INTERNATIONAL CONDITIONS WITH EFFECT ON ROMANIAN ECONOMY

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Abstract: *The global economy is a complex system, influenced by a variety of interconnected factors. In recent years, there have been notable global economic features, but also a series of unforeseen events that have negatively influenced it. The pandemic has had a profound impact on the global economy, leading to a significant contraction of economic activity and accentuating already existing vulnerabilities. As countries implemented measures to reduce the spread of the virus, economic output has declined. In the first months of 2020, there was an unprecedented decline in the GDP of all affected countries and implicitly of global GDP, the measures initially adopted led to economic stagnation, with knock-on effects on global trade, tourism and consumption of goods and services. Conflicts and political instability have also disrupted global trade and capital flows. The most recent example is the conflict in Ukraine, which has affected energy markets and supply chains. The increase in global inflation, especially due to the increase in energy and food prices, has reduced purchasing power and affected global economic growth. Although the Romanian economy has recorded sustained economic growth in recent years, managing to reduce the gap with developed countries in Western Europe, in recent years a series of macroeconomic imbalances have accumulated, namely increased public debt, rapidly growing external debt, very high interest rates on newly contracted loans, high inflation, budget deficit, trade deficit, current account deficit, imbalances that require efficient and sustainable economic policies to be reduced and not further hamper economic development. Continuing reforms and adapting to international conditions are essential for its economic future. The paper aims to create a picture of the domestic and international economic situation with an effect on the current and prospective evolution of the Romanian economy.*
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1. Introduction

The Romanian economy has experienced significant macroeconomic imbalances over the past years. As the 12th largest economy in the European Union by nominal GDP, Romania has seen robust growth rates, including a notable increase of 4.8% in 2022. This growth has primarily been driven by strong domestic consumption, rising wages, and a declining unemployment rate following the lifting of pandemic restrictions. However, the economic landscape has been marred by persistent challenges such as high inflation, currency depreciation, and fiscal deficits, which raises questions about the sustainability of this growth trajectory.

Several internal and external economic factors have influenced Romania's macroeconomic stability during this period. Domestically, issues such as government financial management, and inflation dynamics have played important roles. In 2023, the government faced a fiscal deficit of 9% of GDP, exacerbated by rising public sector wages and the economic fallout from geopolitical events, notably the COVID-19 pandemic and the ongoing conflict in Ukraine. The annual inflation rate reached an average of 12% in 2022, driven primarily by energy and food prices.

Romania's economy is intertwined with its European Union partners, with approximately 80% of its trade conducted within the EU. This integration has provided access to vital markets and funding, yet also exposed the economy to vulnerabilities linked to global trade dynamics and geopolitical tensions. Although it was recorded a gradual recovery in external demand, concerns remain regarding the impact of geopolitical risks, which could hinder growth and exacerbate inflationary pressures.

Despite the encouraging growth trajectory, Romania has faced multiple economic challenges, particularly in 2023, where it dealt with high inflation rates, currency depreciation, and fiscal imbalances.

2. International context

The pandemic has had a profound impact on the global economy, leading to a contraction in economic activity and exacerbating existing imbalances. As countries imposed lockdowns to reduce the spread of the virus, economic output has declined. In the first months of 2020, there was a major decline in GDP across all countries. International trade has also faced disruptions, as border closures and reduced demand led to a severe decline in global trade volumes.

At the end of 2021, global output was below its pre-pandemic level. Inflation rates have risen, driven by government stimulus measures, supply chain disruptions, and the expansion of the money supply in response to the crisis.

Government responses to the pandemic have included substantial fiscal stimulus packages designed to alleviate economic hardship.

Supply chain disruptions have emerged as a negative factor for the global economy in recent years, triggered by the pandemic and continued by geopolitical tensions, namely Russia's invasion of Ukraine, rising tensions between China and Taiwan, the conflict in the Gaza Strip. These disruptions have not only affected production and logistics, but have also led to rising costs and inflation in various sectors.

According to IMF data in 2023, inflation rates increased globally, reaching a rate of 6% in advanced economies and 9.5% in developing economies. The persistence of inflation is due to a large number of factors, namely supply chain disruptions, which have exerted considerable cost pressures on economies around the world, then the increase in raw material and energy prices, which have spread to all areas of the economy, especially food, followed with some lag by wage increases that were required to cover the devaluation created by inflation, followed by an increase in demand that together with fiscal incentives from governments to support disadvantaged categories but also companies, have intensified inflationary pressures in many countries.

The recession has led firms and financiers to be cautious about new investments abroad, even as they prepare for potential capital expenditures in a "recovery" phase. Geopolitical instability, inflation, and rising interest rates continue to pose threats to global economic stability, impacting sector growth and investment profitability expectations.

Technological advancement has been a significant driver of change in economic development. The shift to a digital economy has opened up new markets and opportunities for businesses to thrive, facilitating global reach and increasing competitive dynamics. As companies adopt new technologies, traditional economies face challenges that require adaptive strategies for development.

In addition, global efforts are being made to gradually eliminate dependence on fossil fuels, while ensuring that the transition to renewable energy sources is accepted across all countries.

Before the outbreak of the coronavirus pandemic, the economic landscape in the European Union was characterised by a gradual recovery from the global financial crisis of 2008 and the sovereign debt crisis of 2012. Economic activity has been resilient, supported by various structural reforms. However, existing vulnerabilities persist, in particular high public debt in several Member States and low productivity growth in some economic sectors.

The pandemic has led to a sharp contraction in economic activity across the European Union. Initial restrictions to curb the spread of the virus have led to a collapse in economic output, with the impact varying by economic sector and region. The pandemic has initially hit industries such as tourism, travel and retail. As firms have struggled with the economic environment, labour markets have tightened, leading to rising unemployment rates and increasing uncertainty among investors.

As restrictions began to ease in 2021, economic activity began to rebound. However, the recovery has been uneven across EU countries, influenced by the different sizes of fiscal support and the economic conditions prevailing in each member state.

In response to the economic crisis, EU Member States implemented a series of fiscal measures aimed at supporting businesses and maintaining employment. The European Commission launched a recovery plan aimed at stimulating economic recovery and strengthening the resilience of the European Union economy through targeted investments in certain economic sectors, in particular innovation and digital transformation and green energy.

The Recovery and Resilience Facility was set up as an instrument to mitigate the economic and social impact of the pandemic. The Facility was designed to support Member States in implementing essential investments and reform measures as set out in their recovery and resilience plans. The Recovery and Resilience Facility plays an important role in facilitating the transitions to green energy and the digital transition by financing various initiatives, such as decarbonising transport and digitalising public services.

The European Union, through the Recovery and Resilience Facility, will strengthen infrastructure investments aimed at improving energy efficiency and the transition to low-emission production processes, in particular for energy-intensive sectors. However, ongoing uncertainty and structural changes are likely to continue to impact segments of manufacturing, particularly in energy-intensive industries.

The global economic downturn, exacerbated by an energy cost shock, has affected the ability of EU firms to maintain their market share. However, firms have been able to pass on some of the increase in import costs to export prices, largely due to the high degree of openness of the EU economy and the role of the euro as the main invoicing currency.

Inflation rates in advanced and emerging economies rose significantly in 2021, driven by high energy prices, disruptions to global production networks, and labor shortages. High energy prices have emerged as a major negative factor for the European Union economy. Rising oil and gas prices, driven by recovering demand, have put pressure on inflation rates. The European Central Bank has sought to manage inflationary pressures by coordinating effective economic policies to stabilize the economic environment while enhancing competitiveness.

The economic outlook for the European Union has been significantly influenced by various external and internal factors over the past two years. A notable impact has resulted from the ongoing war between Russia and Ukraine, which has introduced considerable uncertainty into the global economic environment. The conflict has affected the European

Union through financial and trade sanctions against Russia, which have led to rising commodity prices and trade disruptions due to the exclusion of Russian companies, especially those supplying raw materials, oil and gas.

3. Internal context

The Romanian economy has experienced significant changes in recent years, reflecting both recovery and the difficulties it must adapt to.

The global supply chain has faced numerous disruptions in recent years, exacerbated by the coronavirus pandemic and logistical constraints. Logistics disruptions, semiconductor shortages, and labor shortages have had a major impact on the timely delivery of goods, contributing to rising prices and an uneven recovery in trade. These supply chain issues have been identified as a factor affecting trade volumes and the pace of economic recovery in Romania.

Geopolitical tensions, especially the conflict between Russia and Ukraine, have complicated Romania's commercial landscape. In early 2023, oil prices almost doubled from the previous year due to various factors, including these geopolitical tensions, which have implications for inflation and overall economic stability.

Inflation has emerged as a significant economic challenge for Romania, especially after the recovery from the pandemic. By early 2022, prices had already increased by 8.2% compared to the previous year. This increase was attributed to the increase in agri-food prices, energy and transport costs, exacerbated by persistent blockages in production and supply chains, influenced by the coronavirus protection measures. The National Bank of Romania indicated that consistent increases in electricity and natural gas prices were major factors in the increase in inflation, along with the influences of fuel prices and the costs of public utility services.

The war in Ukraine has reshaped economic expectations for Romania. Initially, forecasts were optimistic, taking into account the recovery from the pandemic and the absorption of European Union funding. However, the conflict has escalated the energy crisis, further worsening inflation that was already rising due to supply chain disruptions. By the end of 2022, the annual inflation rate reached 16.8%, up from the previous year. In response to persistent inflationary pressures, the NBR, following the model of other national banks, was forced to increase the central bank's policy rate several times during the year. Inflation remained well above the central bank's upper target limit, largely due to the lifting of the electricity and gas price cap scheme, as well as the EU embargo on Russian oil imports in 2023.

Rising inflation, driven by rising energy prices and supply constraints, was a negative factor for Romania's economic recovery and for household purchasing power, leading to a decline in total consumption.

The presence of the untaxed "grey" sector in the economy complicates labor market dynamics, with total tax revenues remaining below 30% of GDP, one of the lowest rates in the EU.

In recent years, Romania's trade dynamics have been significantly influenced by global economic conditions, including supply chain disruptions, geopolitical tensions, and commodity price fluctuations. In 2023, Romania's imports of goods and services amounted to approximately USD 154.12 billion. Imports increased by 2.40% in 2023 compared to previous years, reflecting ongoing demand and economic recovery trends. Exports also play an important role in Romania's economy, with the value of exported goods and services reaching significant annual figures. In 2023, exports recorded a decrease of 1.41%.

Foreign direct investment has been a critical factor in Romania's economic landscape, with net inflows reaching approximately USD 11.48 billion in 2022. This figure demonstrates interest from international investors, reflecting Romania's growth and development potential. In contrast, portfolio stocks have seen a decline, with a reported 7% decline in 2023, indicating fluctuations in investor confidence and market conditions.

Geopolitical tensions, especially the conflict between Russia and Ukraine, have also posed significant risks for the Romanian economy. The potential for an escalation of armed conflict could lead to dramatic increases in oil prices if tensions materialize.

The economic outlook for Romania remains uncertain, with forecasts indicating that continued geopolitical instability could further affect the global economy and push prices higher. The future dynamics of Romania's economy depend on both international economic conditions and local responses.

In 2023, Romania's economy presented the following main characteristics:

- GDP growth of around 2.1% in 2023, above the EU average, although lower than in previous years. This slowdown was influenced by inflation and the global economic context.

- Romania ended 2023 with a budget deficit of approximately 5.7% of GDP, above the initially assumed target, which remained a major concern for economic stability.

- The trade deficit remained significant, although there was a slight improvement compared to the previous year. Exports increased, but imports continued to exceed them.

- The current account deficit stood at around 24 billion euros in 2023 , representing approximately 8% of GDP , a slight reduction compared to 2022, when the deficit was around 26.6 billion euros .

- Import-export coverage was approximately 80%.

- The budget deficit was 5.7% of GDP, above the target of 4.4% of GDP, with a gradual reduction plan towards the 3% target according to EU criteria.

- Public debt continued to increase, reaching around 50% of GDP, but remains below the EU average.

- High inflation rate, reaching high levels in the first part of the year, but with a downward trend towards the end of 2023, reaching approximately 10.4% in December 2023.

- The unemployment rate is relatively stable, around 5.4%.

- The average net salary continued to increase, exceeding 4,000 lei, the equivalent of 800 euros.

4. Conclusion

The economic landscape in Romania over the past five years has been significantly influenced by various imbalances, particularly in the current account, budget, and trade sectors. These imbalances have had profound effects on the nation's macroeconomic stability and growth trajectory.

The persistent current account imbalance in Romania has been largely driven by a structural fiscal deficit, which has weakened the overall economic framework. The fiscal deficit has been identified as a principal factor exacerbating the current account deficit, with implications for debt accumulation and currency valuation. High levels of trade deficits, (particularly in key sectors such as food, fuels, chemicals, and manufacturing), have contributed to a deterioration of the balance of payments. The trade imbalance has been exacerbated by strong internal demand and insufficient production capabilities to meet this demand, leading to an increased reliance on imports. Such trade imbalances can trigger economic repercussions, including potential debt crises and currency devaluation, particularly if foreign reserves are depleted due to continuous trade deficits.

Year by year, Romania faced a budget deficit, indicating a deterioration in public finance management. The budget shortfall has necessitated actions from policymakers, including potential cuts in public spending and a re-evaluation of investment plans.

Inflation has emerged as a critical concern, with core inflation driven by rising wage pressures and constrained by cautious monetary policy. The inflation rate peaked significantly in 2022, reaching 14.6%, and although it fell to 6.7% by early 2024, it remained well above regional averages, indicating underlying economic stress. High inflation rates can adversely affect consumer purchasing power and overall economic activity, further complicating the situation stemming from trade and fiscal imbalances.

Foreign direct investment inflows are recognized as significant contributors to the economic landscape of Romania and play a crucial role in influencing the country's current account, budget, and trade imbalances. A variety of macroeconomic factors (market size and growth, trade openness, economic stability) impact FDI and, consequently, the overall economic situation in Romania. The economical and political stability of a country are essential for attracting FDI. Investors often seek environments where there is a strong regulatory framework, transparency, and low corruption levels, and this can be done by involving decision-makers at the state level.

Structural reforms have been a focal point of Romania's policy response to macroeconomic imbalances. Efforts to enhance governance and improve public service delivery are essential for achieving sustainable economic growth. The government is prioritizing the transition to a carbon-neutral economy, recognizing the need to modernize its industrial base and infrastructure. The government has to implement a series of fiscal and structural reforms aimed at restoring economic stability and growth. Measures include significant cuts in public sector expenditures and tax reforms designed to enhance revenue generation, must be adopted. These efforts are crucial for addressing the macroeconomic imbalances and securing the long-term sustainability of Romania's economic development, particularly in the face of ongoing domestic and international uncertainties.

The absorption and effective utilization of EU funds, especially those from the Next Generation EU programme, are critical for Romania's economic stability and growth. These funds are tied to the successful implementation of structural reforms, including energy transition and governance improvements, which are necessary to mitigate the contractionary impacts arising from geopolitical conflicts and budget consolidation measures.

The continued inflow of EU funding and foreign investment is essential for sustaining growth and enhancing Romania's competitiveness on the global stage.

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