Country Report 2016
Romania

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2016 In-depth review

- **External sector and competitiveness**
  - Net international investment position
  - Current account balance
  - Cost and non-cost competitiveness

- **Financial sector**
  - Banking sector
  - Insurance sector

- **Medium-term risks**
  - Demand side policies
  - Supply side policies
Scene setter

- Economic growth has been strong over the last three years, gradually broadening its base
- The output gap is projected to close and turn positive in 2016
- The current account balance has improved substantially
- The large negative net international investment position (NIIP) has been improving since 2012 and is expected to sustain this trend in the coming years
- Going forward, risks of less sustainable growth are emerging
Current account

- The current account deficit has decreased significantly in recent years.
- The adjustment has been due to non-cyclical factors, including the structural improvement in the trade balance.
- Current account deficit forecast to widen, but to remain contained until 2017, due to a boost to domestic demand leaking out through imports.
External sustainability

- Relatively large negative net international investment position (NIIP)
- Not unusual for a catching-up economy
- Improving since 2012 and set to sustain this trend
- High share of volatile sources of financing
- Sensitive to macroeconomic shocks
Cost competitiveness

- One of the highest growth rates in export market shares in the EU between 2010 and 2014
- Export performance fuelled by improvements in cost competitiveness
- Real effective exchange rate had negative or low positive growth
- Until recently the expansion in export market share has been associated with contained unit labour costs
- Cut in social security contribution in 2014 helped contain unit labour costs

Real effective exchange rate (ULC based)
Non-cost competitiveness

- Romania competes mostly on price rather than quality
- R&D and innovation expenditure is low and inefficient
- Underdeveloped transport infrastructure
- Unstable regulatory framework
- Access to credit for SMEs is difficult
Banking sector

- In 2015 cleaning up of banks' balance sheets continued...
- ...banks profitability recovered...
- ...AQR and stress test are being launched by the NBR
- However, risks have increased due to domestic sources of vulnerabilities:
  - Draft law on debt discharge with risks to financial sector stability and to economic growth
  - Court decisions on unfair contract terms in loan contracts may put significant pressure on banks' capital buffers
Insurance sector

- In 2015, a comprehensive balance sheet review (BSR) and stress test was successfully completed, the first such exercise in an EU Member State.
- The BSR revealed several deficiencies, which required corrective measures and included putting into insolvency one company.
- The BSR also showed that:
  - Several insurance undertakings did not comply with the Solvency I requirements and
  - Most insurance undertakings need further efforts to prepare for Solvency II.
Demand side policies

- Romania achieved fiscal adjustment in past few years...
- ...but fiscal deficit as a percent of GDP is expected to more than triple in only two years
- Lack of strategic planning, and weak implementation of the fiscal rules are key drivers of pro-cyclicality
- Tax cuts and public wage increases will contribute to deficit in 2016-17
- Pro-cyclical fiscal policy in a strong-growth environment could trigger internal and external imbalances in the absence of supply-side measures
Supply side policies

- Lack of medium- to long-term strategic planning on infrastructure development
- Constrained capacity to absorb EU structural funds
- Insufficient or low-quality infrastructure reduces accessibility and may limit investment
- Low and inefficient R&D and innovation expenditure
- Government regulation and legal uncertainty continue to weigh on competitiveness
- The effectiveness and efficiency of public administration remain limited

Quality of public infrastructure index, Romania and regional peers

Scale: 1-7 (best)
Barriers to investment

- Ineffective public administration
- Red tape
- Legal uncertainty due to frequent changes of tax and other business-related legislation
- Predictability and enforcement of judicial decisions
- Corruption
- Inefficient and insufficient investment in infrastructure
- Limited access to financing for SMEs
Barriers to investment

Medium-term risks of imbalances

COH = BG, CZ, EE, HR, HU, LT, LV, MT, PL, RO, SI, SK

- Public admin/ Business env RO
- Public admin/ Business env COH
- Labour market/ Education RO
- Labour market/ Education COH
- Financial Sector / Taxation RO
- Financial Sector / Taxation COH
- Sector specific regulation RO
- Sector specific regulation COH

Legend:
- No action
- Action
CONCLUSION

• Romania has reduced internal and external imbalances
• However...
• ...vulnerabilities for the Romanian economy may re-emerge:
  o legislative initiatives with potential impact on the banking sector
  o pro-cyclical fiscal policy
    ➢ accelerating wage growth
    ➢ no counterbalancing supply-side measures.
• Sustainable growth would require boosting investment and increasing the pace of structural reforms
THANK YOU
Vă Mulţumesc

Link to the 2016 country report: