

23. ROMANIA

Investment plunge weighs on the economy in 2014

Economic growth is expected to recover following a dent in 2014 induced by a drop in investment. Inflation should slowly pick up after a sharp decrease in 2014. The fiscal consolidation path is forecast to be reversed in 2015.

Private consumption and exports support growth in 2014

The pace of real GDP growth slowed down from 3.5% in 2013 to 2.4% y-o-y in the first half of 2014, largely due to a strong deceleration in the second quarter (1.2% y-o-y). Private consumption and net exports were the main drivers of growth while investments continued to contribute negatively (gross fixed capital formation dropped by 11.1% y-o-y in the first half of 2014). As a result, GDP growth in 2014 is projected at 2.0%. In the second half of 2014, improved confidence and higher real disposable income are expected to support consumption. Investment growth is projected to regain momentum, sustained by both private and public investments.

Growth to rise over 2015-16

Against a background of a subdued economic scenario in the euro area, growth in Romania is nevertheless forecast to gradually pick up and stay above potential at 2.4% in 2015 and 2.8% in 2016. Private consumption is projected to remain resilient, supported by increasing real disposable income on account of still dynamic growth of wages, low inflation and declining interest rates. Credit growth, which has been contracting for the last two years, is expected to marginally improve based on the recent recovery in local currency lending, eased credit conditions and an expected slowdown in the deleveraging process. The increase of investor confidence, together with a tax exemption for reinvested profits (as of July 2014) and a cut in social-security contributions (from 1 October 2014) are likely to provide additional resources for businesses to boost investment.

Exports of goods and services rose strongly in the first half of 2014, outpacing expectations with a yearly growth of 12.8% while imports were up by 10.6%. The positive growth contribution of net exports is set to fade in H2 2014 and to turn negative over 2015-16 as import growth slightly outpaces export growth, due to stronger domestic demand. Exports are forecast to remain resilient despite subdued activity in the euro area.

Sharply decelerating inflation in 2014

Inflation remained subdued in the first half of 2014, reaching a record low in June (HICP was 0.9% y-o-y) but picked up marginally in recent months. The low inflation can largely be attributed to temporary supply-side shocks including the VAT cut for bread, an appreciation of the leu, and persisting subdued inflation in the euro area. Inflation is now expected to average 1.5% in 2014, lower than projected in spring, on account of the prospects for a good harvest, delays in gas price liberalisation, lower global energy prices, and lower inflation expectations. It is forecast to reach an annual average of 2.1% in 2015 and 2.7% in 2016 due to the recovery in domestic demand, to the base effects from low food prices in 2014 and to the on-going convergence of prices towards the EU average.

Broadly balanced macroeconomic risks

Downside risks include faster-than-expected deleveraging by households and financial institutions and the impact of a further deterioration in geo-political tensions hurting confidence and the main trading partners' economic outlook. Upside risks comprise higher investment thanks to better-than-expected absorption of EU funds and stronger domestic demand induced by fiscal slippages in connection with this year's presidential elections. Risks to the inflation outlook are balanced over the forecast horizon.

Labour market remains weak

Labour market developments remained subdued in the first half of 2014. The number of employees was unchanged, while overall employment further decreased by 1% y-o-y due to a fall in the number of self-employed. For the full year, overall employment growth is expected to stay marginally below its 2013 level. In 2015 and 2016, employment is forecast to gradually recover, supported by stronger growth. Unemployment declined from 7.3% in December 2013 to 7% in July 2014, and it is expected to stabilise over the

forecast horizon. Growth in nominal compensation per employee, which stood at around 9% in 2013, is set to fall somewhat in 2014 and 2015.

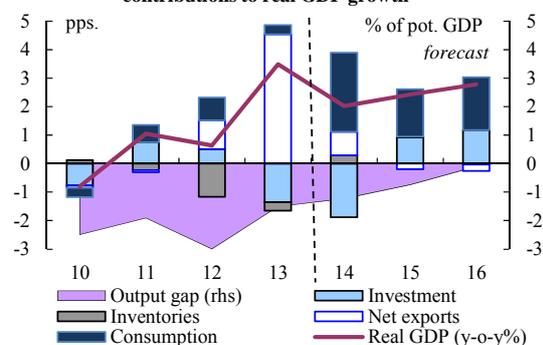
Budget deficit to increase in 2015

In 2014, the deficit is projected to fall to 2.1% of GDP, from 2.2% of GDP in 2013. On the revenue side, an increase in excise duties on fuels and a broadening of the basis for property taxation counterbalanced subdued growth from VAT receipts and lower social-security contributions following a rate cut of 5 pps., which took effect on 1 October 2014. On the expenditure side, EU funds absorption and domestic capital expenditure have been significantly below expectations, but should pick up in the last quarter of the year.

For 2015, Romania's deficit is projected to increase to 2.8% of GDP under a no-policy-change assumption. No draft for the 2015 budget has been brought forward by the cut-off date of this forecast. The forecast includes the full-year impact of the cut in social-security contributions that should lead to net loss of revenue of around 0.8% of GDP over the course of 2015. A reduction in the rate of the property tax on special constructions by 0.5 pp is expected to lead to a further loss in

revenues of around 0.1% of GDP. According to the law, excise rates are expected to be reduced in 2015. Expenditures should decline somewhat, also on account of slightly lower public investments.

Graph II.23.1: Romania - Output gap and contributions to real GDP growth



For 2016, the headline deficit is expected to decrease to 2.5% of GDP, as revenues improve in line with improving growth prospects, again under a no-policy-change assumption. In structural terms, the deficit is forecast to deteriorate from 1¾% of GDP in 2014 to about 2½% of GDP in 2015-16. Government debt should increase from 37.9% of GDP in 2013 to 41.1% in 2015.

Table II.23.1:

Main features of country forecast - ROMANIA

	2013			95-10	Annual percentage change					
	bn RON	Curr. prices	% GDP		2011	2012	2013	2014	2015	2016
GDP	639.3		100.0	3.0	1.1	0.6	3.5	2.0	2.4	2.8
Private Consumption	397.1		62.1	5.5	0.8	1.2	0.9	3.8	2.3	2.4
Public Consumption	93.7		14.7	0.4	0.6	0.4	-1.6	4.5	1.6	2.0
Gross fixed capital formation	158.1		24.7	5.0	2.9	1.9	-4.9	-7.4	4.4	5.5
of which: equipment	53.6		8.4	5.9	19.6	-2.1	-3.8	-7.5	4.8	6.3
Exports (goods and services)	265.0		41.4	8.0	11.9	1.0	21.5	8.9	5.1	6.0
Imports (goods and services)	270.5		42.3	11.7	10.2	-1.5	8.2	6.8	5.5	6.5
GNI (GDP deflator)	623.6		97.6	3.0	1.0	0.2	2.8	1.6	2.5	2.9
Contribution to GDP growth:										
Domestic demand				5.3	1.4	1.8	-1.3	1.2	2.6	3.0
Inventories				-0.2	-0.2	-1.7	0.0	0.0	0.0	0.0
Net exports				-2.2	-0.1	1.0	4.5	0.8	-0.2	-0.2
Employment				-1.8	-0.8	2.5	-1.2	-0.1	0.3	0.5
Unemployment rate (a)				6.5	7.4	7.0	7.3	7.0	6.9	6.7
Compensation of employees / head				34.5	-4.1	0.8	9.2	5.5	4.9	5.6
Unit labour costs whole economy				28.2	-5.8	2.7	4.2	3.4	2.7	3.2
Real unit labour cost				-1.0	-10.1	-2.2	0.6	0.2	0.1	0.6
Saving rate of households (b)				-2.9	-7.0	-11.7	-10.8	-11.9	-10.4	-10.1
GDP deflator				29.5	4.7	4.9	3.5	3.2	2.7	2.6
Harmonised index of consumer prices				-	5.8	3.4	3.2	1.5	2.1	2.7
Terms of trade goods				2.7	1.8	-3.4	-1.1	-0.5	-0.3	0.3
Trade balance (goods) (c)				-7.9	-6.7	-5.8	-2.6	-2.5	-2.8	-3.0
Current-account balance (c)				-6.6	-4.7	-4.7	-1.4	-1.2	-1.4	-1.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-6.1	-4.2	-3.3	0.9	1.1	1.0	0.9
General government balance (c)				-3.6	-5.5	-3.0	-2.2	-2.1	-2.8	-2.5
Cyclically-adjusted budget balance (c)				-	-4.7	-1.9	-1.7	-1.7	-2.5	-2.4
Structural budget balance (c)				-	-3.6	-2.5	-1.7	-1.7	-2.5	-2.4
General government gross debt (c)				18.1	34.2	37.3	37.9	39.4	40.4	41.1

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