26. ROMANIA

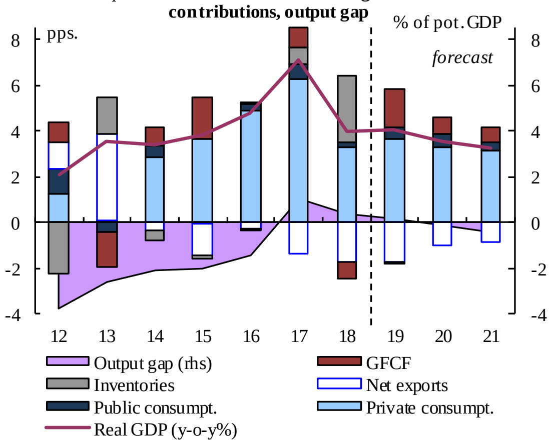
Fiscal loosening driven by pension increases

Real GDP growth is set to remain robust in 2019 driven by private consumption and a recovery in investment. Net exports are projected to continue to weigh on growth while the current account is set to worsen further. Growth is forecast to ease in 2020 and 2021 with the current account deficit projected to widen. The labour market is expected to remain tight but inflation is forecast to decline from its 2018 peak. Spending on pensions is set to lead to a significant rise in the budget deficit.

Strong growth during the first quarters signals a solid 2019

Real GDP rose by 4.6% year-on-year in the first half of 2019. Private consumption remained the main growth driver, spurred by increases in minimum and public sector wages. Following a drop in 2018, investment recovered in the first half of 2019 and is set to make a positive contribution to growth. This was largely due to strong growth in construction, induced by fiscally supportive measures adopted at the end of 2018. Net exports are forecast to have a negative impact on growth in 2019, with both imports and exports set to decline, the latter being affected by a slowdown in external demand. The current account deficit is set to continue to widen to –5.1% in 2019 from an already high level of –4.4% of GDP in 2018.

Graph II.26.1: **Romania - Real GDP growth and contributions, output gap**



Growth expected to moderate

Real GDP is forecast to grow by 4.1% in 2019, 3.6% in 2020 and 3.3% in 2021. Private consumption is expected to ease but remain the main growth driver throughout the forecast horizon, as disposable income continues to be supported by an expansionary fiscal policy and strong growth in real wages. Investment is projected to remain relatively robust, supported by construction and an acceleration of EU-funded projects towards the end of the current programming period. The output gap is projected to narrow over the forecast horizon.

Exports are expected to continue growing, although at a slower pace, supported by services while imports are expected to decelerate in line with a slowdown in private consumption. Net exports' negative contribution to real GDP growth is set to progressively decline. Nevertheless, the trade balance is forecast to continue widening as a percentage of GDP, causing the current account deficit to increase further in 2019 and beyond.

Turning to the labour market, unemployment continues to decline, reaching a new historical low of 3.8% in August 2019. The labour market is expected to remain relatively tight as structural weaknesses are set to persist, exerting upward pressure on wages. However, overall wage growth is projected to moderate slightly over the forecast horizon as the economy is slowing down and the effects of past public sector wage hikes and minimum wage increases fade away.

Inflationary pressure set to ease

From an annual peak of 4.1% in 2018, headline inflation decelerated to 3.5% in September 2019 mainly on account of declining food and energy prices. It is expected to remain at around 3.9% in 2019 and to re-enter the National Bank of Romania's target band (2.5% ± 1 pp.) as of 2020. Core inflation is projected to increase from 2.7% in 2018 to 3.8% in 2019, on the back of strong wage growth, but should decline somewhat after 2020. The National Bank of Romania recently decided to maintain its key monetary policy rate at 2.50%.

Downside risks to the growth forecast

Risks to economic growth stem from both external and internal conditions. Externally, a potential slowdown in some of Romania's main trading partners could negatively affect exports. Internally, a heavy election calendar throughout 2020 and recent political uncertainty could delay the restart of structural reforms and dampen efforts to reduce macroeconomic imbalances. Continued unpredictability of public policies could delay a sustained recovery of investment.

High public deficit set to widen considerably

The general government deficit is set to increase to 3.6% of GDP in 2019, from 3.0% in 2018, driven by continued high increases to public sector wages. Public investment is set to rebound somewhat from the record low levels of the recent years.

The general government deficit is forecast to reach 4.4% of GDP in 2020 and 6.1% of GDP in 2021, driven by significant increases to old-age pensions enacted in summer 2019. In particular, the pensions have been indexed by 15% in September 2019 and will be indexed by an additional 40% in September 2020. Public investment is set to continue increasing thanks to an acceleration of spending on projects co-funded by the EU towards the end of the current programming period.

The structural deficit is projected to gradually increase over the forecast horizon as a result of the government's expansionary fiscal policy. Meanwhile the debt-to-GDP ratio is projected to rise from 35.0% in 2018 to 40.6% in 2021.

Graph II.26.2: **Romania - General government budget balance and gross debt**

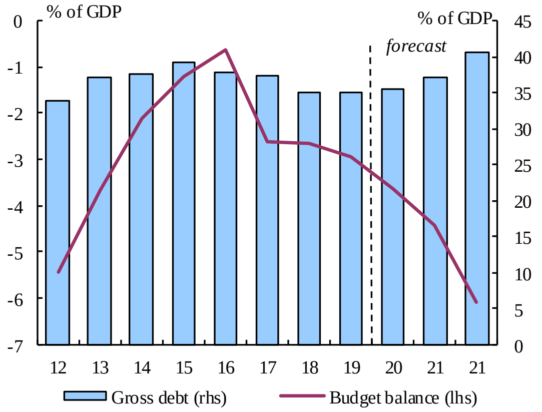


Table II.26.1:

Main features of country forecast - ROMANIA

		2018		Annual percentage change						
		bn RON Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		944.2	100.0	3.7	4.8	7.1	4.0	4.1	3.6	3.3
Private Consumption		589.6	62.4	5.3	7.9	10.0	5.2	5.8	5.2	5.0
Public Consumption		156.8	16.6	-0.5	2.2	4.2	1.5	3.1	3.5	2.1
Gross fixed capital formation		200.4	21.2	6.7	-0.2	3.6	-3.3	8.0	3.4	2.8
of which: equipment		70.2	7.4	5.6	-8.9	-9.9	-4.6	3.7	1.9	1.8
Exports (goods and services)		393.2	41.6	8.7	16.0	7.6	5.4	3.8	3.7	3.6
Imports (goods and services)		423.5	44.9	11.2	16.5	10.8	9.1	7.3	5.6	5.1
GNI (GDP deflator)		924.6	97.9	3.7	4.5	7.5	3.9	4.3	3.8	3.4
Contribution to GDP growth:	Domestic demand			5.5	5.1	7.7	2.8	5.8	4.6	4.1
	Inventories			-0.1	0.0	0.8	2.9	0.0	0.0	0.0
	Net exports			-1.6	-0.3	-1.4	-1.7	-1.7	-1.0	-0.9
Employment				-1.5	-1.1	2.4	0.2	0.2	0.1	0.1
Unemployment rate (a)				7.1	5.9	4.9	4.2	3.9	4.2	4.3
Compensation of employees / head				16.6	15.0	14.8	16.3	13.0	9.2	7.1
Unit labour costs whole economy				10.8	8.5	9.8	12.2	8.8	5.6	3.8
Real unit labour cost				-2.0	5.9	4.9	5.9	1.4	1.0	-0.5
Saving rate of households (b)				-9.0	-9.3	-7.3	-2.3	-2.8	-2.0	-0.4
GDP deflator				13.1	2.5	4.7	5.9	7.3	4.5	4.4
Harmonised index of consumer prices				10.9	-1.1	1.1	4.1	3.9	3.5	3.4
Terms of trade goods				2.9	-1.7	-2.4	1.5	1.3	0.5	0.4
Trade balance (goods) (c)				-10.4	-5.5	-6.5	-7.3	-8.2	-8.9	-9.6
Current-account balance (c)				-5.9	-2.0	-3.4	-4.4	-5.1	-5.3	-5.4
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-4.9	0.5	-1.8	-3.2	-3.7	-3.9	-3.9
General government balance (c)				-3.3	-2.6	-2.6	-3.0	-3.6	-4.4	-6.1
Cyclically-adjusted budget balance (d)				-3.3	-2.2	-3.0	-3.1	-3.7	-4.4	-5.9
Structural budget balance (d)				-	-1.8	-3.0	-2.7	-3.5	-4.4	-5.9
General government gross debt (c)				25.2	37.3	35.1	35.0	35.5	37.2	40.6

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.