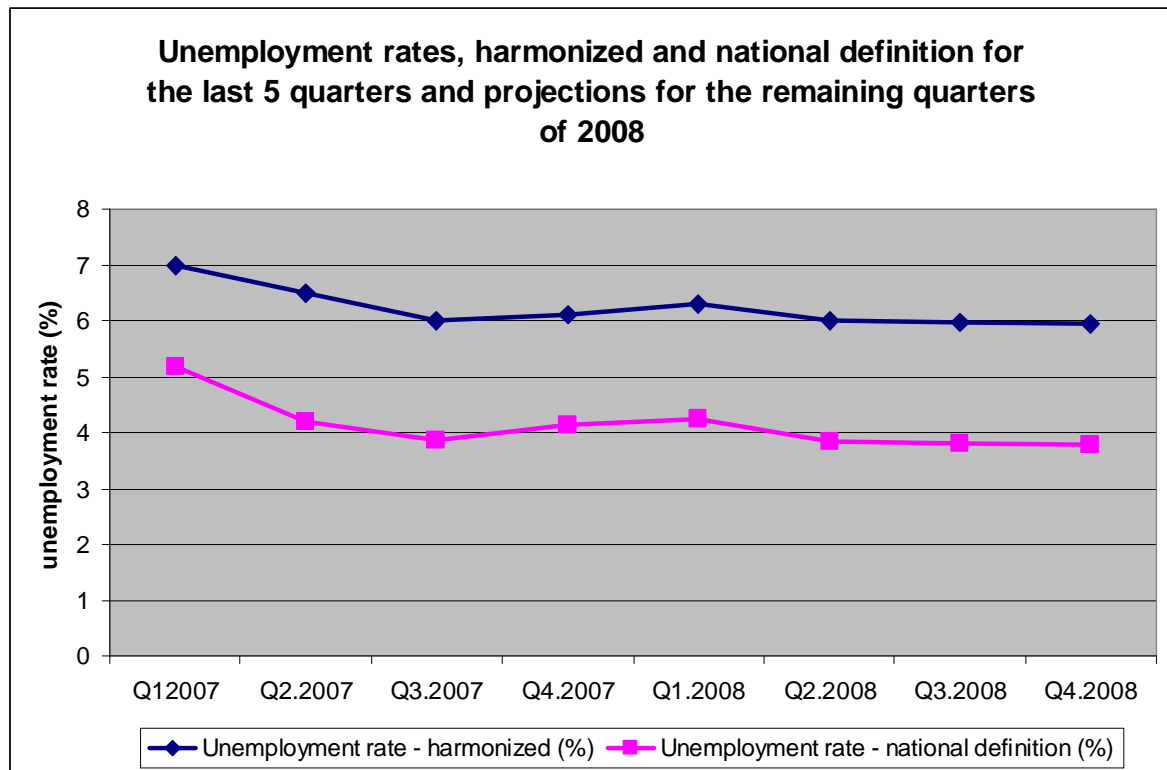
To watch: Wages on the rise strongly. If Government will give up demands for a hike in the minimum salary this might significant consequences on inflation although not as much as feared; Salaries on the average have been growing fast anyway, so a 8% rise in the minimum wage, would not matter much. Far more important for inflation is the rise in petrol prices as well as a ballooning consumer credit (See also at www.bnr.ro- “Studii si analize – Evolutia riscurilor populatiei din perspectiva stabilitatii financiare”/Evolution of household credit risks; A Financial Stability Perspective, author: BNR-Directia de Stabilitate Financiar/Financial Stability Directorate).

Unemployment rate: The rate of unemployment continued to keep itself at very low level, with the average for the national definition one as communicated by the NAE, as low as 3.83%, thus maintaining itself constant as against levels recorded for the same period of the last year and therefore witnessing to an economy in full swing. The total number of registered unemployed nationwide according to NAE figures was of 337,084 persons at the end of the month of June. In accordance with the LFS figures communicated by the NIS for Q1.2008, the harmonized rate of unemployment was for the quarter in question of 6.3%, thus showing a continuously descending trend and being on a convergence course apparently with the NAE rate. The fact in itself can only be attributed to high growth. Nonetheless, it has to be said that while the national definition rate of the NAE shows practically that only frictional unemployment or long-term hard to dislodge unemployment would slack the market, which would thereby classify as uptight, the harmonized rate shows that there is some more slack on the market than only the frictional one. Actually if we do take the two rates, we would come up with at least round 3 pp. of non-frictional unemployment or in absolute numbers with around 280,000 individuals that would constitute a labour reserve ready to be employed. Therefore, the idea

that the marker would face a real deficit of unprecedented proportions does not truly sustain itself or has to be taken with some reserve. According to NAE (See at www.anofm.ro – “Situatia somajului inregistrat la 30 iunie 2008”/Registered Unemployment as of June 30th 2008) figures the highest rate of unemployment is recorded by the “judets” (counties) of Vaslui (400 km approx. NE of Bucharest) and Mehedinti (500 km approx. SW of Bucharest), being in both cases at 8.3%, while the lowest is recorded in the county of Ilfov, the “judet” practically surrounding the capital city of Bucharest, where bustling construction activity has plunged this indicator to an all-out low of 1.2%!. For this latter case true one can speak about a labour deficit. As a lot of the economic activity is concentrated in Bucharest and the surrounding area, with a lot of labour-intensive construction and infrastructure works going on, it is likely that the impression of deficit is conveyed by the situation of Bucharest and its surroundings, which nonetheless account for large swathe of the country’s GDP.

To Watch: Continuously falling unemployment rates will add to inflationary by fuelling into aggregate demand although labour deficits while more apparent than before will nonetheless remain highly localized;

Chart No.3



Source: NAE and NIS data;

Participation and Employment rates: As figures for the 2nd quarter have not yet been released by the NIS, we will look upon the recently released figures for the 1st quarter as they cm out of the LFS (See also at www.insse.ro – “Ocuparea si somajul”/Employment and Unemployment – 04.07.2008) Thus the employment rate for the 15+ has been at 53.35%, while the employment rate for the same age group stood at almost 50%, with the total employment being in absolute numbers 9.11 million.

For the working age population (15-64), participation rate stood at 61.8%, showing practically little variation as against the previous quarter or against the same quarter of 2007. Same goes for the employment rate where at 57.7% this indicator has gained 0.5 pp as against the same quarter of 2007 but in the meantime has lost 0.2 pp as against the last quarter of 2007.

While the unemployment rate drops it seems however that employment rates fail to grow by much. Actually if one will fully discard the national definition unemployment rate as representing a mere frictional unemployment (see here the case of Ilfov) or hard to dislodge long-term unemployment, then, the variations in the harmonized rate which is incremental, would more than match the variations in the employment rate and in the participation rate which are also incremental. Looking just at the

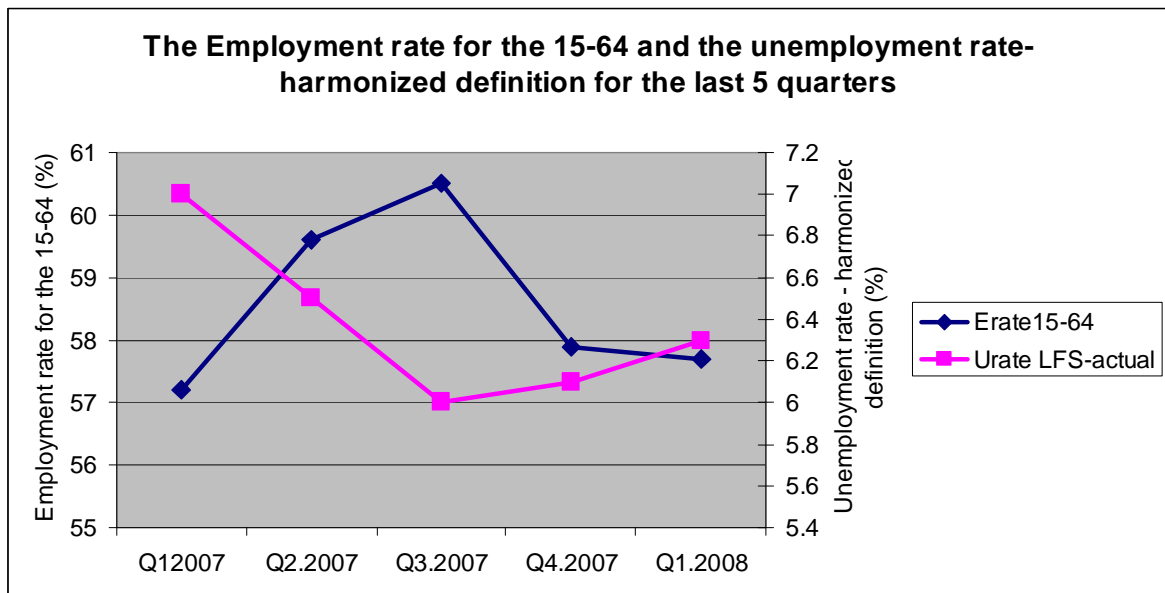
figures for the first quarter of this year, which has been characterized by stronger than ever expected economic activity (actually it is the best ever recorded first quarter in the terms of the GDP growth rate since Romanian returned to a capitalist economy in the early 1990s) then we will see that the two rates, namely the unemployment rate and the employment rate for the 15-64m, which constitutes the main reservoir for labour are moving hand in hand. While the unemployment rate has registered a small increase from the fourth quarter of the last year to the first quarter of this year, of 0.2 pp, this is practically perfectly matched by a decrease in the employment rate for the 15-64, also from the last quarter of 2007 to the first quarter of 2008, which is again of exactly 0.2 pp. Therefore, while some claim that there is a deficit of labour, the figures made available by the national statistics and which cannot be discarded due to the fact that they refer to the 1st quarter of the year as this year this has proved itself as being more than dynamic, show that what might actually be the case is a high turnover of labour, as workers aware of the fact that employment opportunities are in more ample supply than ever before in the last two decades and pay-cheques are on the rise tend to easily change jobs in the search for the best bet. From hereon the employer's bid for a more strict enforcement of contracts in the case of the firm's investment in its own human resources which would prevent fast changing of jobs as employees would have to remain in the companies long enough to return the investment they benefited from.

Unemployment rate for youngsters remain stubbornly high at 19.8%, therefore three times the average rate, a fact which only highlights the fact that the deficit is only apparent and localized as otherwise employers would have to jump into this untapped reservoir, which would theoretically at least accept wages lower than prime age potential employees. However, this does not happen which, once again suggests that it is not actually about deficit, with some exceptions of course, but it is about high turnover with which employers will have to cope, especially by improving working conditions and investing more so as to boost productivity and therefore be able to pay higher wages, which would dissuade at least partly the current over-mobility. Also, one has to take into account the rather low internal population mobility in Romania, which means that regions with high rates of growth and in need of labour have to rely almost entirely on their own resources, as they cannot practically tap into the labour reservoirs of other, so to say, slightly more depressed regions. True also is the fact that regions like Bucharest and the surrounding county of Ilfov, where the deficit is a reality nonetheless are also the ones where prices for lodging have simply exploded thereby making

almost impossible or firms to bring-in workers as they would simply collapse under the weight of this expenditure alone.

To Watch: Employment rates will be on the rise if the economy will continue to steam ahead at the same speed and indications are that it will. Therefore, expect even lower unemployment rates and a rise in employment and participation rate that would only be beneficial, though it would surely add to inflationary pressures;

Chart No.4



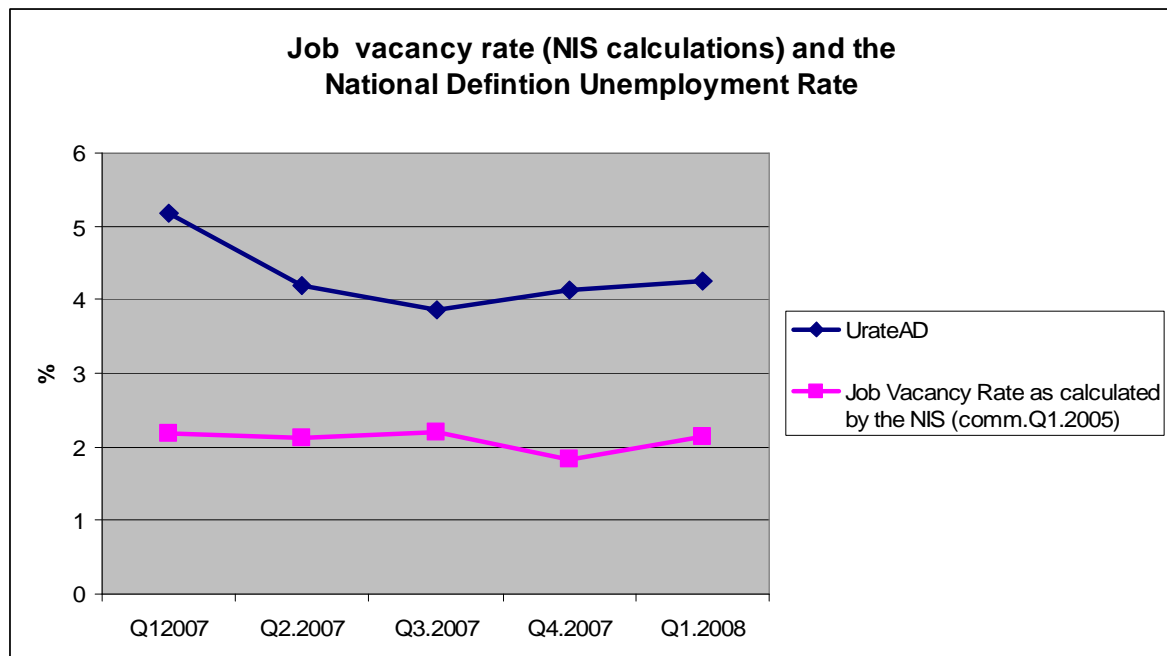
Source: NIS data;

Vacancy rates: The specialized research conducted by the NIS, shows for the 1st quarter of 2008, a vacancy rate of 2.14%, 0.32 pp higher than the one recorded for the last quarter of 2007, but at the same level with the one recorded for the same quarter of 2007. As between the 1st quarter of 2008, for which we now dispose of validated data for practically all of the main aggregates and the 1st quarter of 2007, in terms of economic growth there is a difference of 2.2 pp., one can only concur to the conclusion in the paragraph above, which are to be further confirmed by the fact that by far the highest rate of vacancies recorded by the NIS is located in the region of Bucharest and Ilfov, where the vacancy rate thus recorded outpaces the national average by almost 40%, being practically the sole region where, although such a comparison would be statistically not so appropriated but it is nonetheless interesting, the vacancy rate outpaces the registered unemployment rate (See also at www.insse.ro – 20.05.2008 – “Locurile de

Munca vacante in trimestrul I 2008”/ Job vacancies in the 1st quarter of 2008).

To watch: Vacancy rate might increase during the second quarter with the main spot being again the region of Bucharest and Ilfov where activity is simply bustling. If growth rates recorded during the first quarter of the year will keep up, it might be that the vacancy rate for the second quarter of 2008 be significantly higher than the one for the same quarter of 2007. If one would look upon the trends for the vacancy rate since the beginning of the NIS research in 20, would notice that each year has witnessed a one pp hike on the average, when compared to the previous year and this while growth rates have no been that high since the 4th quarter of 2004. Therefore it might be reasonable to believe that at such growth rates, vacancies will gobble more than 1pp.

Chart No.5



Source: NIS data;