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## THE GOVERNMENT LAUNCHES THE PLAN TO DEEPEN AND PROLONG THE CRISIS IN ROMANIA

The unavoidable recession

After months of denying the economic reality, the Romanian government announced, two days ago, the initiation of a 10 billion Euros worth plan against the crisis. The stock market was unimpressed and dropped 5% more yesterday, and the business environment gave the Prime Minister's proposals a lukewarm reception.



Nevertheless, by announcing the plan Romania joined an elite club: that of countries with far-fetched proposals to stop a crisis which they themselves have created, to which they paid no heed when it started rising above the horizon, but they are now struggling to contain. How can the effects be eliminated, if the causes are not tackled directly?

In Romania the monetary and fiscal policy have largely contributed to the creation of an illusion of prosperity, which only lasted as long as cheap money was flowing into the economy. A return to a similar situation will take place many years from now, maybe even never.

The government's plan would be "bliss" (author's note: Why only 10 billion Euros?), if it didn't have one little problem, which was also noticed by the IMF representative: the financing sources. Does the government intend to issue bonds? If yes, then it had better be prepared to face harsh competition for attracting funding, because almost all the governments of Europe have announced fiscal stimulation plans.

The proposals for the reduction of Social Security Contributions, the granting of subsidies and the building of social housing will not help increase Romania's economic competitiveness. The plan tries to preserve the current economic structure, but the perspectives for economic growth are almost void in that case. Will retained dividends be exempt from taxes? But why not all dividends, as profit gets distributed to the shareholders after the payment of profit tax? And this is just one classic example of double taxation.

The government's direct expenses for the construction of social housing will inflate the prices of construction materials again and will stop the correction of the real estate market. The housing prices must drop by at least 70%, from the current levels, in order to reach a level which would match the average income of the Romanians. The prudent people, who saved money in the hope of buying a home, will be punished by the government and will sadly watch their dream vanish into thin air.

The IMF representative also estimates that the new fiscal relaxation will cause the budget deficit to increase up to more than 3% of the PIB. It is possible that the increase above this level is just an optimistic scenario of Juan Jose Fernandez Ansola, which is very unlikely in these times of crisis.

If the current rate of mass layoffs remains steady, it will put a huge strain on budget revenues. The latter will have to be balanced by a drastic reduction of expenses, and the target for the budget

deficit must be 0%. The chances of a pragmatic approach of the crisis after the election are low, because most of the electoral programs are completely disconnected from reality. The main political parties consider a 4% GDP growth as worst case scenario. What will they do when the NSI (National Statistics Institute) reports a contraction of the economy by the end of next year?

All the economic indices of the developed countries show that the estimates for 2009 are glum. John Whitehead, former chairman of Goldman Sachs, stated during a conference at the Reuters Global Finance Summit, that the economy of the United States will face a crisis which will surpass the Great Depression of the "30s. Whitehead warned that the financial strength of the USA is threatened by the requests for the reduction of tax burdens and by the long list of government plans, according to news by Reuters. "Before I go to sleep at night, I wonder if tomorrow will be the day where Moody's and S&P will announce a downgrading of the rating for the United States Government bonds. Eventually, the United States bonds will lose their AAA rating, which they have always had", John Whitehead further stated. Unfortunately, the former chairman of Goldman Sachs considers that the increase of taxes is needed to finance the programs that the government announced, but there is no political to do such thing.

A little closer to us, the Baltic Countries might need to give up on the monetary council until the second half of next year, and to depreciate their currencies, in order to avoid an extended recession. This is the opinion of the analysts of Bank of America, as presented by Bloomberg. "If the real exchange rate is overvalued, there are two options: you can devalue the currency or you can accept the recession, to lead a relative drop in inflation in relation to the commercial partners ", stated David Hauner, an economist at Bank of America, for Bloomberg.

The implementation of the devaluation scenario, even under conditions of a remission of the financial crisis, will have a deeply negative effect over all the Central and East European currencies. Speculative attacks will become the norm rather than the exception.

Regardless of the optimistic declarations of our authorities, Romania enters the crisis with an extremely fragile economy, based on services and constructions. The latest data from the NBR show that the medium and long term foreign debt at the end of September, was higher than 48 billion Euros, up 25% compared to the end of the year 2007. The foreign debt not backed by the state grew by almost 26% during the same period, reaching 31,5 billion Euros. Romania's main problem is not given by the size of the debt, but rather by the extremely high difference between its rate of growth, compared to the rate of growth of the GDP. Where will the reimbursement funds be found?

For Romania, the solution lies not with Keynes, and even less so with Marx. The crisis represents an opportunity to increase savings and create a basis for the national capital, which would allow a relaunch of the economy. There are solutions, but the time is up for debt-based growth.

Note: This article represents the author's point of view, does not reflect or implicate the opinions of his employer, and does not represent an investment recommendation.

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"I've always been a positive and optimistic person, but this time I see no solutions."

John Whitehead, former chairman of Goldman Sachs