

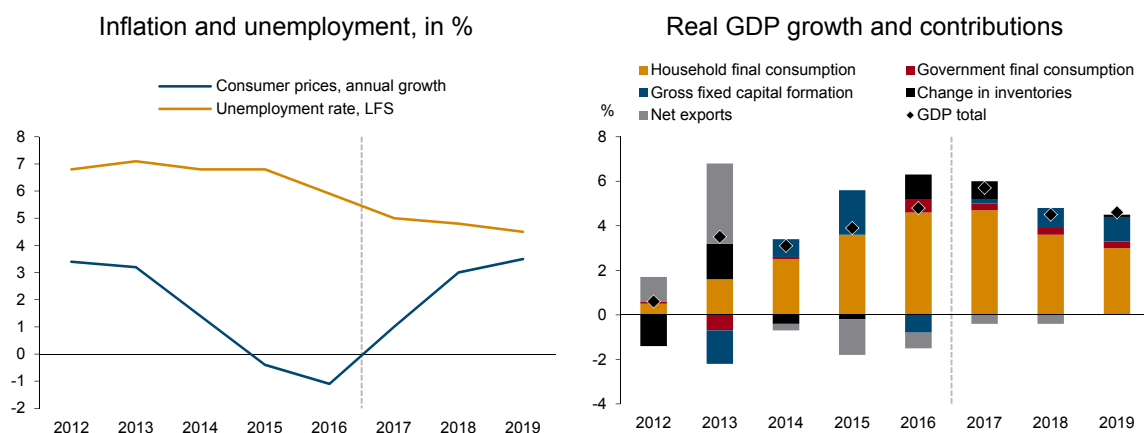


## ROMANIA: Economic deceleration to follow the current boom

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Economic growth in Romania is expected to climb to 5.7% in 2017 and to subside to 4.5% in the following two years. Household demand has boomed and investments have stagnated this year. The most recent measures aim to keep the fiscal deficit below 3% of GDP. Inflation has returned to positive figures and is bound to accelerate, putting the National Bank under pressure to hike the prime rate.

Figure 45 / Romania: Main macroeconomic indicators



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

**Economic growth accelerated to 5.9% in the first half of 2017 and a similar rate is expected for the year as a whole.** Pro-cyclical fiscal measures have stimulated a boom in household consumption, while investments have been essentially stagnant. A deterioration of the external balance occurred in the wake of surging imports of consumer goods and despite rapidly rising exports. In the real sector both industry and agriculture registered high rates of output growth, while construction contracted. Infrastructure investments suffered delays waiting for the resumption of projects co-financed from EU funds.

**Household consumption has carried most of the economic boom, stimulated both by tax and income measures of the government.** VAT cuts in mid-2016 and early 2017 brought down the prices of consumer goods and have stimulated retail sales. People also spent more on services and vacations. Gross and net real wages are expected to rise by 14% in 2017 driven by wage rises and a new wage

scheme in the public sector. The private sector, competing for manpower, had to follow even if wage increases are not covered by productivity increases.

**As decided by the government, 2018 will bring additional wage hikes in the public sector focusing on education and health care.** In addition, a restructuring of the social security contributions from the employer to the employee will take place across the whole economy, giving a one-time boost to gross wages but having no impact on net wages. Up to 2017 the contribution was split between employee and employer while the latter often forgot to pay his part. Under the new system, the employee is expected to gain information about the total contribution due to his social security budget, while its rate will be reduced from 39% to 35% of the gross wage.

**Fiscal expansion was on the agenda until August 2017, but lately the government seems determined to keep the deficit below 3% of GDP.** Putting a brake on public expenditures means cutting investments, first of all. On the revenue side, state-owned companies have been requested to transfer their retained profits to the treasury, depriving them of the means to finance investments in the rest of the year. Higher excise duties on fuel and gas have been implemented for the fourth quarter of the year, bringing additional revenues.

**The impact of VAT cuts is phasing out and consumer prices have started to rise also as a consequence of the demand surge.** Administered prices of electricity and fuel increased as well as of 1 October. While inflation will be only about 1% on the annual average in 2017, it may climb close to 2% by the end of the year and above 3% in 2018. These are sober rates, but they come abruptly after two years of negative inflation. The money market has reacted to the recent change in inflationary expectations by hiking the cost of borrowing on the interbank market (ROBOR). The National Bank tightened the band between the lending and deposit facility from +/- 1.5% to 1.25% around the policy rate on 4 October. The policy rate, which is currently at 1.75%, may be hiked in December.

**The current account deficit expanded sharply in the first half of the year.** Exports of goods expanded by 10% in the first semester but imports surged by more than 12%. A new development can be observed in the trade of services where imports grew more rapidly than exports for the first time after many years, especially on the transport and travel accounts. Increasing domestic demand will trigger further high current account deficits in the years to come.

**The economic upturn has had positive labour market effects.** The number of employed persons grew for the first time after two years of decline and the activity rate increased to above 66% of the working-age population. The unemployment rate fell to close to 5%. Labour shortage is widely present which, combined with higher wages, may have reduced the push to emigrate.

**Political life has hardly calmed down after the tug-of-war in the first half of the year.** The conflict related to the fight against corruption, which led to street protests in early 2017, contributed to the replacement of the Sorin Grindeanu cabinet after just six months in office. On 26 June 2017, Mihai Tudose became the prime minister of the new cabinet led by the Social Democratic Party (PSD) while the real power still lies in the hands of party leader Liviu Dragnea. The conflict between the National Anti-corruption Directorate (DNA) and the government escalated in September when the DNA started the prosecution of three ministers in a case that may ultimately target Mr Dragnea. He accepted to replace the three cabinet members in October. Meanwhile, DNA chief prosecutor Laura Codruta Kovesi,

enjoying the support of President Iohannis and Western embassies, is being investigated by the Judicial Inspection for possible misconduct.

**All in all, the current upturn is narrowly based and unsustainable.** The economy will have a lower but still robust growth rate of about 4.5% in the next two years. (The Romanian government forecasts sustainable growth of at least 5.5% annually in the next four years.) External and fiscal imbalances will persist but will not be excessive so as to become a serious danger to stability. The recovery of investments hinges on the risk perception of companies and banks whose expectations are improving. The inflow of EU funds will be moderate and will involve larger amounts only towards the end of the forecasting horizon.

Table 20 / Romania: Selected economic indicators

	2013	2014	2015	2016 <sup>1)</sup>	2016 January-June	2017	2017 Forecast	2018 Forecast	2019
Population, th pers., average	19,984	19,909	19,815	19,699	.	.	19,600	19,500	19,500
Gross domestic product, RON bn, nom.	637.5	668.1	711.1	761.5	325.2	360.9	850	910	980
annual change in % (real)	3.5	3.1	3.9	4.8	5.2	5.8	5.7	4.5	4.6
GDP/capita (EUR at PPP)	14,600	15,300	16,500	17,200	.	.	.	.	.
Consumption of households, RON bn, nom.	385.5	406.4	433.1	463.1	210.1	228.9	.	.	.
annual change in % (real)	2.6	4.2	5.9	7.6	9.8	7.7	7.7	6.0	5.0
Gross fixed capital form., RON bn, nom.	157.5	162.4	176.1	172.6	68.1	71.7	.	.	.
annual change in % (real)	-5.4	3.2	8.3	-3.3	4.0	1.1	1.0	4.0	5.0
Gross industrial production <sup>2)</sup>									
annual change in % (real)	7.8	6.1	2.8	1.7	1.3	8.1	8.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	24.5	2.9	-6.8	0.6	.	.	.	.	.
Construction industry <sup>2)</sup>									
annual change in % (real)	-0.6	-6.7	10.3	-4.8	4.6	-7.2	.	.	.
Employed persons, LFS, th, average	8,549	8,614	8,535	8,449	8,388	8,645	8,620	8,710	8,800
annual change in %	-0.7	0.8	-0.9	-1.0	-0.7	3.1	2.0	1.0	1.0
Unemployed persons, LFS, th, average	653	629	624	530	558	466	450	440	410
Unemployment rate, LFS, in %, average	7.1	6.8	6.8	5.9	6.3	5.2	5.0	4.8	4.5
Reg. unemployment rate, in %, eop	5.7	5.4	5.0	4.8	4.7	4.2	.	.	.
Average monthly gross wages, RON <sup>3)</sup>	2,163	2,328	2,555	2,809	2,803	3,237	3,200	4,400	4,900
annual change in % (real, gross)	0.8	6.5	10.4	11.7	15.7	15.0	14.0	32.0	7.0
Average monthly net wages, RON	1,579	1,697	1,859	2,046	2,029	2,331	2,400	2,600	2,900
annual change in % (real, net)	0.8	6.4	10.1	11.8	15.8	14.4	14.5	6.0	6.0
Consumer prices (HICP), % p.a.	3.2	1.4	-0.4	-1.1	-2.1	0.5	1.0	3.0	3.5
Producer prices in industry, % p.a.	2.0	-0.2	-2.4	-1.9	-2.8	3.3	4.0	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	33.3	33.5	35.0	31.7	.	.	33.0	33.0	34.0
Expenditures	35.4	34.9	35.8	34.7	.	.	36.0	36.0	37.0
Net lending (+) / net borrowing (-)	-2.1	-1.4	-0.8	-3.0	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	37.8	39.4	38.0	37.6	.	.	39.0	40.0	41.0
Stock of loans of non-fin.private sector, % p.a.	-3.4	-3.7	2.5	0.9	0.6	3.8	.	.	.
Non-performing loans (NPL), in %, eop	21.9	13.9	13.5	9.6	11.3	8.3	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	4.00	2.75	1.75	1.75	1.75	1.75	2.00	3.00	3.50
Current account, EUR mn	-1,542	-1,004	-1,977	-3,496	-2,197	-3,004	-5,540	-6,600	-7,350
Current account, % of GDP	-1.1	-0.7	-1.2	-2.1	-3.0	-3.8	-3.0	-3.3	-3.5
Exports of goods, BOP, EUR mn	43,893	46,839	49,111	52,164	25,489	28,125	57,400	60,800	65,100
annual change in %	10.1	6.7	4.8	6.2	4.6	10.3	10.0	6.0	7.0
Imports of goods, BOP, EUR mn	49,709	53,375	56,896	61,412	29,648	33,340	68,800	73,600	78,800
annual change in %	1.2	7.4	6.6	7.9	8.6	12.5	12.0	7.0	7.0
Exports of services, BOP, EUR mn	13,434	15,104	16,640	18,006	8,608	9,979	20,710	22,370	24,160
annual change in %	36.1	12.4	10.2	8.2	8.1	15.9	15.0	8.0	8.0
Imports of services, BOP, EUR mn	8,733	9,236	9,849	10,284	4,804	5,961	12,550	13,550	14,630
annual change in %	18.1	5.8	6.6	4.4	1.2	24.1	22.0	8.0	8.0
FDI liabilities, EUR mn	2,894	2,931	3,885	5,656	2,477	1,920	4,000	.	.
FDI assets, EUR mn	-24	227	930	1,143	402	231	600	.	.
Gross reserves of NB excl. gold, EUR mn	32,525	32,216	32,238	34,242	31,729	35,208	.	.	.
Gross external debt, EUR mn	98,069	94,744	92,069	92,910	91,799	94,057	96,000	100,000	105,000
Gross external debt, % of GDP	68.0	63.0	57.6	54.8	54.1	50.3	51.4	50.5	50.4
Average exchange rate RON/EUR	4.4190	4.4437	4.4454	4.4904	4.4956	4.5364	4.55	4.60	4.70

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers will be added to gross wages increasing the latter by 25%. - 4) One-week repo rate.

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