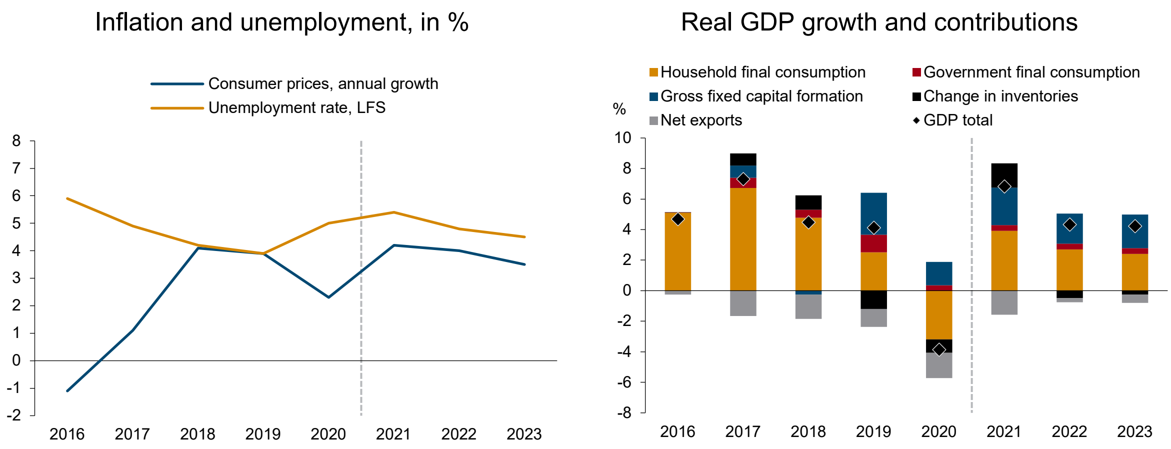
ROMANIA: Recovery shaken by triple crisis

GÁBOR HUNYA

With expected growth of 6.8% in 2021, the Romanian economy will surpass the pre-crisis level of 2019. The high twin deficits on the fiscal balance and the current account could become a problem only in the event of negative external shocks. The short-term prospects are dimmed by three simultaneous crises in the areas of the pandemic, gas supply and government.

Figure 4.17 / Romania: Main macroeconomic indicators



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

The Romanian economy experienced robust GDP growth of 6.6% in the first half of 2021, following a decline of 4.4% the year before. Investments and household consumption boosted the economy, while deteriorating trade balances exerted a moderating influence. We witnessed strong growth in Q3, but expect a more modest increase in Q4. The expansion in demand will slow, and thus the annual growth rate for 2021 will be only marginally higher than for the first half of the year. With growth forecast at 6.8%, 2021 real GDP will be 2.6% above the pre-COVID level of 2019 – a strong performance in international terms.

With 12% growth in the first half of 2021, gross fixed capital formation was a major driver of economic development. Gross capital formation expanded by as much as 27%, making the accumulation of stocks an important contributor to growth. It remains to be seen what proportion of the unfinished investments can be completed by the end of the year, thus turning stocks into fixed assets. An increasing part of the new investment in the first half of the year went into construction, while less went into new equipment than before. Stimulated by low interest rates, the housing market became overheated, resulting in a rapid rise in prices during the current year. The construction industry is at the very limits of its capacity, and in the short run will be unable to increase its contribution to economic growth beyond the current level.

Household consumption has made up for the losses of the previous year, but will be depressed during the winter. The relaxation of COVID-related rules boosted the accommodation and catering sector in Q3. Renewed restrictions (due to rapidly rising COVID-19 cases) will again depress demand in Q4. The very modest (33%) vaccination rate is not expected to improve substantially, despite the need for a ‘green card’ to enter public places. Late-night curfews and online education are again on the agenda in major cities. As of early October, hospitals are overcrowded and there is limited access for non-urgent cases. The COVID-related death rate has again reached the peak last seen in April 2021, so that Romania (together with Bulgaria and Montenegro) leads the rankings of the worst-affected European countries. Everyday life is again coming under increased stress, with a negative impact on attitudes to work and consumption. The accelerating inflation is yet another burden.

Inflation has been steadily rising throughout the year – partly driven by demand, but mainly as a result of higher import prices. Energy has become far more expensive, not only on account of international price developments, but also due to the domestic price liberalisation introduced at the beginning of the year. The outgoing government has not intervened in price setting, but instead offered support for consumers. About 60% of households will be eligible for a subsidy of 22% on their electricity bills and 25% on their gas bills, up to a certain consumption ceiling. This compensation will cover about half of the tariff hikes announced by distributors. The most needy households will receive additional cash support for heating. All in all, inflation will eat up much of the nominal wage increases introduced during the year. Therefore, real wages will increase by only 3.8% in 2021, less than in the crisis year 2020. Increased uncertainty caused by elevated inflation may depress household consumption next year, too. A 10% rise in the minimum wage announced for 2022 does not seem very high now, in view of the fact that inflation is expected to be close to 7% by the end of 2021.

The post-pandemic export rebound is being hampered by a shortage of production inputs in the car industry. But the macroeconomic effect is smaller than in more open economies that have a heavier reliance on automotive exports. The Romanian car industry is relatively small, and – compared to Slovakia or Czechia –it tends to export more components than ready-built vehicles. Following the European trend, the main fertiliser factory in the country will be working at half capacity in Q4, due to a natural gas shortage.

In October, the central bank hiked its base rate by 0.25 percentage points (to 1.5%), and we expect at least one more correction this year. The bank had let it be known in September that most of the inflation witnessed was due to one-off rises in household energy prices, and that core inflation had hardly moved, so that no change to the base rate would be needed. But inflation targeting does not stand still: despite its conviction that the spike in inflation was supply driven and transitory, now the board of the central bank believes that higher rates are needed to maintain capital inflows in order to fund the rising current account deficit, particularly in the context of heightened political risk.

Fiscal revenues have expanded more than envisaged, due to stronger economic growth and the recouping of taxes deferred by companies. But the pressure to raise expenditure allows only for a moderate narrowing of the deficit. An extra rise in pensions and the energy price compensation are unplanned burdens on the expenditure side. The fiscal deficit can be financed from the market, albeit at a heightened rate of interest (due to the political uncertainty). The 10-year yield on government bonds rose to 4.4% in early October – the highest level since May 2020.

Romania entered a political crisis in mid-September. The reformist element of the three-party coalition – the Save Romania Union (USR) – left the government led by the National Liberal Party (PNL), saying it would only return if Prime Minister Cîţu was replaced. That did not happen, as he had won the election as leader of the PNL and enjoyed the strong support of President Iohannis. On 5 October, the government fell after nine months in office, when parliament passed a motion of no confidence that was introduced by the Social Democratic Party (PSD). A caretaker government will take over for a limited period, during which time several options may be tested, and a restored coalition may emerge only after the other short-term options have been exhausted; early elections – an unusual option in Romania – cannot be ruled out this time. In any case, no government with wide legislative support will emerge in the next few months. A weak government may not be able to combat the pandemic and get to grips with the fiscal and current account imbalances. Businesses will have to operate in an uncertain environment.

In the period 2021-2027, Romania will have at its disposal loans and grants from the EU worth around EUR 80bn (a quarter of the 2021 GDP). Of this, close to EUR 50bn will be made available from the Multiannual Financial Framework (MFF) – the bulk of it (EUR 26.8bn) from the European Structural and Investment Funds (ESIF) and a further EUR 18.6bn allocated for agriculture and rural development. While the new MFF is being phased in, the money provided under the 2014-2020 ESIF has to be spent by the end of 2023. Since only half of that money had been disbursed by mid-2021, over the next two years the government will need to concentrate on spending that, rather than the new funds.

About EUR 30bn from the EU's Recovery and Resilience Facility (RRF) – a combination of loans and grants – is due to be allocated to mitigate the economic and social impact of the coronavirus pandemic in the period 2022-2026. The national RRF programme was agreed with the European Commission (EC) before the government crisis, and thus it could be disbursed from 1 October. The content of the RRF had to be renegotiated with the EC several times: the government had wanted to have the delayed motorway programme financed, but that did not fit with the green and innovative targets of the RRF. A compromise was found, but conditionalities have been imposed: one of those stipulates that Romania must pursue fiscal policies aimed at increasing the budget-revenue-to-GDP ratio by 2.5 percentage points by 2025. That target could be reached by increasing the tax collection rate through digitalisation, while leaving the statutory tax rates untouched. Such reforms will not be easy to implement, as the administration is unprepared. The upshot of failure would be delays in fund disbursement or the forgoing of some of the loans.

Despite the potential problems related to disbursement, the EU funds will make a positive contribution to growth, alongside foreign and domestic private investment. Economic growth will be maintained at an annual rate of somewhat above 4% over the next two years. The slowdown compared to 2021 reflects the elevated base effect and the change in the global environment following the bounce-back from the COVID crisis. The GDP forecast has both upside and downside risks. On the one hand, investments may rise more rapidly if the absorption of EU funds improves under a new government. On the other hand, the continuation of epidemic-related restraints and supply-chain disruptions may put the brakes on the economy.

Table 4.17 / Romania: Selected economic indicators

	2018	2019	2020 1)	2020 January-June	2021 January-June	2021 Forecast	2022 Forecast	2023 Forecast
Population, th pers., average	19,474	19,372	19,258	.	.	19,200	19,100	19,000
Gross domestic product, RON bn, nom.	951.7	1,058.2	1,055.5	443.7	493.8	1,180	1,280	1,390
annual change in % (real)	4.5	4.1	-3.9	-4.4	6.6	6.8	4.3	4.2
GDP/capita (EUR at PPP)	19,830	21,690	21,300	.	.	.	.	.
Consumption of households, RON bn, nom.	599.4	654.8	635.6	278.7	306.1	.	.	.
annual change in % (real)	7.6	4.0	-5.2	-4.5	5.1	6.5	4.5	4.0
Gross fixed capital form., RON bn, nom.	200.4	239.4	259.2	95.2	112.7	.	.	.
annual change in % (real)	-1.1	13.0	6.8	8.7	11.9	10.0	8.0	9.0
Gross industrial production 2)								
annual change in % (real)	3.5	-2.3	-9.2	-16.3	16.1	10.0	6.0	5.0
Gross agricultural production								
annual change in % (real)	7.2	-3.8	-15.3	.	.	.	.	.
Construction industry 2)								
annual change in % (real)	-4.1	27.6	15.9	19.4	5.9	.	.	.
Employed persons, LFS, th, average 3)	8,689	8,680	8,521	8,512	7,740	7,800	7,900	7,900
annual change in %	0.2	-0.1	-1.8	-1.6	.	0.5	0.3	0.0
Unemployed persons, LFS, th, average 3)	380	353	452	432	457	450	400	370
Unemployment rate, LFS, in %, average 3)	4.2	3.9	5.0	4.9	5.6	5.4	4.8	4.5
Reg. unemployment rate, in %, eop	3.3	3.0	3.4	3.0	3.0	.	.	.
Average monthly gross wages, RON	4,357	4,853	5,213	5,269	5,685	5,600	6,000	6,400
annual change in % (real, gross)	8.0	7.3	4.7	2.4	4.4	3.8	3.6	3.8
Average monthly net wages, RON	2,642	2,986	3,217	3,224	3,484	3,500	3,800	4,100
annual change in % (real, net)	8.0	8.8	4.9	2.7	4.5	4.0	3.8	4.0
Consumer prices (HICP), % p.a.	4.1	3.9	2.3	2.6	2.7	4.2	4.0	3.5
Producer prices in industry, % p.a.	5.1	3.8	0.0	0.6	6.2	7.0	4.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	31.9	31.8	33.1	.	.	34.0	34.0	34.0
Expenditures	34.9	36.2	42.4	.	.	41.0	40.0	39.0
Net lending (+) / net borrowing (-)	-2.9	-4.4	-9.2	.	.	-7.0	-6.0	-5.0
General gov.gross debt, EU def., % of GDP	34.7	35.3	47.3	.	.	49.0	51.0	52.0
Stock of loans of non-fin.private sector, % p.a.	7.9	7.0	5.0	4.1	10.9	.	.	.
Non-performing loans (NPL), in %, eop	5.0	4.1	3.8	4.4	3.8	.	.	.
Central bank policy rate, % p.a., eop 4)	2.50	2.50	1.50	1.75	1.25	1.75	2.00	2.00
Current account, EUR m	-9,497	-10,906	-10,970	-4,050	-7,500	-14,000	-11,700	-10,900
Current account, % of GDP	-4.6	-4.9	-5.0	-4.4	-7.4	-5.8	-4.6	-4.0
Exports of goods, BOP, EUR m	61,814	63,056	57,541	26,440	34,105	67,300	71,300	74,900
annual change in %	8.1	2.0	-8.7	-17.0	29.0	17.0	6.0	5.0
Imports of goods, BOP, EUR m	77,153	80,900	76,479	35,316	44,586	89,500	93,100	96,800
annual change in %	10.3	4.9	-5.5	-11.2	26.3	17.0	4.0	4.0
Exports of services, BOP, EUR m	23,791	27,058	23,768	11,431	12,523	26,100	28,400	30,700
annual change in %	9.5	13.7	-12.2	-9.9	9.6	10.0	9.0	8.0
Imports of services, BOP, EUR m	15,431	18,408	14,321	7,006	8,189	16,000	17,300	18,700
annual change in %	13.9	19.3	-22.2	-18.8	16.9	12.0	8.0	8.0
FDI liabilities, EUR m	6,205	6,574	3,056	-26	4,210	5,000	.	.
FDI assets, EUR m	1,259	1,721	112	-1,015	588	500	.	.
Gross reserves of CB excl. gold, EUR m	33,065	32,927	37,379	35,002	36,831	.	.	.
Gross external debt, EUR m	99,841	109,783	126,807	113,705	129,087	135,000	142,000	150,000
Gross external debt, % of GDP	48.8	49.2	58.1	52.1	53.9	56.4	55.7	55.3
Average exchange rate RON/EUR	4.6540	4.7453	4.8383	4.8174	4.9014	4.93	5.02	5.12

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) One-week repo rate.

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