

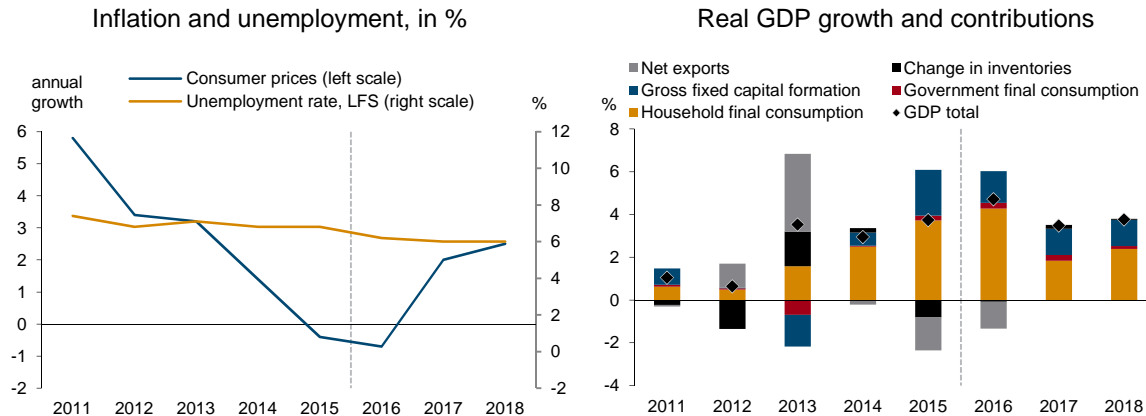


ROMANIA: Sobering to follow upbeat

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Economic growth is projected to accelerate exceptionally to 4.7% in 2016. Private consumption has received a pro-cyclical boost in the form of tax cuts and wage increases, while fixed investments have also continued to grow. With every expectation of inflation climbing to positive levels and wage increases losing momentum, the consumption boom will settle down in 2017. An economic growth of 3.5% is expected for 2017 and 3.7% for 2018, thus helping the country to retain its relative robustness by international standards.

Figure 38 / Romania: Main macroeconomic indicators



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

Economic growth is ahead of expectation in 2016, reaching 5.2% in the first half of the year. Household demand has been the main driver of growth (up 10.4%). A general VAT-rate cut from 24% to 20% has been in place since the beginning of the year and the minimum wage was hiked in May (to about EUR 270; it is still the second lowest among the EU members), leading to an automatic proportional increase in the salaries of civil servants. An unexpectedly good harvest has generated additional income and consumption in rural areas.

Another source of high economic growth has been the vibrant investment activity. Gross fixed capital formation expanded by 6.4% in the first half of 2016 and investment outlays increased by 8.7%. Investments in equipment, including means of transport, grew faster (13.3%) than investments in new buildings (6.1%). The branches having achieved a higher increase in investments than a year before

comprised industry, trade and construction. Most of the corporate investments were financed from growing retained profits while new credit to the economy shrank. The construction industry expanded by 5.3% mainly on account of building roads, flats and shop-spaces. During the first half of 2016, 20% more dwellings were completed than a year earlier. This boom does not seem lasting as the number of newly issued construction permits declined.

Industrial production stagnated in the first eight months of 2016 mainly due to declining mining activity but also to sluggish manufacturing output growth, at less than 2%. Relatively strong growth was observed in the manufacturing of cars, electrical equipment and construction materials, while production declined in the pharmaceuticals, metallurgy and electronics industries. The low rate of industrial growth was coupled with declining labour productivity and rising unit labour costs. It is too early to predict a loss of longer-term cost competitiveness of the Romanian industry, but recent developments might suggest a need for correction.

Despite higher turnover, the tax cuts had a negative impact on fiscal revenues. The budget deficit amounted to 0.4% of GDP in the first eight months of the year in contrast to the surplus of 0.9% in the same period of last year. It is unusual in Romania to have budget deficits in the middle of a year as most of the expenditures are booked in December. Therefore, the deficit for the whole year of 2016 may reach 3% of GDP. The consolidated budget revenues went down by 1.9% in the first eight months of 2016 compared to the same period of last year. The drop was mainly due to lower VAT revenues and lower EU fund inflows, which cancelled out the increase recorded by other revenue categories. On the expenditure side, a 4.7% increase was recorded in the first eight months of this year, most of it owing to current expenditures driven up by higher personnel costs in the public sector, and higher welfare expenses.

Export activity increased only modestly in the first half of 2016 mainly on account of sales to the EU. The share of machinery and transport equipment expanded, comprising almost half of the exports, while the share of crude materials declined (measured in current euros, thus reflecting price effects). Imports expanded in all product groups except fuels. Low international commodity prices helped curtail expenditures on imports, but external vulnerability has increased in the wake of the consumption boom.

The current account deficit widened almost threefold in the first seven months of the year against the same period of the previous year mainly on account of higher goods imports. The surplus on the services balance, which is predominantly earned by the transport sector, increased also in telecommunications, computer, and information services, signalling that Romania is a favoured location for shared service outsourcing and call centres. The primary account deficit contracted due to somewhat lower profits earned by foreign investors. The secondary income surplus declined on account of lower remittances transferred by Romanians working abroad. Higher incomes earned in Romania seem to curtail the need for remittances. The financing of the current account deficit has a favourable structure. Transfers through the capital account increased due to delayed EU financing for the 2007-2013 period. Also the inflow of FDI increased (calculated according to the directional principle) mainly in the form of equity and reinvested earnings.

Accelerated economic growth has generated employment; still, the number of employed persons declined for demographic reasons. In the second quarter of 2016, the employment rate for the working-age population was 61.8%, 2 percentage points higher than last year. The unemployment rate declined

rapidly: from 6.8% in August 2015 to a mere 6% in August of the current year. The vacancy rate increased only marginally, to 1.2% in the second quarter of 2016 year on year. As emigration is a permanent process, the government wants to stimulate immigration. To this end, it intends to shorten the work permit and visa procedures and simplify the visa regime for neighbouring non-EU country citizens. The inflow of refugees through the Balkan route is curtailed by the Romanian authorities and very few intend to stay in the country. Similar to other EU-wide discussions, Romania keeps a low profile in the refugee question and has no intention to join the Visegrad group. The country takes a more active stance in NATO by allowing the stationing of additional troops and a US missiles base on its territory.

Monetary policy has not reacted to the temporary deflation caused by lower VAT and oil prices. The policy rate has been kept at 1.75% – close to the underlying inflation rate. The National Bank managed to modify but could not block some new legislative acts which benefit the population by softening their financial constraints. Parliament has passed a ‘giving in payment law’, which allows debtors to transfer mortgaged assets to banks and get out of (mostly non-serviced) loans. In the future, banks will be obliged to look for solutions to help mortgage clients who have difficulties in repaying their loans and reduce their financial burden before foreclosure. Another law, on personal insolvency, comes in force as of November this year. Insolvent persons will be able to reschedule their debts over five years. A further initiative under discussion in Parliament intends allowing the conversion of foreign currency loans into local currency at a yet undecided historic rate. While such measures provide relief to victims of the financial crisis, they also discourage prudent behaviour in the future.

Installing a caretaker government in December 2015 was the solution to a political crisis. Despite some intellectual efforts to initiate changes in public governance, this government lacks political support in Parliament to implement thorough reforms before the elections scheduled for 11 December. Economic policy will most probably not be in the focus of the upcoming election campaign except generous wage promises from all parties. Currently the odds are in favour of the previously governing socialists-led coalition, but if they do not win with a convincing majority, the President will do all he can to help the national-liberals to form a government.

The new government will not be installed before January, thus the 2017 budget will not be passed by Parliament before late February. Nevertheless, the EU Commission expects the current government to take steps in order to keep the fiscal deficit within 3% of GDP. There is ample room for improving tax collection by making online payment general and putting stricter limits on using cash between economic agents. As this can only be achieved in the longer run, we expect that the scheduled VAT cut by 1 percentage point together with another minimum-wage hike will not come into force as of 1.1.2017.

As the one-time effects of previous tax cuts and wage corrections expire, a slowdown in economic growth will set in in 2017. Household demand will cool down; first signs of this can already be observed in construction and retail trade. Investments may keep growing, with the disbursement of EU funds playing a crucial role. Romania has been allocated EUR 30.8 billion from ESI funds over the period 2014-2020 and only a tiny fraction has been used in the first three years. Disbursement may accelerate in 2018 and GDP growth may speed up to close to 4%.

Table 21 / Romania: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	20,058	19,984	19,909	19,815	.	.	19,830	19,780	19,700
Gross domestic product, RON bn, nom.	595.4	637.5	667.6	712.8	303.4	325.6	760	800	850
annual change in % (real)	0.6	3.5	3.0	3.8	3.9	5.2	4.7	3.5	3.8
GDP/capita (EUR at exchange rate)	6,700	7,200	7,500	8,100	.	.	8,600	9,000	9,600
GDP/capita (EUR at PPP)	14,300	14,400	15,200	16,300	.	.	.	.	.
Consumption of households, RON bn, nom.	366.2	385.5	406.2	435.8	195.9	211.9	.	.	.
annual change in % (real)	0.8	2.6	4.1	6.1	5.1	10.2	7.0	3.0	3.9
Gross fixed capital form., RON bn, nom.	162.8	157.5	161.4	176.2	64.8	70.4	.	.	.
annual change in % (real)	0.1	-5.4	2.5	8.9	7.9	7.3	6.0	5.0	5.0
Gross industrial production ²⁾
annual change in % (real)	2.4	7.8	6.1	2.8	2.4	1.3	1.0	2.0	3.0
Gross agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	-21.9	24.5	2.9	-10.5	.	.	.	.	.
Construction industry ²⁾
annual change in % (real)	1.4	-0.6	-6.7	10.3	10.4	4.6	.	.	.
Employed persons, LFS, th, average	8,605	8,549	8,614	8,535	8,450	8,388	8,550	8,550	8,550
annual change in %	0.9	-0.7	0.8	-0.9	-1.0	-0.7	0.2	0.0	0.0
Unemployed persons, LFS, th, average	627	653	629	624	640	558	570	550	550
Unemployment rate, LFS, in %, average	6.8	7.1	6.8	6.8	7.1	6.3	6.2	6.0	6.0
Reg. unemployment rate, in %, end of period	5.5	5.7	5.4	5.0	5.0	4.7	.	.	.
Average monthly gross wages, RON ³⁾	2,063	2,163	2,328	2,525	2,485	2,803	2,900	3,000	3,200
annual change in % (real, gross)	0.8	0.8	6.5	9.1	6.9	15.7	14.5	3.0	3.0
Average monthly net wages, RON ³⁾	1,507	1,579	1,697	1,838	1,797	2,029	2,100	2,200	2,300
annual change in % (real, net)	1.0	0.8	6.4	9.0	6.8	15.8	14.5	3.0	3.0
Consumer prices (HICP), % p.a.	3.4	3.2	1.4	-0.4	0.4	-2.1	-0.7	2.0	2.5
Producer prices in industry, % p.a.	5.2	2.0	-0.2	-2.4	-2.0	-2.8	1.0	2.0	2.5
General governm.budget, EU-def., % of GDP	.	.	.	.	.	.	.	.	.
Revenues	33.4	33.1	33.5	34.8	.	.	33.0	33.0	33.0
Expenditures	37.1	35.2	34.3	35.5	.	.	36.0	35.5	35.5
Net lending (+) / net borrowing (-)	-3.7	-2.1	-0.9	-0.7	.	.	-3.0	-2.5	-2.5
Public debt, EU-def., % of GDP	37.4	38.0	39.8	38.4	.	.	38.0	38.0	38.5
Central bank policy rate, % p.a., end of period ⁴⁾	5.25	4.00	2.75	1.75	1.75	1.75	1.75	2.25	3.00
Current account, EUR mn	-6,394	-1,542	-1,004	-1,928	273	-2,027	-6,800	-8,900	-9,500
Current account, % of GDP	-4.8	-1.1	-0.7	-1.2	0.4	-2.8	-4.0	-5.0	-5.0
Exports of goods, BOP, EUR mn	39,855	43,893	46,839	49,119	24,369	25,509	50,600	53,100	55,800
annual change in %	-0.6	10.1	6.7	4.9	7.4	4.7	3.0	5.0	5.0
Imports of goods, BOP, EUR mn	49,114	49,709	53,375	56,892	27,282	29,631	60,900	63,900	67,700
annual change in %	-0.7	1.2	7.4	6.6	7.4	8.6	7.0	5.0	6.0
Exports of services, BOP, EUR mn	9,868	13,434	15,104	16,640	7,960	8,584	16,600	17,400	18,300
annual change in %	13.6	36.1	12.4	10.2	11.9	7.8	0.0	5.0	5.0
Imports of services, BOP, EUR mn	7,392	8,733	9,236	9,849	4,748	4,825	9,600	10,100	10,600
annual change in %	5.1	18.1	5.8	6.6	12.4	1.6	-3.0	5.0	5.0
FDI liabilities (inflow), EUR mn	2,380	2,894	2,931	3,885	2,268	2,067	3,000	.	.
FDI assets (outflow), EUR mn	-175	-24	227	930	655	68	0	.	.
Gross reserves of NB excl. gold, EUR mn	31,206	32,525	32,216	32,238	30,111	31,729	.	.	.
Gross external debt, EUR mn	100,857	98,069	94,744	90,034	90,858	88,256	90,000	92,000	95,000
Gross external debt, % of GDP	75.5	68.0	63.1	56.1	56.7	52.0	53.1	51.8	50.3
Average exchange rate RON/EUR	4.4593	4.4190	4.4437	4.4454	4.4475	4.4956	4.48	4.50	4.50
Purchasing power parity RON/EUR	2.0753	2.2083	2.2120	2.2036	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) Half-year data refer to enterprises with 4 and more employees. - 4) One-week repo rate.

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