23. ROMANIA

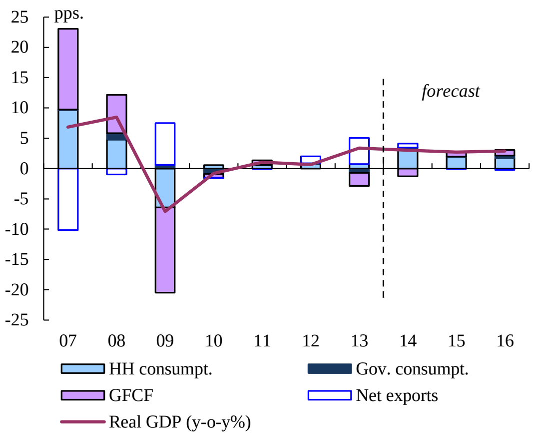
Sustained growth ahead

Romania's economic growth is forecast to remain robust in 2015 and 2016, mainly driven by domestic demand and accompanied by a stable labour market. After a sharp decline in 2014, inflation is expected to remain moderate over the forecast horizon. Fiscal consolidation is due to continue in 2015.

Continued economic growth powered by domestic demand

Romania's economy registered surprisingly strong growth in 2014-Q3 (1.8 % q-o-q) thanks to better-than-expected private consumption and exports, and a significant contribution from inventories. Investment continued to contribute negatively although its contraction eased significantly. Confidence indicators are back to pre-crisis levels, pointing to continued momentum for the economy. As a result, annual growth is estimated to have reached 3.0% in 2014.

Graph II.23.1: **Romania - Real GDP growth and contributions**



Economic growth in Romania is forecast to stay above potential, at 2.7% in 2015 and 2.9% in 2016, powered by domestic demand and also supported by the gradual recovery expected in the global economy. Private consumption is expected to remain robust, as growing wages, low inflation, falling interest rates and improving labour market conditions are all supportive for the purchasing power of households. As already observed in 2014, local currency lending is projected to continue growing given easing credit conditions and an expected slowdown in the deleveraging process.

After two years of contraction, both private and public investments are forecast to start recovering. The improvement in investor confidence, together with recent changes in tax policies favourable to businesses (a tax credit for reinvested profits, lower social security contributions and a lower special construction tax) and improving financing conditions are likely to boost private investment. Moreover, public investment is expected to accelerate driven by a pick-up of projects co-financed with EU funds. Given the strength of exports, the growth contribution of net exports continued to be positive in 2014. Exports are forecast to continue increasing in 2015 and 2016 thanks to the expected recovery of Romania's main trading partners, but the pace of growth will be somewhat slower. Imports, however, are expected to rise at a faster rate, propelled by the strengthening of domestic demand. The growth contribution of net exports is expected to turn slightly negative in 2016.

Risks to the macroeconomic and inflation outlook appear broadly balanced. Downside risks include faster-than-expected deleveraging and the impact of a further deterioration in geo-political tensions from the Ukraine-Russia conflict hurting market confidence and the economic outlook in major trading partners. Upside risks are related to stronger-than-expected effects from the EU Investment Plan and actual implementation of more structural reforms.

Lower unemployment and moderate inflation

Romania's labour market has been remarkably stable over the last few years, with employment and unemployment rates hovering around constant levels. Domestic employment in the private sector is expected to improve slightly against a slowly declining working-age population, accompanied by a drop in the unemployment rate over the forecast horizon, to 6.8% in 2016. Further stepwise increases in the gross minimum wage in 2015 and the 5% cut of the employers' social security contribution will have opposing effects on labour costs. Compensation per head is projected to grow by more than 3% in 2015 and by some 4% in 2016, entailing further real wage increases in an environment of moderate inflation.

After reaching an historical low of 0.9% in June 2014, HICP inflation slightly picked up in recent months. Annual average inflation declined from 3.2% in 2013 to 1.4% in 2014 mainly reflecting a VAT cut for bread, a good harvest and lower global energy prices. It is forecast to remain at moderate levels and to reach an annual average of 1.2% in 2015, mainly due to the significant decline in energy prices, subdued inflation in the EU and lower inflation expectations. In 2016, inflation is forecast to accelerate to 2.5% as the recovery in domestic demand continues.

Fiscal consolidation to continue in 2015

In 2014, the budget deficit is estimated to have decreased to 1.8% of GDP, from 2.2% in 2013. An increase in excise duties on fuels and the introduction of a special construction tax outbalanced the impact of lower social security contributions following a rate cut of 5 pps., which took effect on 1 October 2014, and the tax exemption on reinvested profits. Tax collection improved in late 2014 following subdued performance earlier in the year. Capital expenditure decreased significantly from 2013.

The government budget deficit is forecast to decrease further to 1.5% of GDP in 2015, as a reduction in tax revenues is outweighed by reductions in expenditure, expressed as a fraction of GDP. The revenue side includes the full-year impact of the cut in social security contribution and the reduction in the special construction tax rate. Expenditure in goods and services is forecast to fall significantly. The public wage bill remains contained, since only some categories benefit from either pay rises or the increases in the minimum wage and social security contributions will be lower. Additional savings stem from the discontinuation of non-recurrent spending in 2014, such as the organisation of elections, and a reduction in subsidies. This forecast assumes full use of the budget allocation for national EU funds co-financing. The past volatility of tax collection and tight budget allocations for social assistance and interest expenditure could emerge as pressure point for the deficit. EU funds absorption might surprise on the downside.

In 2016, the headline deficit is expected to remain at 1.5% of GDP under the customary no-policy-change assumption with revenues developing in line with better growth prospects. In structural terms, the deficit is forecast to improve from 1½% of GDP in 2013 to around 1¼% of GDP in 2014-16. Government debt is forecast at 38.7% in 2014 and should plateau in 2015-16 below 40%.

Table II.23.1:
Main features of country forecast - ROMANIA

		2013			Annual percentage change					
	bn RON	Curr. prices	% GDP	95-10	2011	2012	2013	2014	2015	2016
GDP		637.6	100.0	3.0	1.1	0.6	3.4	**3.0**	**2.7**	**2.9**
Private Consumption		395.0	62.0	5.6	0.8	1.2	1.2	**5.0**	**3.0**	**2.7**
Public Consumption		90.5	14.2	0.2	0.6	0.4	-4.8	**2.5**	**0.3**	**3.2**
Gross fixed capital formation		151.6	23.8	5.9	2.9	0.1	-7.9	**-5.4**	**3.5**	**4.1**
of which: equipment		52.1	8.2	5.1	19.6	-2.7	-7.2	**-5.9**	**4.0**	**4.5**
Exports (goods and services)		253.4	39.7	9.3	11.9	1.0	16.2	**8.4**	**5.7**	**5.8**
Imports (goods and services)		257.6	40.4	12.8	10.2	-1.8	4.2	**6.6**	**5.8**	**6.3**
GNI (GDP deflator)		621.9	97.5	3.0	1.0	0.2	2.7	**3.0**	**2.6**	**2.9**
Contribution to GDP growth:	Domestic demand			5.8	1.4	0.9	-2.1	**2.2**	**2.7**	**3.1**
	Inventories			-0.4	-0.2	-1.4	1.2	**0.2**	**0.0**	**0.0**
	Net exports			-2.2	-0.1	1.1	4.3	**0.6**	**0.0**	**-0.2**
Employment				-1.8	-0.8	-4.8	-0.6	**0.2**	**0.3**	**0.4**
Unemployment rate (a)				6.9	7.2	6.8	7.1	**7.0**	**6.9**	**6.8**
Compensation of employees / head				34.5	-4.1	9.4	2.7	**4.7**	**3.4**	**4.1**
Unit labour costs whole economy				28.2	-5.8	3.5	-1.3	**1.8**	**0.9**	**1.5**
Real unit labour cost				-1.0	-10.1	-1.4	-4.5	**-0.6**	**-1.4**	**-0.9**
Saving rate of households (b)				-2.9	-7.0	-8.0	-10.4	**-13.3**	**-13.4**	**-14.2**
GDP deflator				29.5	4.7	4.9	3.4	**2.4**	**2.3**	**2.5**
Harmonised index of consumer prices				-	5.8	3.4	3.2	**1.4**	**1.2**	**2.5**
Terms of trade goods				2.4	1.8	-3.4	-1.1	**-0.1**	**0.0**	**0.7**
Trade balance (goods) (c)				-7.9	-6.7	-5.8	-3.9	**-3.6**	**-3.6**	**-3.6**
Current-account balance (c)				-6.6	-4.7	-4.7	-1.2	**-0.9**	**-1.1**	**-1.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-6.1	-4.2	-3.3	1.1	**1.4**	**1.3**	**1.2**
General government balance (c)				-3.6	-5.5	-3.0	-2.2	**-1.8**	**-1.5**	**-1.5**
Cyclically-adjusted budget balance (c)				-4.0	-4.4	-1.6	-1.4	**-1.4**	**-1.2**	**-1.3**
Structural budget balance (c)				-	-3.3	-2.1	-1.4	**-1.3**	**-1.2**	**-1.3**
General government gross debt (c)				18.1	34.2	37.3	38.0	**38.7**	**39.1**	**39.3**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.