Mugur Isărescu: 10 years since the launch of Ziarul Financiar

Speech by Mr Mugur Isărescu, Governor of the National Bank of Romania, on the occasion of 10 years since the launch of Ziarul Financiar, Bucarest, 16 December 2008.

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It is a great pleasure for me to be present at this special anniversary of *Ziarul Financiar*. The one-decade long presence of this prestigious economic daily newspaper overlapped a turbulent period in the history of Romania.

Allow me to dwell for a while upon a series of events that occurred shortly after the release of the first issue of *Ziarul Financiar*. In the wake of the crises in Russia and Southeast Asia, Romania's need for external financing was much more difficult to cover, while the then level of foreign currency reserves left the authorities with little room for manoeuvre. Back then, the same as today, the rating agencies were extremely cautious in assessing Romania's country risk, and according to the headlines disseminated obsessively by international agencies for over a year, Romania would have faced an imminent payment default. At that moment, the situation became even more complex due to the fact that the International Monetary Fund resorted to a new approach to indebted countries, called P.S.I. (private sector involvement) or "burden sharing". This approach, which was tested in four countries including Romania, proved to be a failure, and the IMF later abandoned it. However, Romania had to choose between adjusting its external deficit by its own means or take foreign borrowings under unacceptable conditions. Romania adopted the former solution and subsequently signed an agreement with the IMF. Nevertheless, Standard&Poor's, which had promptly downgraded Romania's rating to one notch above a level which would have indicated external debt payment default – which had not occurred in the case of Romania – maintained this low rating for a long time, even after the crisis had been overcome band the country's reserves had resumed growth.

I reminisced this event that occurred ten years ago as I have been experiencing a particularly strong déjà-vu feeling during recent months. First came the bleak assessments of some foreign analysts, followed by the failed speculative attack against the RON. The next stage of the game was the downgrading of the sovereign rating to below investment grade, Romania being the only EU Member State in such a situation. Yesterday, I read another comment anticipating neither more nor less that Romania and Bulgaria risk a default on sovereign foreign debt payments even though most of the foreign debt stock is private. In order to underpin this viewpoint, the most far-fetched reasons are put forward, such as the cases of other countries in the region that concluded agreements with the IMF or the statement that the Bulgarian and Romanian currencies have depreciated against the US dollar, even though the Bulgarian currency is pegged to the euro and fluctuates against the US dollar at the same rate as the euro, while the RON is traded against the euro. To a certain extent, this approach is similar to that used during 1998-1999.

There is however a fundamental difference, despite its being mentioned only occasionally, namely that Romania's foreign exchange reserves are currently higher than its whole stock of public debt. Therefore, by implementing appropriate domestic policies, Romania is likely to move past this period in better conditions than in 1999.

I strongly believe this for yet another reason: the past decade as a whole – covered together with *Ziarul Financiar* – marked significant progress for Romania. We should not overlook that our country witnessed economic growth in nine years out of ten, while annual GDP growth rates exceeded 5 percent in seven years out of ten. The three-digit inflation rates of the early '90s dropped to single-digit levels in recent years.

Moreover, Romania's joining NATO and the European Union also places it in a political context underpinning sustainable economic growth. This year's gross domestic product will amount to nearly EUR 140 billion, i.e. EUR 6,500 per capita. In 1999, Romania's GDP stood at merely EUR 33 billion, while GDP per capita was lower than EUR 1,500. This leap, which led to significant changes including higher consumer standards, will have to be accompanied by similar progress in understanding economic issues, so that the path forward should be as smooth as possible.

If we look at the long-term development of the Romanian society, the decade elapsed since the launch of *Ziarul Financiar* is a significant landmark, which can be compared with the significant upturn after World War I and the achievement of the Grand Union of 1918.

At such turning points, the quantitative developments, which are nonetheless important, need to be accompanied by qualitative changes that are related to social philosophy as a whole, as well as to progress in national standards and values. From this perspective, the opinion-makers and the press in general play a major role. Economic newspapers in particular find themselves in a very special position.

As a matter of fact, the National Bank of Romania has steadily promoted economic education and has done its best to raise journalists' level of professionalism when approaching economic issues. Let us remember that *Ziarul Financiar* was launched ten years ago in the very Marble Hall of the NBR. Numerous occasions have arisen over the years when NBR representatives participated in events organised by *Ziarul Financiar* and vice versa. There has been a steadfast dialogue benefiting, in my opinion, both *Ziarul Financiar* journalists and central bank experts. And, if it is true that the central bank should not be confined to an ivory tower, it holds equally true that economic media should avoid slipping into cheap sensationalism, which only yields short-term gains. Eventually, the media should help its public take informed decisions, to the benefit of overall economic developments.

I am well aware that shaping the public opinion is neither simple, nor linear. It is hard for a generation that has learnt that prices are formed by adding the planned benefit to the planned cost to grow accustomed to today's reality, when price formation depends on demand and supply. Hence the greater difficulties faced by economic policymakers, analysts and the media alike.

Disseminating – sometimes in good faith – the statements of certain market participants may equally generate confusion. For instance, let us recall that representatives of some edible oil producers claimed a few months ago that the price of their products would be on the rise, although this year's market supply is several times higher than a year earlier. As it was normal, edible oil prices entered a downtrend which is likely to persist given the change in the supply-demand ratio. Another example is that of a businessman who said that weaker demand in a particular industry would entail higher prices in the producers' attempt to safeguard their profits. This was another statement that did not receive an adequate response, so that the message conveyed to the market is that prices will rise no matter what.

Another instance I would like to briefly refer to relates to the assertion of several colleagues from credit institutions, who claim that the NBR performed some sort of a trick in October 2008, making the liquidity in the banking system vanish. In other words, in its attempt to sanction those having orchestrated the speculative attack on the domestic currency, the central bank actually hit domestic credit institutions. Understanding the channels whereby RON-denominated liquidity moves about in the system is, indeed, quite complex and hence likely to easily generate confusion and twist the true meanings of words and actions. In fact, one cannot speak of a liquidity crunch as long as banks have complied with the 20 percent level of reserve requirements in both October and November (according to preliminary data). At most, relative decreases might occur temporarily relative primarily to corporate tax payments to the government budget. But even in such situations the NBR provides a lending facility, allowing immediate access to all banks capable of setting up the required collateral.

The fact that some banks have not taken due care to set up a stock of government securities in a timely manner only means that the management of these credit institutions has decided to take chances for higher profit and increased market share. However, it is often the case that taking chances does not necessarily bring profit alone.

The role of specialised media in grasping the actual dimensions of the phenomena under review is equally important. Furthermore, a specialised newspaper boasting the strength and the prestige of *Ziarul Financiar* has the obligation to judiciously calibrate any piece of information with an analysis of its significance. For instance, the media have adopted a bleak, sometimes apocalyptic, tone these past few days amid an abundance of news alerts on the likely number of unemployed over the upcoming months, i.e. around 30,000 individuals. Of course, taken individually, anyone being made redundant is faced with a tough issue. However, from an economy-wide perspective, the rise in unemployment by 30,000 people only accounts for about 0.5 percent of the workforce. Coupled with the very low level of unemployment (3-4 percent) prior to the outbreak of the ongoing global recession, the economic analyst will conclude that unemployment is hardly a pressing issue in Romania for the time being.

On the other hand, it is equally true that the short-term outlook for the domestic economy is not and cannot be too favourable. To the bleak international environment added what we may also call the irrational exuberance of both markets and, on many occasions, state authorities. In my opinion, the mixture between a hostile external environment and what seems to be an inadequate domestic response to this environment stands out as the underlying reason for which rating agencies have downgraded, sometimes rather severely, our sovereign rating. Of course, we may voice our discontent with the rating agencies' evaluation. At times, rating agencies themselves have facilitated our criticism. Indeed, I find it hard to understand how an earnest rating agency might assess sovereign risk without even referring to that country's level of public debt and international reserves. As a professor, I can safely assume that the "subject is not treated", hence the conclusion is unsubstantiated.

As concerns these assessments, I must say however that things are not in the least that simple. Of course, we could assert that at present our economy is in a better position than those of other countries in the region rated within the "investment grade" range. But those countries have at least adopted austerity measures at domestic level.

How do things stand in our country? After two consecutive years of wage increases in a range from 20 percent to 25 percent per year – i.e. more than twice the labour productivity gains – the wage rises envisaged for 2009 ranged between 50 percent and 60 percent, whereas the agreements with the trade unions, whenever struck, do not provide for hikes lower than 35 percent. Such an approach reveals a dangerous decoupling between aspirations and reality. In the current international context and given the already dangerously high level of external deficit, we must not aim at further increases in domestic consumption above labour productivity gains, since there are no more financing sources for something like that. And unless we understand this state of affairs ourselves, rating agencies are going to warn us. And if we act so as to reach wage agreements and even compile laws that are not backed by real economic resources, and if demand – potential at this moment – becomes real and immediate, we might witness some of the worst effects possible. The wage rise will not bring about a higher living standard – on the contrary, all the accomplishments made in terms of economic stability, investment expansion and growth potential over the past years might dissipate very easily. As I have already stated before the Parliament of Romania, should the improvement of the living standard boil down to a matter of willingness and political decisions, there would no longer be poor countries anywhere in the world.

It is true that the economic press tackles this issue in a balanced manner. The economic press evolved significantly over the past decade. Now we have dedicated publications, even dedicated TV channels, a financial analysts' market, which is ultimately indicative of a mature Romanian society. I would even dare say that economic journalists and analysts are generally more connected to reality than most decision-makers.

I must be very clear about one thing: Romania has no alternative to adjusting domestic demand in order to visibly cut down external deficit. I know how painful this is and I am well aware of the difficulties that every government encounters in putting this measure into practice. I was head of government during the critical period of 1999-2000 and I know exactly how difficult it is to adjust domestic consumption, even by two percentage points of GDP only. This time, the difficulty posed by the adjustment will be perceived as rather big, because it must be accomplished after several years of significant increases in consumption. The trend seemed to go on forever, which led to the decoupling between aspirations and real possibilities to fulfil them. Therefore, it is adequate to adjust domestic demand sooner rather than later, as long as we still enjoy a marked economic growth, given that at this point adjustment implies only resizing and not amputation.

An essential issue that the Romanian society must solve without delay refers to what should be adjusted first: consumption or investment. I realise that we must ponder on this matter. The question is whether we should opt for buying an increasing number of cars or set aside resources in order to build the adequate road infrastructure. In a few years, the former choice could lead us to a total traffic jam, and the only additional consumption left for us could be that of carbon monoxide released by the exhaust pipes. This example is not only metaphorical. We can see everywhere that the imbalance between domestic consumption and saving, as an investment financing resource, is already posing serious problems, both to the economy as a whole and to citizens – whose true living standard is paradoxically amputated precisely as a result of the imbalance between consumption and investment.

The current state-of-affairs is undoubtedly a critical one and therefore the adjustment of domestic demand cannot be delayed. It is not my intention to dramatise or to give any unjustified warning. But, as I have pointed out on other occasions as well, either we will proceed to a soft landing via wise domestic policies or we will face an adjustment triggered from outside, by the external capital market, and in this case the adjustment will be neither smooth nor reasonably sized. I have only one thing to add to my previous statements on this topic: the international context no longer leaves too much time for hesitations.

I would like to end on an optimistic note. As a matter of fact, *Ziarul Financiar* has adopted more often than not a positive note, which I wish it can keep unaltered. With you by my side, I have confidence in our country's future. And I wish, as much as you do, that wisdom prevail in front of impatience, and that the risk of a severe slippage fail to materialise in the forthcoming months.

With these thoughts, I wish the best of luck to all the editors of *Ziarul Financiar* as well as professionalism in dealing with the difficult economic issues to all the economic media.