23. ROMANIA

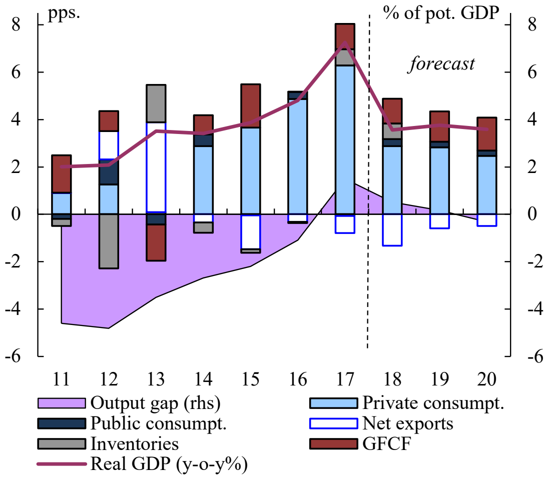
Strong growth set to decelerate

Romania's economic boom is cooling down as private consumption growth slows and the negative contribution of net exports to growth worsens further. GDP is forecast to grow more moderately over the forecast period and the labour market looks set to remain tight. Inflation peaked in spring 2018 and is expected to progressively slow down. The budget deficit is forecast to continue increasing, mostly due to significant increases in public wages and pensions.

Growth is set to slow but remain robust

Romania's economic boom has started to cool down in 2018. Real GDP growth slowed from 4.3% to 4.2% between the first and second quarters of the year and is expected to slow further. For the year overall, real GDP growth is forecast at 3.6%. Private consumption, the main contributor to growth, appears clearly to be weakening. This stems from persistently high inflation, mainly due to energy prices, and the fading out of public policies directed at increasing disposable income. Investment is expected to remain subdued for the rest of 2018. Import growth remains dynamic, despite softening private consumption, while exports are slowing, rendering net exports a drag on real GDP growth.

Graph II.23.1: **Romania - Real GDP growth and contributions, output gap**



In 2019 and 2020, private consumption is forecast to slow down further as nominal wage growth moderates and inflation continues to weigh on real disposable income. It will nonetheless remain the main driver of growth. Investment is expected to increase its contribution to growth on the back of an increase in non-residential construction. Overall, real GDP growth is projected to amount to 3.8% in 2019 and 3.6% in 2020. The output gap, which turned positive in 2017, is expected to narrow over the forecast horizon.

Imports are projected to continue rising at a higher pace than exports in 2019 and 2020. Accordingly, net exports will again make a negative contribution to real GDP growth. The current account deficit is set to continue increasing steadily as the trade balance widens from 3.7% in 2018 to 4.5% in 2020.

The labour market continues to tighten

Unemployment in Romania fell to a new historical low of 4.3% in spring 2018 and is set to stay at a broadly similar level over the forecast horizon. The tight labour market conditions suggest that wages should continue to grow, with some expected spillovers from the public to the private sector, but the pace will likely slow. This should reduce pressure on unit labour costs, which are nonetheless forecast to rise moderately in 2019 and 2020. Real wage growth, however, is expected to moderate significantly in 2018, due to higher inflation.

Inflation is set to rise

Headline inflation continued to grow at a strong pace in spring 2018 as the effect of a cut to standard VAT rates and excise duties on fuel, made in January 2017, faded away. The decision to reverse those cuts in October 2017, added further fuel to the figures. For 2018 as a whole, inflation is forecast at 4.3%, while in 2019 and 2020 it is expected to fall to 3.5% and 3.3% respectively on account of weakening domestic demand.

Risks tilted to the downside

A main risk to the forecast is that wage growth could continue to outpace productivity growth, causing Romania's economic competitiveness to decline further and weaken export growth. Furthermore, volatile food prices and persistently high international commodity prices could cause the current account deficit to widen even further. Uncertainty regarding the government's policies, with potential negative repercussions on the business environment, and the challenge of budgetary deficit targets could hamper investment decisions. On the other hand, an improved absorption of EU funds represents a positive risk for GDP growth in 2019 and 2020.

Public deficit set to increase

In 2018, the general government deficit is projected to increase to 3.3% of GDP, from 2.9% in 2017. Gross wages in the public sector were raised by 25% with even higher increases in the health and education sectors. The fiscal cost of these increases to gross wages was partially compensated for by a shift in the burden of social security contributions from employers to employees (from 22.75% and 16.5% to 2.25% and 35% respectively). The flat personal income tax (PIT) rate was cut from 16% to 10%. Moreover, public investment is projected to rebound slightly from a record low in 2017.

The general government deficit is projected to increase to 3.4% of GDP in 2019 and 4.7% in 2020. This projection is mostly driven by plans to significantly increase the pension point (the main parameter used for pension indexation), included in the governing programme and implemented through the pension law recently adopted by the government. The pension point is set to increase by 15% in September 2019 and 40% in September 2020.

As a consequence of these policy developments, Romania's structural deficit is projected to increase from around 3½ % of GDP in 2017 to around 4½ % in 2020. The debt-to-GDP ratio is projected to increase from 35.1% of GDP in 2017 to 38.2% in 2020.

A positive risk to the 2018 budget balance forecast comes from possibly lower than budgeted public investment. A possible freeze in public wages and potential changes to the draft pension law represent a positive risk for 2019 and beyond. On the other hand, a potential rebound of public investment from its record-low levels represents a negative risk to the general government balance projection in 2019 and 2020 via increased expenditure.

Table II.23.1:

Main features of country forecast - ROMANIA

		2017			Annual percentage change						
		bn RON	Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP			858.7	100.0	3.4	3.9	4.8	7.3	**3.6**	**3.8**	**3.6**
Private Consumption			537.0	62.5	4.6	6.0	7.9	10.1	**4.6**	**4.6**	**4.0**
Public Consumption			130.0	15.1	1.0	-0.3	2.2	-0.5	**2.0**	**1.5**	**1.4**
Gross fixed capital formation			193.6	22.6	6.0	7.5	-0.2	4.7	**4.6**	**5.6**	**5.9**
of which: equipment			77.5	9.0	6.0	-3.9	-8.9	5.0	**8.5**	**6.5**	**5.5**
Exports (goods and services)			355.7	41.4	10.0	4.6	16.0	9.7	**6.3**	**6.5**	**6.1**
Imports (goods and services)			374.0	43.6	10.7	8.0	16.5	11.2	**9.1**	**7.4**	**6.7**
GNI (GDP deflator)			839.1	97.7	3.5	2.7	4.5	7.4	**4.0**	**3.8**	**3.7**
Contribution to GDP growth:	Domestic demand				5.0	5.5	5.1	7.3	**4.2**	**4.3**	**4.1**
	Inventories				-0.2	-0.1	0.0	0.7	**0.7**	**0.0**	**0.0**
	Net exports				-1.3	-1.4	-0.3	-0.7	**-1.3**	**-0.6**	**-0.5**
Employment					-1.5	-1.3	-1.1	2.8	**0.2**	**-0.3**	**0.1**
Unemployment rate (a)					7.1	6.8	5.9	4.9	**4.3**	**4.2**	**4.1**
Compensation of employees / head					19.0	1.9	15.0	11.1	**13.0**	**6.7**	**6.7**
Unit labour costs whole economy					13.3	-3.1	8.5	6.5	**9.3**	**2.5**	**3.0**
Real unit labour cost					-2.0	-5.6	5.9	1.8	**2.7**	**-1.2**	**-0.5**
Saving rate of households (b)					-2.7	-4.3	-0.7	-1.0	**-0.5**	**-2.2**	**-1.4**
GDP deflator					15.8	2.6	2.5	4.6	**6.5**	**3.8**	**3.5**
Harmonised index of consumer prices					13.5	-0.4	-1.1	1.1	**4.3**	**3.5**	**3.3**
Terms of trade goods					2.0	1.0	-1.7	-1.2	**0.8**	**-0.6**	**-0.4**
Trade balance (goods) (c)					-7.8	-4.9	-5.5	-6.3	**-6.7**	**-7.4**	**-8.0**
Current-account balance (c)					-5.6	-0.8	-1.7	-3.1	**-3.7**	**-4.2**	**-4.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)					-4.9	1.6	0.8	-1.6	**-2.1**	**-2.5**	**-2.9**
General government balance (c)					-3.5	-0.7	-2.9	-2.9	**-3.3**	**-3.4**	**-4.7**
Cyclically-adjusted budget balance (d)					-3.6	0.1	-2.5	-3.4	**-3.5**	**-3.4**	**-4.6**
Structural budget balance (d)					-	-0.2	-2.2	-3.4	**-3.3**	**-3.4**	**-4.6**
General government gross debt (c)					24.2	37.8	37.3	35.1	**35.1**	**35.9**	**38.2**

(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.