

## TRENDS OF THE ROMANIAN ECONOMIC GROWTH IN THE EU ENVIRONMENT

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**Abstract:** *Given its economy, which is open and strongly integrated into the European Union economy, Romania is sensitive to external economic environment changes and especially to the economic evolution of the main trade partner countries in the European Union. A macroeconomic approach must especially consider, for the external sector, the European Commission plans, namely those of the Autumn 2006 Forecast, meaning that in the reference period, the economic growth stands strong, despite the estimation of a moderation as compared to the achievements of 2006.*

**Keywords:** economic growth, forecast, development, inflation.

### *European prospects*

Economic growth in the European Union countries is determined by the significant increase of the domestic demand, which is a positive prospect, important for the economic development of Romania.

In 2007 and 2008, the European Union economy is expected to grow close to its potential. The autumn forecast of the European Commission stated that in 2006 – the best year after 2000 – the economic growth reached 2.8% on the whole of the European Union (2.6% in the Euro area), being estimated at 2.4% in 2007 and 2008 (about 2.2% in the Euro area).

These estimations are based on a positive prospect on the global economy, even if, as far as the USA are concerned, a lower growth is anticipated (from 3.4% in 2006 to 2.3% in 2007 and 2.8% in 2008)<sup>1</sup>. Moreover, other recent estimations of certain specialized international institutions state that the optimistic economic growth prospects in the main trade partner countries and even in the whole Euro area in 2007 are well-grounded<sup>2</sup>.

An important support of the Romanian economy development is the fact that the European economy is influenced by the domestic demand. The

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1 Another item considered by the macroeconomic scenario is the expected negative impact on the economic growth of the VAT increase in Germany in 2007. This is the more important as Germany is the second largest trade partner (after Italy) of Romania, with a percentage of 15% of the overall exports (in and outside the EU). As for Italy, which has a percentage of almost 20% in the Romanian exports, an annual increase of 1.4% of the economic growth is estimated.

2 Thus, the “Consensus Forecast” publication reviewed its forecast on the GDP increase in the Euro area from 2.5% in September 2006 to 2.7% in December (for Italy, from 1.6% to 1.7%; Germany, from 2.2% to 2.5%; Austria, from 2.8% to 3.1%; France is an exception, where the forecast decreased from 2.3% to 2.1%).

annual investment increase is considerably higher than the one of the previous cycles and, moreover, the investment conditions remain positive: significant profits, improving capacity use rates.

On the whole of the European Union, investments are expected to grow by 3.6% in 2007 and 3.3% in 2008. Also, consumers' confidence remains high, which grounded an estimation of an annual consumption growth estimation of over 2%.

The estimations of the macroeconomic scenario rely, in addition to the significant increase of the European economy and positive global economic and financial conditions, on other assumptions like: stability of the international goods prices, moderate oil price increase (about 1% in 2007 and 2.5% in 2008), gradual improvement of the labor market (decrease of the actual labor and unemployment unit cost) and diminution of budget deficits.

#### ***Romanian economy: growth, expectations, scenarios***

After 2005, Romania has experienced a slowing down of the economic growth rhythm of 4.1%, given the extremely difficult international and domestic conditions, in 2006 an increase of the gross domestic product over its potential occurred. The 7% gross domestic product increase is the highest in the last few years.

An important characteristic of the economic growth is the well-balanced contribution of the components of aggregated demand, with an accelerated increase of the gross fixed capital formation and of the goods and services exports, as compared to those of 2005.

In the same line with this trend, the gross domestic product increased further to superior dynamics of the gross fixed capital formation and of the improvement of the negative contribution of the net exports, as a consequence of an accelerated goods and services export.

These evolutions led to increase of the gross fixed capital formation by more than 13%, as compared to about 10% in 2005 and to the decrease of the contribution of the net export to the actual increase of the gross domestic product from 5.7% in 2005 to 4.6% in 2006.

Positive effects of the economic growth, especially further to the investment increase, were noticed both in the improvement of the employment structure in various business sectors, and in most of the employed population by 2.4% in 2006 as compared to 2005. The highest increases were noticed in the constructions and services sectors.

The population employed in agriculture decreased to 30.8% of the whole employed population. The employment rate of the population fit to work (15 to 64 years of age) has had an increasing trend as of 2005, being 59% in 2006.

The unemployment rate according to the International Labor Office has continuously decreased, each quarter, reaching 7.0%. Romania's achievements related to inflation decrease, although more modest as compared to other countries in the center and East of Europe, have been obvious even since 2000.

The inflation rate calculated as annual mean value, is also considered by the European Commission, reached for the first time in 2005 after the revolution a one digit level, namely 9.0%.

At the end of 2006, the inflation rate decreased to a historic level of 4.87%, inflation deceleration being more pregnant in April due to a basic effect, but also in July and September, when the quarterly inflation rate clearly showed a deceleration of the price increase rhythm.

The strong disinflation process is firstly due to the positive effects of the combination of monetary and fiscal policies that were implemented, to the improvement of the market expectations regarding the disinflation trend sustainability and the increased competition in the retail sector.

Moreover, the administrated price increase was more moderate, and the volatile prices of the agricultural sector were additionally adjusted by the deflation of the food group<sup>3</sup>.

As concerns demand, the inflation potential created by the consumption increase, which was rather the effect of credit expansion than of population wages income increase, was moderated by the positive import price evolution, determined by the continuous strengthening of the national currency.

### ***Medium-term development process and cyclic evolutions***

According to the estimations of the Cobb-Douglas functional form of production, the mean increase rate of the potential gross domestic product calculated for the period 2006-2009 is 6.08%.

Due to certain significant investment increase rates, the capital stock will increase on the average by 2.4% each year, at a depreciation rate of 5%. This evolution will lead to the increase of the capital contribution to the increase of the potential gross domestic product. The employment rate of the population fit to work (15 to 64 years of age) will have an increasing trend, of about 0.1% per year. We should point out that the evolution of the employed population is expected to change beginning with 2007, which will lead to a positive contribution to the increase of the potential gross domestic product.

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3 In fact, in August 2006, for the first time in 1990, the monthly inflation decreased by 0.07%. As compared to the mean value of 2005, consumption prices increased by 6.56%, being by 2.44% below the level of the similar period of the previous year.

Total factor productivity (TFP) will continue to have the most significant contribution, due to the qualitative technological improvements associated with direct foreign investments, as well as with an improved business environment.

The output gap remains positive but decreasing in the near future, as inflation pressure reduction and disinflation process continuation are expected. This will diminish by 0.66% as compared to 2006, reaching 1.33% of the potential gross domestic product in 2009.

Finally, the economic growth estimated for 2006-2009 is on the average similar to that of the potential gross domestic product. Its evolution grounds the expectations concerning the acceleration of the actual convergence process to the economic level of the member states of the European Union.

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