ROMANIA: EU-financed investments cushioning the slowdown

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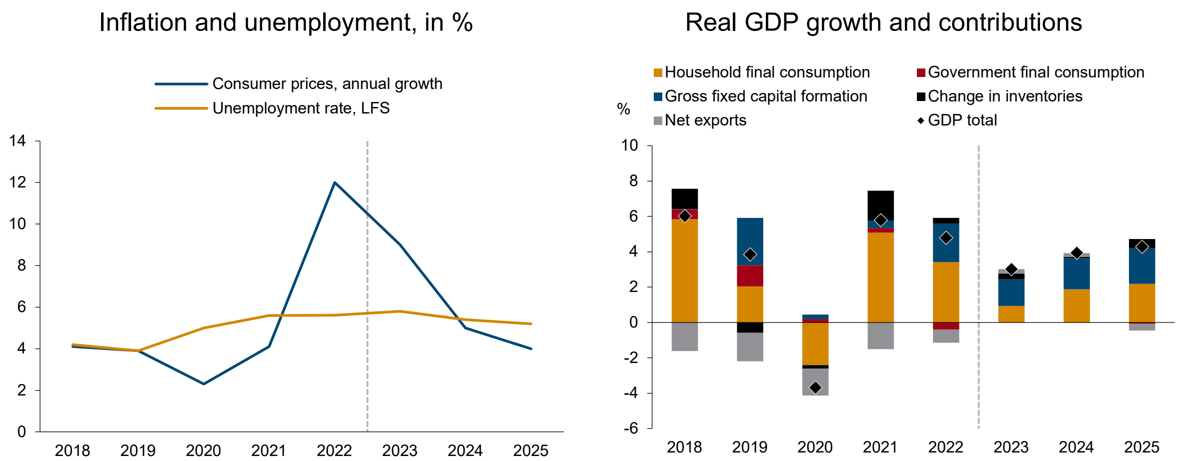
Economic growth will slow to 3% in 2023, from close to 5% the previous year. Domestic demand will be eroded by high inflation and sluggish wage growth. The dynamic expansion of investments financed mainly by EU programmes and FDI will continue. Fiscal and current account deficits will contract, but will remain elevated – which will constitute a moderate risk. The improved international position of Romania in economic, political and military aspects supports its long-term economic development.

Figure 5.17 / Romania: Main macroeconomic indicators



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

Romania has been more resilient to recent external shocks than its peers and managed to attain economic growth of 4.8% in 2022. The growth momentum weakened only marginally in Q4: real GDP increased by 1.0% against the previous quarter and by 4.5% year on year. Household consumption bounced back in 2022 from the COVID-related depression of the previous year, despite the elevated inflation. Gross fixed capital formation increased rapidly, supported by the inflow of foreign direct investment (FDI) and EU funds. On the production side, industrial and especially agricultural value added contracted, but this was counterbalanced by increases in construction and services. The war in Ukraine had a moderately negative effect on supply, but it also had some positive effects on domestic demand by way of arriving refugees. Limited trade exposure to the Russian economy and to energy imports overall helped the country to maintain its economic stability, despite slippages in the current account and fiscal deficits.

Net exports made a negative contribution to growth, reflecting the temporary deterioration in terms of trade and supply-chain disruptions. The current account deficit widened to 9.3% of GDP in 2022 (from 7.2% the previous year); this was due not only to an expanding trade deficit, but also to a doubling of the primary income deficit. The latter included exceptionally high profits earned by foreign investors, most of which were retained in the Romanian subsidiaries and recorded as FDI inflow. Rapid GDP growth resulted in a declining foreign-debt-to-GDP ratio, which fell below 50% toward the end of 2022, against almost 57% the previous year.

The fiscal deficit of about 6% of GDP in 2022 was elevated, though lower than the previous year. Driven by inflation, revenue increased substantially, while expenditure failed to keep pace. As a result, government consumption was a burden on economic growth. Financing of foreign public debt is increasingly costly (although still barely more than 1% of fiscal expenditure), as Romania has to pay the highest risk premium of all EU-CEE countries.

High inflation and modest wage growth have dampened household consumption since mid-2022. The annual Harmonised Index of Consumer Prices (HICP) peaked in November 2022 at 14.6%, year on year, and amounted to 12% on average for the year as a whole. Inflation was both cost and demand driven, though tempered by price caps on electricity, gas and firewood for households, as well as temporary subsidies on motor fuel. Net real wages declined by 1.4%, but the real income of households did not fall, due to rising social assistance. The real growth in retail sales turnover slowed, but remained positive throughout the year.

Early 2023 data indicate a significant slowdown in economic performance, though a contraction will probably be avoided. The year-on-year change in retail trade turnover and investment outlay remained positive in January and February. The recent rise in industrial new orders (which had been down in December) indicates growing optimism. Investments in house building have subsided, but other investments have kept growing. The foreign trade deficit has narrowed, mainly on account of lower import prices. On the negative side, inflationary pressure remains elevated, fuelled mainly by food prices. Loans to the private sector have been stagnating in nominal terms since September, meaning a decrease in real terms.

The general outlook for Romania is rosier than some years ago, thanks to its improved international position in economic, political and military aspects. In terms of per capita GDP at purchasing power parity (PPP) it has made good headway internationally, achieving 77% of the EU average in 2022 (up from 57% in 2015). The grand coalition of the Social Democratic, National Liberal and Hungarian parties (PSD-PNL-UDMR) provides a political stability not seen in the country for many years. Romania is a firm supporter of EU initiatives and avoids disputes with the European Commission on ideological grounds. The war in Ukraine and the strains in the Black Sea region have bolstered Romania's strategic role. The country plays host to new NATO military bases and technologies, provides support to Ukrainian refugees and gives invaluable backing to Moldova's pro-EU government. All this has generated goodwill among US and EU leaders.

Romania is set to benefit from EU funds and FDI to the tune of some 4% of GDP each in 2023 and 2024. The share of EU funds in public revenues amounted to 11.8% in 2022, and the government expects this to rise to 13.2% in 2023; in terms of expenditure the share will rise from 11.7% to 16%. EU funds within the Recovery and Resilience Facility (RRF) and the Multiannual Financial Framework will allow the financing of large-scale investment programmes. Beyond transport infrastructure, a number of projects have commenced in healthcare, green energy and environmental protection. The positive impact on society and the economy is overwhelming, even if several of the projects envisaged may not come to fruition, due to exploding construction costs and cuts in funding. As Romania's economic growth in 2020-2021 exceeded the assumptions used for the initial allocation of RRF funds, the amount of the grants earmarked for the country (EUR 14.2bn) will be cut by EUR 2.1bn. This makes it all the more important for it to stay on track by fulfilling the conditions required for the disbursement of the next instalments. Delays are looming, however, due to the non-fulfilment of politically sensitive conditionalities and sluggish project implementation.

Household consumption will slow and fiscal consolidation will be sluggish in 2023. At the start of the year, the minimum wage was raised by 17.7% and public pensions were increased by 12.5%, which compensated for the average inflation of the previous year. In the private sector, real wages will keep pace with inflation, as the labour shortage forces employers to offer real pay rises. Household demand may catch up in the second half of the year, as inflation may well come down significantly in the absence of external shocks and with more abundant food supply from domestic sources. The government plans to reduce the fiscal deficit in 2023, despite the overall economic slowdown and falling inflation (which will erode revenue). At the beginning of the year, public-sector wages were increased by 10% – below the rate of inflation. The scheduled mid-term switching of the post of prime minister from the liberals to the socialists in May 2023 may erode fiscal discipline; thus we expect the deficit to stay at above 5% of GDP this year.

The current account deficit will remain high (7% of GDP), although it will shrink thanks to improving terms of trade and the lower expected profits of foreign investors. The central bank will manage to keep the exchange rate relatively stable, which will help combat inflation but may harm the competitiveness of certain Romanian products. In Q1 2023, the RON was supported by large forex inflows (particularly following Eurobond issues), and the international financial market turbulence in mid-March 2023 had almost no impact on the daily exchange rate. Still, the Romanian currency is the most undervalued in the EU-CEE in respect of purchasing power parity, which provides scope for appreciation.

Due to sluggish demand on EU markets, the recovery of manufacturing will be slow and the structural shift to services will continue. FDI inflow will remain high and will go mainly into modernising existing capacities and targeting sectors of domestic consumption, including retail, oil, gas and electricity. The re-shoring from Russia and Ukraine that has got under way in ICT services could accelerate and encompass other sectors, too. Agriculture is expected to recover from the drought-caused low of the previous year, allowing for higher consumption by rural households, more exports and recovery in the food-processing industry.

Romania will probably be able to maintain more rapid economic growth than most of its EU-CEE peers – 3% in 2023. This is largely due to its lower exposure to external markets and the more significant inflow of EU funds. By implementing the ongoing investment programmes, Romania can strengthen its energy self-sufficiency and benefit more from the transport re-direction from Ukraine and Moldova. An acceleration in economic growth to 4% or beyond is feasible from 2024, depending on the momentum of household and external demand and the influx of EU funds. The country's likely access to the Schengen area will reduce transaction costs and provide a further boost to the economy.

Table 5.17 / Romania: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	19,372	19,265	19,120	19,000	18,900	18,800	18,700
Gross domestic product, RON bn, nom.	1,063.8	1,066.8	1,187.4	1,412.5	1,600	1,760	1,890
annual change in % (real)	3.9	-3.7	5.8	4.8	3.0	4.0	4.3
GDP/capita (EUR at PPP)	21,790	21,830	24,040	27,190	.	.	.
Consumption of households, RON bn, nom.	653.0	642.1	732.6	883.8	.	.	.
annual change in % (real)	3.3	-3.9	8.4	5.5	1.5	3.0	3.5
Gross fixed capital form., RON bn, nom.	244.5	251.0	281.9	355.3	.	.	.
annual change in % (real)	12.6	1.1	1.9	9.2	6.0	7.0	8.0
Gross industrial production 2)							
annual change in % (real)	-2.3	-9.2	7.1	-1.8	1.0	3.0	5.0
Gross agricultural production							
annual change in % (real)	-3.8	-15.4	14.3	-15.4	.	.	.
Construction industry 2)							
annual change in % (real)	27.6	15.9	-0.6	12.9	.	.	.
Employed persons, LFS, th, average 3)	8,680	8,521	7,756	7,806	7,820	7,860	7,860
annual change in %	-0.1	-1.8	0.7	0.7	0.2	0.5	0.0
Unemployed persons, LFS, th, average 3)	353	452	459	464	480	450	430
Unemployment rate, LFS, in %, average 3)	3.9	5.0	5.6	5.6	5.8	5.4	5.2
Reg. unemployment rate, in %, eop	3.0	3.4	3.0	3.1	.	.	.
Average monthly gross wages, RON 4)	4,853	5,213	5,535	6,159	6,800	7,300	7,800
annual change in % (real, gross)	7.3	4.7	1.1	-2.2	1.0	2.0	3.0
Average monthly net wages, RON	2,986	3,217	3,416	3,832	4,200	4,500	4,800
annual change in % (real, net)	8.8	4.9	1.1	-1.4	1.5	2.5	3.5
Consumer prices (HICP), % p.a.	3.9	2.3	4.1	12.0	9.0	5.0	4.0
Producer prices in industry, % p.a.	3.8	0.0	14.9	44.7	15.0	4.0	3.0
General governm. budget, EU def., % of GDP							
Revenues	31.6	32.3	32.7	34.0	33.8	34.0	34.0
Expenditures	36.0	41.5	39.8	40.0	39.1	38.5	38.0
Net lending (+) / net borrowing (-)	-4.3	-9.2	-7.1	-6.0	-5.3	-4.5	-4.0
General gov. gross debt, EU def., % of GDP	35.1	46.9	48.6	49.5	49.0	48.0	47.0
Stock of loans of non-fin. private sector, % p.a.	7.0	5.0	14.3	11.2	.	.	.
Non-performing loans (NPL), in %, eop	4.1	3.8	3.4	2.7	.	.	.
Central bank policy rate, % p.a., eop 5)	2.50	1.50	1.75	6.25	6.00	4.00	3.00
Current account, EUR m	-10,906	-10,893	-17,471	-26,706	-22,600	-20,900	-18,400
Current account, % of GDP	-4.9	-4.9	-7.2	-9.3	-7.0	-5.9	-4.9
Exports of goods, BOP, EUR m	63,056	57,532	70,170	85,862	87,600	94,600	106,000
annual change in %	2.0	-8.8	22.0	22.4	2.0	8.0	12.0
Imports of goods, BOP, EUR m	80,900	76,476	93,286	118,222	120,600	129,000	140,600
annual change in %	4.9	-5.5	22.0	26.7	2.0	7.0	9.0
Exports of services, BOP, EUR m	27,058	23,764	27,881	37,002	38,900	43,600	48,000
annual change in %	13.7	-12.2	17.3	32.7	5.0	12.0	10.0
Imports of services, BOP, EUR m	18,408	14,321	18,462	24,290	25,500	28,100	29,800
annual change in %	19.3	-22.2	28.9	31.6	5.0	10.0	6.0
FDI liabilities, EUR m	6,574	3,056	9,933	11,295	.	.	.
FDI assets, EUR m	1,721	112	1,117	1,663	.	.	.
Gross reserves of CB excl. gold, EUR m	32,927	37,379	40,475	46,636	.	.	.
Gross external debt, EUR m	109,783	126,750	136,585	144,561	160,000	175,000	185,000
Gross external debt, % of GDP	49.0	57.5	56.6	50.5	49.5	49.7	49.4
Average exchange rate RON/EUR	4.7453	4.8383	4.9215	4.9313	4.95	5.00	5.05

1) Preliminary and wiiw estimates. - 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) Including the employers' social security contribution. - 5) One-week repo rate.

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