

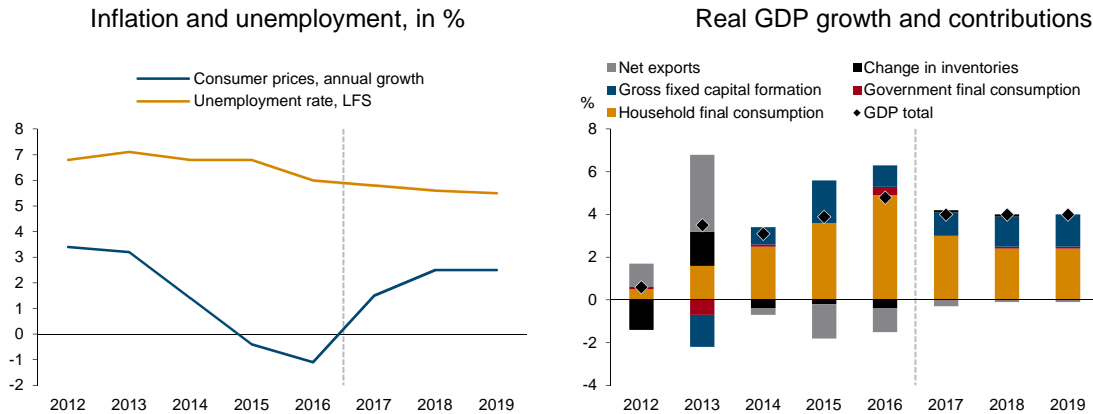


ROMANIA: Economic deceleration follows the boom

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Economic growth in Romania is expected to hover around 4% in 2017 and beyond. Household demand will remain the main driver, but investments may also play a bigger role. Rising private sector wages may speed up the growth in household consumption; this constitutes an upside risk to the forecast. The capacity to absorb EU funds and political uncertainty constitute downside risks. Currently the government's official GDP forecast for 2017-2019 of annual growth above 5% looks unrealistic.

Figure 48 / Romania: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The fight against corruption is an issue on which the new government could find itself paralysed.

The coalition government led by the Social Democratic Party (PSD), which came to power in January 2017, has a comfortable majority in parliament; nevertheless, the battle between the government and the presidency could spark a political crisis at any time. The main controversy centres on the fight against corruption and the status of the National Anticorruption Directorate (DNA) and the domestic intelligence service. The government wants to extend its oversight over these bodies, which have allegedly become states within the state. But they enjoy the unconditional backing of the president and of European institutions.

As one of its first actions, overnight the government softened the penal code with an emergency decree that it soon had to repeal, under popular pressure. The attempt to decriminalise certain corruption offences (such as abuse of office and conflict of interest) triggered massive public protests in early February. The general prosecutor and the chief anticorruption prosecutor both criticised the decree, claiming that it would render the anticorruption fight in Romania ineffective. Criticism also came from several EU institutions and European governments, the Foreign Investors Council and other business organisations. Although the ordinance has been lifted, the PSD has not given up on its goal. The controversy may escalate at any time into a lasting political crisis that could deter investors.

In a wider sense, there is a conflict between the traditional political establishment and a new generation of people, movements and institutions representing 'European', democratic values. The political establishment of almost all parties is based on clientelism and corruption. The promoters of liberal democracy are growing in number and are becoming better organised. But the notion of placing unconditional trust in the DNA is also controversial. The anticorruption prosecutors are by no means blameless and often act arbitrarily, especially in cases of influence peddling or embezzlement. Decision makers know from experience that at any time they could be prosecuted for a decision they take; therefore public procurement, and public investment activity generally, have slowed. Meanwhile the country has received a fillip in its battle against corruption: on 1 February, the World Bank approved a EUR 60 million loan to help Romania improve its judicial services.

Economic growth started to decelerate in the third quarter of 2016; annual growth was still one of the most robust rates in Europe, 4.8%. Soaring household consumption was the main component of growth in 2016, but investments and government consumption contributed positively as well, while the foreign balance was on the negative side. The demand surge was generated by fiscal easing in the form of VAT cuts and minimum-wage hikes. Real wages increased by almost 15% in 2016 also on account of negative inflation.

The government intends to speed up economic growth in 2017 by further generous incomes policy measures. The gross minimum salary was increased from RON 1,250 to RON 1,450 (EUR 322), starting 1 February 2017 benefiting about 2.1 million employees, 300,000 of whom work in the public sector. Also the minimum pensions were increased from RON 400 to, still meagre, RON 520. Wage increases of 20% were introduced for the local and municipal administration. Students also received benefits including free railway transportation and higher public scholarship payments. In exchange for pay rises, the cap of five times the minimum wage, above which social insurance contributions were no longer payable, was lifted. A further benefit to consumers is that the standard rate of VAT was reduced by 1 percentage point and the excise tax on fuel was cut. All in all, there is no economic reason for public dissatisfaction – only political.

Services were the fastest growing economic sector in 2016, most prominently retail trade (up 13.5%), sale and repair of motor vehicles (+18%) and personal services (+9%). Industrial output grew only modestly, mainly on account of declines in the mining sector and the energy sector. Manufacturing production grew by more than 3%, and the production of consumer durables and cars rose especially rapidly. Domestic production of goods and services absorbed most of the surge in household demand, and thus the trade balance did not deteriorate greatly.

Inflation levelled off toward the end of 2016, but over the year as a whole it was negative. It is expected to reach low positive rates in 2017 on account of continuing demand pull and higher international oil prices. A further inflationary factor is that the one-off effects of the previous tax cuts will expire and the new cuts will have only a marginal effect on prices.

The labour market will tighten further in 2017. Unemployment fell to 6.2% on average in 2016 and to below 6% by the end of the year. More sectors report labour shortages, although there are still pools to tap in the eastern regions. The longer-term outlook does not promise more labour force, since the population will fall due to demographic reasons. Emigration may decrease, however, if wages continue to rise and if host countries introduce restrictions. Immigration from Moldova and Ukraine may increase on account of the widening wage gaps between those countries and Romania.

The government's 2017 budget law is based on the unrealistic assumption of 5.2% GDP growth. The National Forecasting Commission revised its figures upwards in January 2017 by 1.5 pp (compared with the October 2016 forecast), without giving any specific reason. The government intends to continue its expansionary fiscal policy by planning deficits of 3% of GDP. The actual figure will most probably be higher, as GDP will be lower, and the fiscal impact of all the social measures introduced at the beginning of 2017 is expected to amount to 0.7% of GDP. Financing of the deficit may not be a problem, given the current abundance of international capital market liquidity.

Monetary policy has been very cautious, with the National Bank keeping the policy rate unchanged throughout 2016. This rate has been relatively high, compared to the consumer price index, and more in line with the producer price index. Some easing has taken place, with a lowering of the reserve requirements. New loans to the economy increased in 2016, albeit modestly. The total loan stock has declined, as non-performing loans (NPLs) are being worked out. The NPL rate fell to 10% at the end of year. Banks have reported robust profits and are increasing their loan portfolios to companies. They are more cautious with lending to the population. Lending interest rates went up recently, reflecting rising demand for consumer loans.

The widening of the current account deficit on account of soaring private consumption is not as severe as expected. Nevertheless, imports did grow ahead of exports, and this trend is expected to continue without any substantial widening of the current account deficit in 2017. The inflow of foreign direct investment (FDI) accelerated in 2016 and may expand further in the future. The largest new projects are in the automotive sector. These include Daimler's EUR 300 million investment in the expansion of its gearbox production in Sebeş, as well as new production units for component suppliers LEONI and Continental. In addition, British American Tobacco announced that it would build one of its largest European factories in Ploieşti. Also real estate and retail investments remain buoyant in view of the rising local purchasing power.

Economic growth in Romania is expected to hover around 4% in the coming years. The 2017 deceleration will prove less severe than predicted in earlier wiiw forecasts, due to the government's new demand-generating measures. Household demand will remain the main driver, but investments may also play a bigger role, financed by both EU funds and FDI. Private sector wages, which are rising on account of the labour shortage, may speed up the growth in household demand and may constitute an upside risk to the forecast. The capacity to absorb EU funds and political uncertainty constitute the downside risks. Based on the current level of knowledge the government's official GDP forecast for 2018-2019 of 5.5% and 5.7% looks unrealistic.

Table 19 / Romania: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017	2018 Forecast	2019
Population, th pers., average	20,058	19,984	19,909	19,815	19,830	19,780	19,700	19,650
Gross domestic product, HUF bn, nom.	595	637	668	711	760	810	860	920
annual change in % (real)	0.6	3.5	3.1	3.9	4.8	4.0	4.0	4.0
GDP/capita (EUR at PPP)	14,300	14,600	15,300	16,500	17,300	.	.	.
Consumption of households, RON bn, nom.	366.2	385.5	406.4	433.1	470.0	.	.	.
annual change in % (real)	0.8	2.6	4.2	5.9	8.0	5.0	4.0	4.0
Gross fixed capital form., RON bn, nom.	162.8	157.5	162.4	176.1	190.0	.	.	.
annual change in % (real)	0.1	-5.4	3.2	8.3	4.0	4.5	5.5	6.0
Gross industrial production ²⁾								
annual change in % (real)	2.4	7.8	6.1	2.8	1.0	2.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-21.9	24.5	2.9	-6.8	-1.7	.	.	.
Construction industry ²⁾								
annual change in % (real)	1.4	-0.6	-6.7	10.3	-4.8	.	.	.
Employed persons, LFS, th, average	8,605	8,549	8,614	8,535	8,490	8,490	8,490	8,490
annual change in %	0.9	-0.7	0.8	-0.9	-0.5	0.0	0.0	0.0
Unemployed persons, LFS, th, average	627	653	629	624	541	520	500	490
Unemployment rate, LFS, in %, average	6.8	7.1	6.8	6.8	6.0	5.8	5.6	5.5
Reg. unemployment rate, in %, end of period	5.5	5.7	5.4	5.0	4.8	.	.	.
Average monthly gross wages, RON	2,063	2,163	2,328	2,555	2,900	3,200	3,400	3,700
annual change in % (real, gross)	0.8	0.8	6.5	10.4	15.3	8.0	5.0	5.0
Average monthly net wages, RON	1,507	1,579	1,697	1,859	2,100	2,300	2,500	2,700
annual change in % (real, net)	1.0	0.8	6.4	10.1	14.7	8.0	5.0	5.0
Consumer prices (HICP), % p.a.	3.4	3.2	1.4	-0.4	-1.1	1.5	2.5	2.5
Producer prices in industry, % p.a.	5.2	2.0	-0.2	-2.4	-1.9	2.0	3.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	33.6	33.3	33.6	35.0	31.0	32.0	33.0	34.0
Expenditures	37.2	35.4	34.4	35.7	33.0	35.2	36.0	37.0
Net lending (+) / net borrowing (-)	-3.7	-2.1	-0.8	-0.8	-2.0	-3.2	-3.0	-3.0
Public debt, EU-def., % of GDP	37.3	37.8	39.4	38.0	38.0	39.0	39.0	39.0
Stock of loans of non-fin.private sector, % p.a.	1.6	-3.4	-3.7	2.5	0.9	.	.	.
Non-performing loans (NPL), in %, Dec	18.2	21.9	13.9	13.5	9.9	.	.	.
Central bank policy rate, % p.a., end of period ³⁾	5.25	4.00	2.75	1.75	1.75	2.25	3.00	3.00
Current account, EUR mn	-6,394	-1,542	-1,004	-1,928	-4,118	-4,500	-4,900	-5,270
Current account, % of GDP	-4.8	-1.1	-0.7	-1.2	-2.4	-2.5	-2.6	-2.6
Exports of goods, BOP, EUR mn	39,855	43,893	46,839	49,119	52,101	55,200	58,500	62,000
annual change in %	-0.6	10.1	6.7	4.9	6.1	6.0	6.0	6.0
Imports of goods, BOP, EUR mn	49,114	49,709	53,375	56,892	61,399	66,300	70,900	75,900
annual change in %	-0.7	1.2	7.4	6.6	7.9	8.0	7.0	7.0
Exports of services, BOP, EUR mn	9,868	13,434	15,104	16,640	17,630	18,860	20,370	22,000
annual change in %	13.6	36.1	12.4	10.2	6.0	7.0	8.0	8.0
Imports of services, BOP, EUR mn	7,392	8,733	9,236	9,849	10,074	10,580	11,110	11,670
annual change in %	5.1	18.1	5.8	6.6	2.3	5.0	5.0	5.0
FDI liabilities, EUR mn	2,380	2,894	2,931	3,885	4,804	.	.	.
FDI assets, EUR mn	-175	-24	227	930	940	.	.	.
Gross reserves of NB excl. gold, EUR mn	31,206	32,525	32,216	32,238	34,242	.	.	.
Gross external debt, EUR mn	100,857	98,069	94,744	90,434	93,000	96,000	100,000	100,000
Gross external debt, % of GDP	75.5	68.0	63.0	56.5	54.9	53.1	52.1	48.7
Average exchange rate RON/EUR	4.4593	4.4190	4.4437	4.4454	4.4904	4.48	4.48	4.48

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) One-week repo rate.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.