

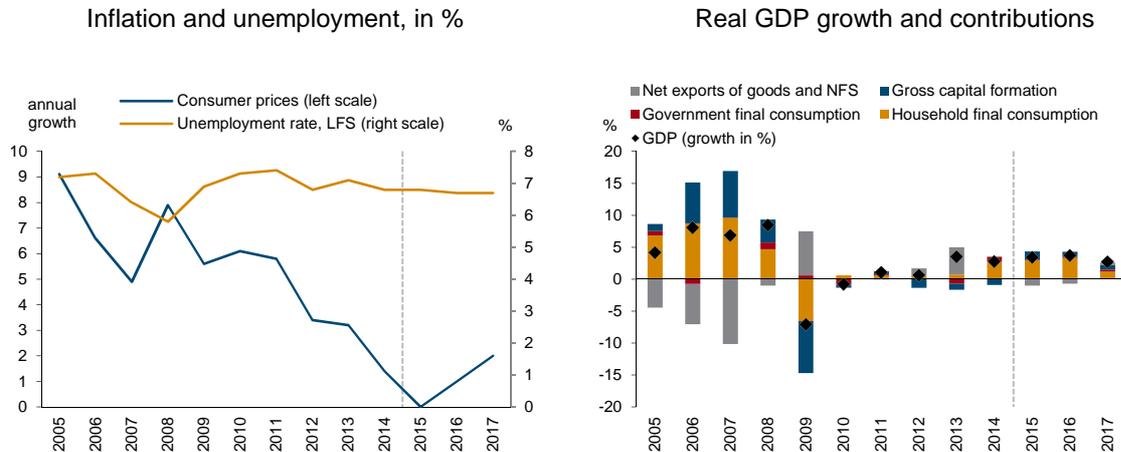


## ROMANIA: Investments and consumption fuel growth

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In all likelihood, expanding private consumption and a recovery in investments will lead to an acceleration in economic growth in the order of 3.4% in 2015. VAT cuts and wage rises in the public sector may further accelerate consumption growth in 2016, yet trigger an increase in the foreign trade deficit. On average, consumer prices are stable; unemployment is hovering just below 7%, while signs of structural labour shortages are emerging.

**Figure 54 / Romania: Main macroeconomic indicators**



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

Romania is about to achieve good growth performance with real GDP up by 3.4% in 2015, which is likely to accelerate further in 2016 to 3.7% on account of robust private consumption and recovering investments. Consumption is stimulated by rising wages and VAT rate cuts. Investments have expanded due to the final efforts by the government to absorb EU funds earmarked for the 2007-2013 financing period. Construction has recovered while the expansion of industry has slowed down. The latter has not yet shown up in exports which expand at a similar rate as last year. The foreign trade balance has improved lately due to lower oil and gas prices, but if these prices level out and consumer demand keeps rising, imports will grow ahead of exports.

The expansion of private consumption has been supported by low inflation and rising wages. It got another push in the third quarter of 2015 as the VAT rate for foodstuffs was reduced to 9% from the standard rate of 24% on 1 June. Food products constitute close to one third of the consumer basket, thus the tax cut allowed the population to restructure its expenditures to other consumption segments. Lower taxes had also a major impact on inflation; consumer prices were 1.9% lower in August 2015 than a year before. The government plans to continue with tax cuts, bringing down the standard VAT rate to 20% in 2016 and to 19% in 2017. Initially this will give a further boost to consumption and imports and keep inflation down even if import prices recover eventually.

The current state of public finances gives ample room for tax cuts without increasing the fiscal deficit in relation to GDP. Up to now, the widening of the tax base has compensated for lower rates, and revenues continued to expand ahead of expenditures. The use of increased fiscal space has been under dispute, however. The National Bank of Romania (BNR), the EU Commission and the IMF see a risk in rapid tax cuts, while the government prefers handing out benefits to consumers. Tax cuts instead of increasing expenditures on investments or public services such as education and health, has been a deliberate choice of the government coalition led by the Social Democratic Party (PSD). Short-term popularity gains are chased due to the shaky position of Prime Minister Ponta in the wake of corruption charges and also in view of the forthcoming parliamentary elections in late 2016.

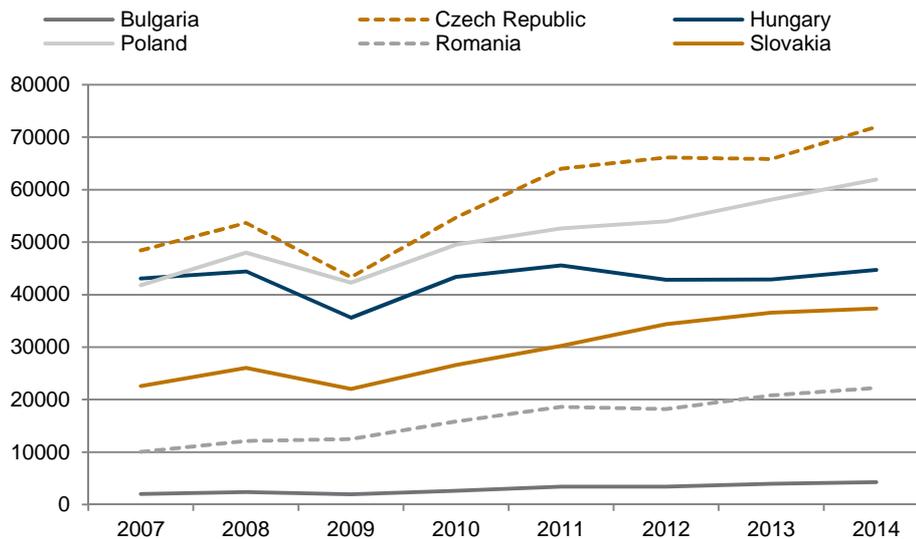
Monetary policy was relaxed very cautiously in the first half of the year. The latest monetary policy rate cut, to 1.75%, took place in May 2015 and the rate was kept steady later despite inflation turning negative. The BNR would like to curtail the emerging credit boom in the household sector, while the corporate sector still continues deleveraging. Loans in domestic currency replace foreign exchange loans and the ratio of non-performing loans is on the decline. The financial sector is working out the problems including those related to the Swiss franc appreciation without major interference either by the government or by the BNR.

The labour market reacted positively to the boom first of all in the construction sector. The decline in the relatively low unemployment rate (just below 7%) continues simultaneously with increasing job vacancy rates. Labour shortage has emerged due to skills mismatches in several sectors of the economy. There is also a widening mismatch between wage development and labour productivity dynamics; labour productivity hardly grows, but employment in industry expands. The BNR warns of possible wage-cost related inflationary pressure which may offset the effects of tax cuts in the coming year or in 2017 at the latest.

The export expansion continued in the first half of 2015 but at a slower pace than earlier while imports increased faster. The current account deficit narrowed, nevertheless, owing to high surpluses in services produced primarily in the transport, IT, and the professional and management consulting services positions. The current account deficit is expected to widen in the second half of the year and especially in 2016 due to increasing demand for imported consumer goods. The change in export composition is obvious comparing the first semester of 2015 with the same period two years before. The share of transport equipment rose from 42.7% to 44.6%, while that of chemicals shrank from 6.2% to 5.1%; changes in other segments were marginal. For comparison: the value of Romanian machinery and transport equipment exports (SITC 7) was hardly more than one quarter of Hungary's in 2008 vs. one half in 2014; while Romania increased exports in this category by 80%, Hungary did not achieve any growth (Figure 55). Romania has become an increasingly favoured location for outsourcing and not only

of manufacturing but also of telecommunications, computer and information services. Net exports of the latter category amounted to EUR 1.3 billion in 2014<sup>52</sup> and is about to expand to EUR 1.5 billion in 2015.

**Figure 55 / Exports of machinery and transport equipment in Romania and peers, SITC 7, EUR million**



Source: wiiw database.

All in all, the growth prospects of the Romanian economy have improved lately while the fiscal and external balances have been maintained and related risks are expected to increase only with some delay. Output and investments are to recover owing to both foreign demand and VAT cuts stimulating domestic private consumption. The effects of the recession in Ukraine and Russia are negligible due to very weak trade links. (Romania is close to energy self-sufficiency.) There is also some, albeit minor, positive contribution of labour to growth for demographic reasons this year and the next. Economic growth will thus accelerate in 2016 (GDP +3.7%), but slow down to 2.7% in 2017. In 2017 the one-time effects of tax cuts will phase out and labour supply will decline again, thus capital inflow will have to accelerate to keep up growth.

<sup>52</sup> The net exports of telecommunications, computer and information services of Hungary amounted to only EUR 0.3 billion, and of Bulgaria to 0.4 billion. in 2014. (Source: National Banks of the respective countries.)

Table 21 / Romania: Selected economic indicators

	2011	2012	2013	2014 <sup>1)</sup>	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average <sup>2)</sup>	20,148	20,058	19,984	19,904	.	.	19,880	19,830	19,780
Gross domestic product, RON bn, nom. <sup>3)</sup>	565.1	595.4	637.5	666.6	285.8	302.7	700	740	780
annual change in % (real)	1.1	0.6	3.5	2.8	2.7	3.8	3.4	3.7	2.7
GDP/capita (EUR at exchange rate) <sup>3)</sup>	6,600	6,700	7,200	7,500	.	.	7,900	8,400	8,900
GDP/capita (EUR at PPP) <sup>3)</sup>	13,300	14,000	14,500	14,600	.	.	.	.	.
Consumption of households, RON bn, nom. <sup>3)</sup>	347.7	366.2	385.5	406.3	185.9	197.2	.	.	.
annual change in % (real)	1.0	0.8	2.6	4.1	5.0	5.2	4.8	5.5	2.0
Gross fixed capital formation, RON bn, nom. <sup>3)</sup>	153.0	162.8	157.5	146.6	51.6	56.6	.	.	.
annual change in % (real)	2.9	0.1	-5.4	-7.2	-8.2	9.2	6.0	3.0	3.0
Gross industrial production <sup>4)</sup>									
annual change in % (real)	7.5	2.4	7.9	6.1	9.1	2.4	4.0	5.0	3.0
Gross agricultural production									
annual change in % (real)	8.9	-21.9	24.5	2.1	.	.	.	.	.
Construction industry <sup>4)</sup>									
annual change in % (real)	2.7	1.4	-0.6	-6.7	-10.4	10.4	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	9,138	8,605	8,549	8,614	8,540	8,451	8,640	8,680	8,680
annual change in %	-1.1	0.9	-0.7	0.8	0.6	-1.0	0.3	0.5	0.0
Unemployed persons, LFS, th, average <sup>5)</sup>	730	627	653	629	640	640	630	620	620
Unemployment rate, LFS, in %, average <sup>5)</sup>	7.4	6.8	7.1	6.8	7.0	7.1	6.8	6.7	6.6
Reg. unemployment rate, in %, end of period	5.2	5.5	5.7	5.3	4.9	4.9	.	.	.
Average monthly gross wages, RON <sup>6)</sup>	1,980	2,063	2,163	2,328	2,318	2,485	2,500	2,600	2,800
annual change in % (real, gross)	-1.6	0.8	0.8	6.5	4.0	6.9	6.0	5.0	4.0
Average monthly net wages, RON <sup>6)</sup>	1,444	1,507	1,579	1,697	1,677	1,797	1,800	1,900	2,000
annual change in % (real, net)	-1.9	1.0	0.8	6.3	3.8	6.8	6.0	5.0	4.0
Consumer prices (HICP), % p.a.	5.8	3.4	3.2	1.4	1.3	0.4	0.0	1.0	2.0
Producer prices in industry, % p.a.	7.1	5.3	2.0	-0.2	-0.3	-2.0	-2.0	0.0	1.0
General government budget, EU-def., % of GDP									
Revenues	33.8	33.5	33.1	33.4	.	.	34.0	34.0	33.5
Expenditures	39.1	36.5	35.2	34.9	.	.	35.5	36.0	36.0
Net lending (+) / net borrowing (-)	-5.3	-2.9	-2.2	-1.5	.	.	-1.5	-2.0	-2.5
Public debt, EU-def., % of GDP	34.2	37.4	38.0	39.8	.	.	39.0	38.0	37.0
Central bank policy rate, % p.a., end of period <sup>7)</sup>	6.00	5.25	4.00	2.75	3.50	1.75	1.75	2.00	2.25
Current account, EUR mn <sup>8)</sup>	-6,186	-6,060	-1,542	-687	-728	-57	-600	-1,200	-1,800
Current account, % of GDP <sup>8)</sup>	-4.6	-4.5	-1.1	-0.5	-1.1	-0.1	-0.4	-0.7	-1.0
Exports of goods, BOP, EUR mn <sup>8)</sup>	40,102	39,855	43,893	46,812	22,677	24,380	50,100	53,100	55,800
annual change in %	22.6	-0.6	10.1	6.6	7.6	7.5	7.0	6.0	5.0
Imports of goods, BOP, EUR mn <sup>8)</sup>	49,063	48,779	49,709	53,158	25,296	27,290	57,400	62,000	65,100
annual change in %	17.7	-0.6	1.9	6.9	7.8	7.9	8.0	8.0	5.0
Exports of services, BOP, EUR mn <sup>8)</sup>	8,685	9,866	13,434	15,102	7,115	7,952	16,600	17,400	18,300
annual change in %	10.9	13.6	36.2	12.4	13.3	11.8	10.0	5.0	5.0
Imports of services, BOP, EUR mn <sup>8)</sup>	7,031	7,392	8,733	9,236	4,223	4,736	10,300	10,900	11,600
annual change in %	11.0	5.1	18.1	5.8	2.9	12.2	11.0	6.0	6.0
FDI liabilities (inflow), EUR mn <sup>8)</sup>	1,745	2,181	2,894	2,926	1,283	1,717	3,000	.	.
FDI assets (outflow), EUR mn <sup>8)</sup>	19	-175	-24	207	-57	381	400	.	.
Gross reserves of NB excl. gold, EUR mn	33,193	31,206	32,525	32,216	31,236	30,111	.	.	.
Gross external debt, EUR mn <sup>8)</sup>	99,926	100,857	98,069	94,744	95,187	90,821	86,700	93,500	100,600
Gross external debt, % of GDP <sup>8)</sup>	75.0	75.5	68.0	63.2	63.5	57.6	55.0	56.0	57.0
Average exchange rate RON/EUR	4.2391	4.4593	4.4190	4.4437	4.4641	4.4475	4.44	4.43	4.42
Purchasing power parity RON/EUR	2.1091	2.1242	2.2043	2.2849	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA 2010. - 4) Enterprises with 4 and more employees. - 5) From 2012 according to census October 2011. - 6) Half-year data refer to enterprises with 4 and more employees. - 7) One-week repo rate. - 8) BOP 6th edition.

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