Romania

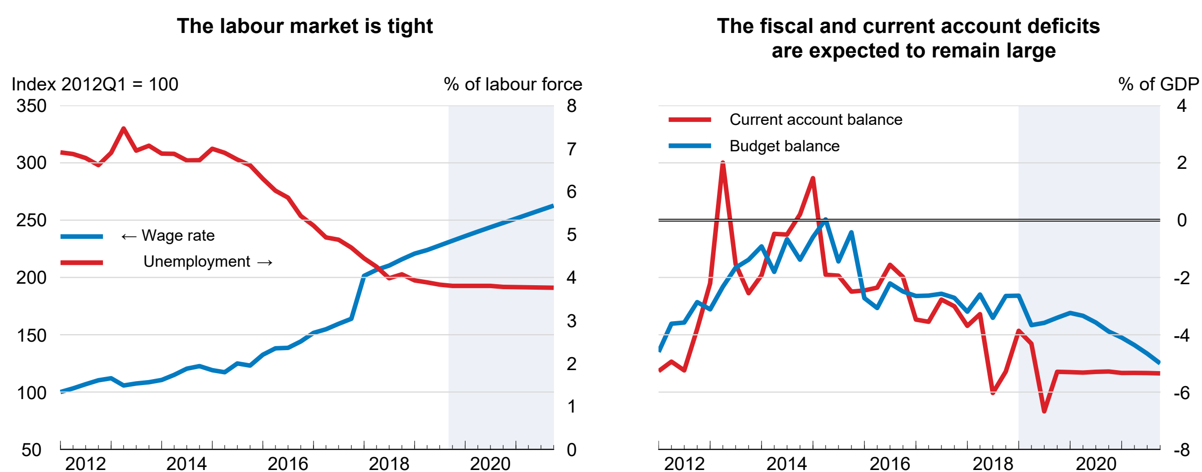
After the strong expansion in recent years, growth is projected to slow to 3.2% in 2020 and then increase to 3.7% in 2021. While wages will return to single-digit growth, private consumption is expected to remain robust, sustained by significant increases in public pensions. The trade deficit will increase further due to weak foreign demand and lower price competitiveness. Investment growth will remain at a moderate pace, supported by higher absorption of EU funds.

Despite relatively high inflation, monetary policy is projected to remain on hold as risks of overheating subside. While public debt is still moderate, fiscal space is limited as the volatile external environment could limit debt-financing capacity. Prudent fiscal policy requires consolidation efforts. This should be done by revising the public spending mix and improving efficiency of tax collection.

Economic growth has been strong

GDP growth has been strong in 2019, sustained by robust consumption and buoyant investment in the construction sector. Increases in both public sector and minimum wages have supported household purchasing power. Unemployment has reached a record low level and labour shortages have intensified. Rising labour costs have undermined the price competitiveness of domestic producers, contributing to the widening of the current account deficit. Furthermore, slowing global trade has damped growth in industrial production and exports. Business confidence is deteriorating and capacity utilisation is falling.

Romania



Source: OECD Economic Outlook 106 database.

Romania: Demand, output and prices

Romania	2016	2017	2018	2019	2020	2021
	Current prices RON billion	Percentage changes, volume (2010 prices)				
GDP at market prices	765.1	7.1	4.0	4.0	3.2	3.7
Private consumption	478.2	10.0	5.2	4.6	3.9	4.3
Government consumption	115.4	4.2	1.5	3.2	3.0	2.0
Gross fixed capital formation	175.0	3.6	-3.3	13.5	5.7	5.1
Final domestic demand	768.7	7.7	2.7	6.2	4.1	4.1
Stockbuilding[1]	3.5	0.8	2.8	-0.9	-0.3	0.0
Total domestic demand	772.2	8.4	5.5	5.3	3.8	4.1
Exports of goods and services	315.1	7.6	5.4	3.2	1.6	2.9
Imports of goods and services	322.2	10.8	9.1	6.3	3.3	3.9
Net exports[1]	- 7.1	-1.4	-1.7	-1.5	-0.8	-0.6
Memorandum items						
GDP deflator	_	4.7	5.9	4.8	3.4	3.5
Consumer price index	_	1.3	4.6	3.9	3.4	3.2
Core consumer price index[2]	_	1.5	2.8	3.2	3.3	3.2
Unemployment rate (% of labour force)	_	4.9	4.2	3.9	3.8	3.8
Household saving ratio, net (% of disposable income)	_	-15.4	-8.9	-8.1	-7.9	-7.7
General government financial balance (% of GDP)	_	-2.6	-3.0	-3.3	-3.5	-4.5
General government gross debt (% of GDP)	_	45.1	43.8	45.5	47.7	50.6
General government debt, Maastricht definition (% of GDP)	_	35.1	35.0	36.7	38.9	41.8
Current account balance (% of GDP)	_	-3.2	-4.6	-5.0	-5.3	-5.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

Fiscal space is limited

Past expansionary and pro-cyclical fiscal policy has reduced available fiscal space. The fiscal deficit is set to widen further over the coming two years, putting public debt on a fast upward trajectory. A recent pension reform will increase public spending by more than 2 percentage points of GDP by 2021. Expected improvements in tax collection and public efficiency are not likely to materialise soon enough to compensate for increases in public spending. As a result, the fiscal stance is expected to be broadly neutral in 2020 and strongly expansionary in 2021.

The deterioration of the budget balance creates some risks by putting further pressure on the current account deficit, with a potential loss of foreign investor confidence in case of a negative macroeconomic shock. Fiscal buffers need to be rebuilt to address these risks and to preserve sustainability of public finances. To reduce the fiscal deficit, the government should reconsider the scope and/or the timetable of the pension reform. Otherwise, the consolidation effort may have to rely on spending cuts in priority areas, including education, health and infrastructure. Increasing taxes that are the least distortive to growth, such as environmental and property taxes, could also be considered.

Financing conditions will remain favourable as monetary policy is projected to remain accommodative despite inflation exceeding the 2.5% (+/- 1%) target in 2019. Interest rates are projected to remain unchanged going forward, as inflationary pressures are expected to ease slowly and return to the central bank's target band in 2020.

The labour market will remain tight as the labour force continues to decline due to ageing and emigration. Activation measures that increase labour market participation from its current low level can help reduce shortages and wage pressures. Growth in public sector pay and in minimum wages will moderate. As a result, wage inflation will ease, but still exceed productivity gains.

GDP growth is projected to slow

After growing at 4% in 2019, GDP is projected to decelerate to 3.2% in 2020 before increasing to 3.7% in 2021. Falling inflation and fiscal stimulus will sustain increases in household purchasing power. Business investment growth will remain relatively low due to the weak external environment, but higher absorption of EU structural funds will sustain public investment. Competitiveness of domestic producers will be affected by rising labour costs. The current account deficit is set to exceed 5% of GDP.

The main downside risks include a further deterioration of trade prospects in the European Union and heightened global financial volatility leading to capital outflows. Excessive fiscal relaxation, especially sharp increases in wages in the public sector and pensions, would entail stronger competitiveness losses. Steep rises in sovereign spreads could strongly affect the banking sector due to its large sovereign debt exposure. By contrast, activation policies could have a more pronounced positive impact on labour force participation and contribute to easing labour market tensions. Improved policy predictability after the elections in 2020 could strengthen business confidence and investment.