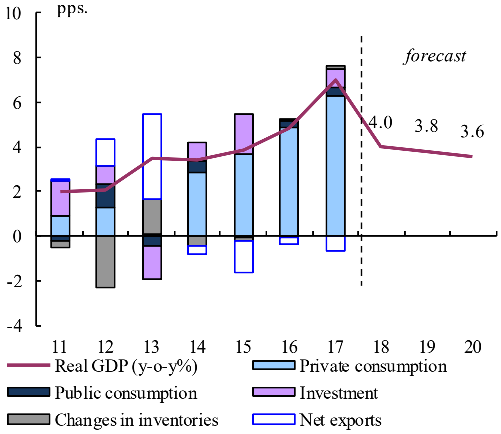
2.1. ROMANIA

The economic boom that began in Romania in 2017 eased in 2018. Real GDP growth eased from 7 % in 2017 to 4.3% annualised in the first three quarters of 2018. For the year as a whole it is estimated at 4 %. The slower pace of growth was due to private consumption, as the effects of tax cuts implemented in 2017 faded away and inflation weighed more heavily on real disposable income. Nonetheless, private consumption growth remained strong as a result of the tight labour market and rising wages.

Investment growth is likely to show a significant decrease in 2018, following contractions in the second and third quarters. According to preliminary data, inventories contributed 2.8 pps. to GDP growth in the first half of 2018. If confirmed, this build-up of inventories may explain the subdued level of private investment in 2018. Net exports contribution to GDP growth turned more negative in 2018, with both imports and exports declining. Consumption goods were the main drivers of import developments. Exports decelerated on the back of more sluggish external demand and an appreciation of the real effective exchange rate.

Real GDP growth is forecast to further decrease to 3.8 % in 2019 and 3.6 % in 2020. The composition of growth is expected to remain fairly stable, with private consumption still the main driver. The evolution of investment in 2019 will largely depend on the impact of policies introduced in December 2018 concerning the banking, energy and telecommunications sectors. The contribution of net exports is expected to remain negative but progressively less so in 2019 and 2020.

Graph 2.23: **Romania - Real GDP growth and contributions**



The annual headline inflation, reached 4.5% in September 2018, the highest level since 2013, and averaged 4.1% in 2018 overall. The deceleration towards the end of 2018 was mainly on account of decreasing food and, above all, energy prices. Over the forecast horizon, headline inflation is forecast to decelerate further to 3.3% in 2019 and 3.1% in 2020, driven by base effects and falling oil prices. However, a further depreciation of the currency vis-à-vis the euro poses an upward risk to price levels. Underlying inflation remained broadly stable in 2018, growing at 2.7% but it is expected to decrease further in 2019 and 2020, in line with headline inflation.

Risks to the forecast are clearly on the downside. Besides a potential negative impact on credit, the impact of the government's emergency ordinance in December could have a much broader effect. For example, significantly increased unpredictability of the business environment in Romania may have a negative knock-on effect on investment decisions.