

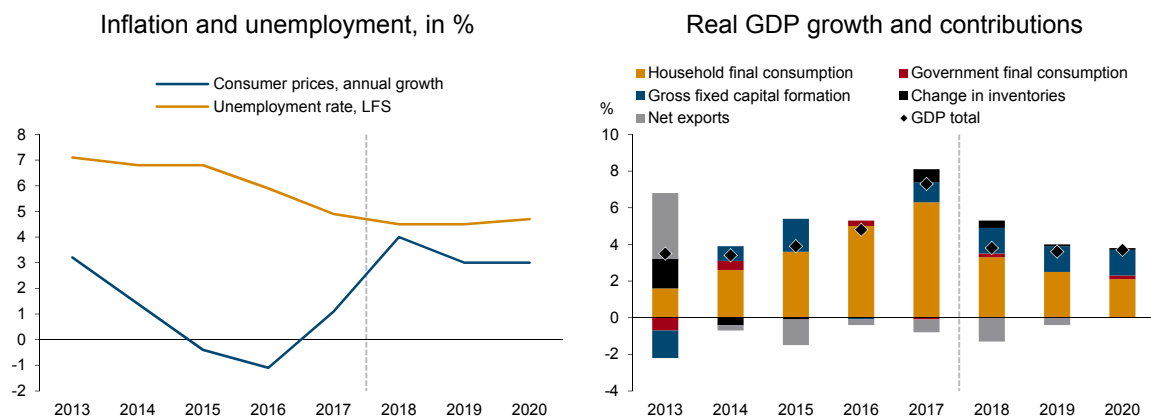


ROMANIA: Slowdown continues

GÁBOR HUNYA

The Romanian economy is experiencing an unavoidable slowdown, following a boom based on fiscal stimulus of household consumption in the past two years. Economic growth is sustainable at rates somewhat below 4% over the forecast period. Business sector investment is supporting economic growth, while public investments are falling victim to fiscal rebalancing.

Figure 51 / Romania: Main macroeconomic indicators



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

Real GDP expanded by 4% in the first half of 2018, a slowdown compared with the boom in 2017 which reduces the risk of overheating. The one-time effects of the fiscal stimulus to household consumption provided in previous years in the form of public sector wage hikes and tax cuts are wearing off. Wage increases in the current year have not only been moderate, but also partly neutralised in real terms by inflation. As the second half of 2017 GDP growth was exceptionally strong, the base effect will further moderate the rate of economic growth to 3.8% for 2018 as a whole. Growth rates in a similar range are sustainable over the next few years, supported by investments in the business sector.

Household consumption remained the main growth driver in the first half of 2018 (+5.5%), but expanded at a much slower pace than previously and is bound to slow further. Net real wages will grow by around 6% in 2018 as a whole, half the rate of the previous year. The fact that real wages are still growing strongly is in part because of an increase in the minimum wage, with a further increase set for 2019. The minimum gross wage will increase by RON 150 or about 7.9% on 1 January 2019, to

RON 2,050 (EUR 440). Tight labour market conditions will further drive up wages. In industry, labour costs increased by 10.5% in the first half of 2018, far ahead of productivity growth, and prompting companies to invest in new capital.

Investment staged a remarkable recovery in the first half of 2018, rising by 12.1% year on year, but this was concentrated almost exclusively in the expansion of inventories. Inventories are unfinished investments and will become part of gross fixed capital formation by the end of the year. Investments in machinery and equipment have been robust as the private sector is eager to increase labour productivity. Public investments are slowing as the government is determined to keep the fiscal deficit under control which also slows down the absorption of EU funds. Private house-building has declined from the high level of the previous year.

All sectors of production have shown lower year-on-year growth rates in the first half of 2018 than a year earlier. Moderate growth was registered in industrial and agricultural value added (4.3% and 6.9% respectively) while construction output declined. The impacts of alternating periods of draughts and floods as well as a severe swine fever epidemic will push agricultural production into negative territory in the rest of the year, with adverse effects on the food industry and rural consumption. Expectations in the business sector remain positive as new orders growth in industry is strong, particularly for producers of capital goods.

The negative contribution of net exports to growth has increased compared with the previous year. The current account deficit has widened on account of worsening foreign trade balances of goods and services. The primary and secondary income balances both improved in the first half of the year, quite unexpectedly. Interest payment on debt contracted, and foreign direct investors' income was significantly lower than in the first half of 2017, despite high profits reported by several companies and banks. Lower amounts of transfers of Romanians working abroad can be explained by lower needs of family members at home on account of higher incomes. More than half of the current account deficit was financed by rising FDI and inflows on the capital account. Modernisation investments in existing foreign investment enterprises are of higher amounts than new greenfield projects in the manufacturing sector.

The consolidated budget deficit was well above that of the first half of last year, and it could well be higher than 3% of GDP for the year as a whole. The budget deficit of RON 14.6 billion (EUR 3.14 billion) in the first eight months of the current year, representing 1.6% of estimated GDP for the period, is the highest recorded for this period in the last eight years, both in nominal terms and as a share of GDP. The August 2018 budget rectification stipulated increases on both the revenues and the expenditure sides based on increasing revenues in the first half of the year. Revenues of the state budget stagnated while the social security budget received increased inflows. The latter was the result of the transfer of social security contributions from the employers to employees. Wages are the hard core of fiscal expenditures, and have grown as a share of expenditure, while investment outlays have been cut. The implementation of large infrastructure projects has suffered renewed delays.

The labour market has tightened as both the working-age population and the number of economically active persons have decreased. Nevertheless, the activity rate increased three percentage points year on year to 68.4% of the working-age population (15 to 64 years) in the second quarter of 2018. The unemployment rate fell to 4.3% in August 2018 from 4.9% a year before. Labour

shortages are widely present, demand for skilled workers being especially unsatisfied. Better job opportunities combined with higher wages may reduce the push to emigrate.

Consumer price inflation peaked in the middle of 2018 with year-on-year rates above 5%, and will amount to at least 4% as an annual average this year. The cyclical element of inflation is the result of excess demand, and also of rising import prices. Government-managed energy prices have increased as these are tied to the import price of gas and oil (with some delay). In response, the National Bank of Romania (BNR) has already hiked the monetary policy rate twice in 2018 – by 0.25 percentage points each time – to 2.5%, although it remains negative in real terms, suggesting still quite loose conditions. The BNR is not pushing for a further tightening in monetary conditions, but is calling for fiscal action to cool the economy and rightly so as fiscal policy caused the overheating.

Government stability is under threat from both internal and external sources. The Social Democratic Party (PSD), which leads a coalition with a comfortable majority in both houses of parliament, is showing signs of disintegration. The position of party boss Liviu Dragnea, who rules over the government, has been challenged as he faces new criminal investigations. In the conflict between the National Anti-corruption Directorate (DNA) and the government, the latter managed to replace the former leader and nominate its own person. This step prompted external criticism of how the government manages the judiciary. On 1 October a meeting of the European Parliament's Committee on Civil Liberties, Justice and Home Affairs (LIBE) criticised the Romanian authorities' initiatives to change the justice laws and criminal codes, as well as the breaching of human rights at the brutal crushing of demonstrations in Bucharest on 10 August. Deputies in the European Parliament expressed similar concerns at a plenary session on 3 October which focused on the reforms of Romania's judicial system in the pipeline. Despite these controversies, action against Romania is not expected to escalate in the way it did in the cases of Hungary and Poland. Risks associated with domestic uncertainties in terms of government instability are far more serious.

In summary, economic growth is expected to slow down further to 3.6-3.7% in the coming years due to fiscal consolidation measures and a growth slowdown in the EU. Household demand will cool, but investment growth may remain robust, especially if the absorption of EU funds improves. Due to more sluggish domestic demand and further foreign investment in export-oriented production of goods and services, the current account will not deteriorate further, and net exports will make a roughly neutral contribution to GDP growth.

Table 26 / Romania: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	19,909	19,815	19,702	19,650	.	.	19,500	19,400	19,300
Gross domestic product, RON bn, nom.	668.6	712.6	765.1	858.7	361.5	399.5	930	990	1,050
annual change in % (real)	3.4	3.9	4.8	7.3	5.9	4.0	3.8	3.6	3.7
GDP/capita (EUR at PPP)	15,200	16,300	17,000	18,700	.	.	.	.	.
Consumption of households, RON bn, nom.	405.7	432.6	471.9	530.3	231.0	252.8	.	.	.
annual change in % (real)	4.2	5.9	8.3	10.1	7.3	5.4	5.3	4.0	3.4
Gross fixed capital form., RON bn, nom.	162.4	176.5	175.0	193.6	71.3	76.8	.	.	.
annual change in % (real)	3.3	7.5	-0.2	4.7	-0.6	0.0	6.0	6.0	6.0
Gross industrial production ²⁾									
annual change in % (real)	6.0	2.8	3.1	7.9	7.0	4.2	4.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	2.9	-6.8	2.5	14.7	.	.	.	.	.
Construction industry ²⁾									
annual change in % (real)	-6.7	10.5	-4.4	-5.5	-7.2	-0.7	.	.	.
Employed persons, LFS, th, average	8,614	8,535	8,449	8,671	8,645	8,655	8,760	8,850	8,940
annual change in %	0.8	-0.9	-1.0	2.6	3.1	0.1	1.0	1.0	1.0
Unemployed persons, LFS, th, average	629	624	530	449	466	397	410	420	440
Unemployment rate, LFS, in %, average	6.8	6.8	5.9	4.9	5.2	4.4	4.5	4.5	4.7
Reg. unemployment rate, in %, eop	5.4	5.0	4.8	4.0	4.2	3.5	.	.	.
Average monthly gross wages, RON ^{3,4)}	2,328	2,555	2,809	3,223	3,237	4,382	4,400	4,800	5,100
annual change in % (real, gross)	6.5	10.4	11.7	13.2	15.0	.	.	5.0	4.0
Average monthly net wages, RON ⁴⁾	1,697	1,859	2,046	2,338	2,331	2,636	2,600	2,800	3,000
annual change in % (real, net)	6.4	10.1	11.8	12.8	14.4	7.7	6.0	5.0	4.0
Consumer prices (HICP), % p.a.	1.4	-0.4	-1.1	1.1	0.5	4.1	4.0	3.0	3.0
Producer prices in industry, % p.a.	-0.2	-2.3	-1.8	3.5	3.3	4.6	4.6	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	33.6	35.0	31.5	30.4	.	.	30.5	31.0	31.0
Expenditures	34.9	35.8	34.5	33.4	.	.	34.0	34.0	33.5
Net lending (+) / net borrowing (-)	-1.3	-0.8	-3.0	-2.9	.	.	-3.5	-3.0	-2.5
General gov.gross debt, EU def., % of GDP	39.1	37.7	37.2	35.0	.	.	36.0	37.0	37.0
Stock of loans of non-fin.private sector, % p.a.	-3.7	2.5	0.9	5.3	3.9	7.0	.	.	.
Non-performing loans (NPL), in %, eop ⁵⁾	13.9	13.5	9.6	6.4	8.3	5.7	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	2.75	1.75	1.75	1.75	1.75	2.50	2.75	2.75	2.75
Current account, EUR mn	-1,004	-1,977	-3,496	-6,298	-3,526	-3,749	-8,700	-9,500	-9,500
Current account, % of GDP	-0.7	-1.2	-2.1	-3.4	-4.4	-4.4	-4.4	-4.5	-4.3
Exports of goods, BOP, EUR mn	46,839	49,111	52,164	57,159	28,163	31,070	62,300	66,700	71,400
annual change in %	6.7	4.8	6.2	9.6	10.5	10.3	9.0	7.0	7.0
Imports of goods, BOP, EUR mn	53,375	56,896	61,412	69,067	33,318	36,947	76,700	82,500	88,300
annual change in %	7.4	6.6	7.9	12.5	12.4	10.9	11.0	7.5	7.0
Exports of services, BOP, EUR mn	15,104	16,640	18,006	20,683	9,847	10,578	21,700	23,200	25,100
annual change in %	12.4	10.2	8.2	14.9	14.4	7.4	5.0	7.0	8.0
Imports of services, BOP, EUR mn	9,236	9,849	10,284	12,752	5,929	6,856	13,900	15,000	16,100
annual change in %	5.8	6.6	4.4	24.0	23.4	15.6	9.0	8.0	7.0
FDI liabilities, EUR mn	2,931	3,885	5,656	4,378	1,920	2,593	5,500	.	.
FDI assets, EUR mn	227	930	1,143	-196	232	685	0	.	.
Gross reserves of NB excl. gold, EUR mn	32,216	32,238	34,242	33,494	35,208	31,766	.	.	.
Gross external debt, EUR mn	94,744	92,069	92,910	97,361	96,264	97,918	99,000	102,000	105,000
Gross external debt, % of GDP	63.0	57.4	54.5	51.8	51.2	49.1	49.6	48.4	47.5
Average exchange rate RON/EUR	4.4437	4.4454	4.4904	4.5688	4.5364	4.6545	4.66	4.70	4.75

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers was added to gross wages increasing the latter by 25%. - 4) January to June data refer to enterprises with 4 and more employees. - 5) From 2015 broader definition of NPL (90 days criteria + loans where the creditor presumes that, without realising the collateral, the debtor will not be able to repay all of its debt). - 6) One-week repo rate.

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