

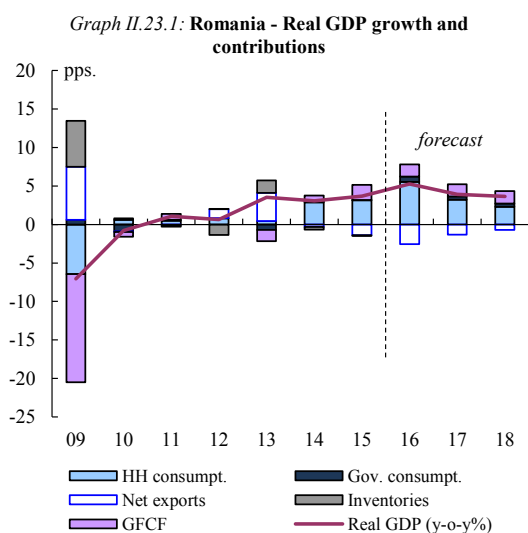
## 23. ROMANIA

### Robust growth sustained by fiscal easing

*Real GDP growth is forecast to remain strong over the forecast horizon, supported by fiscal easing and wage increases. Unemployment decreased significantly in 2016 and is projected to remain stable at low levels. With a positive output gap and the impact of previous tax cuts fading, inflation is set to pick up. The general government deficit is projected to widen due to tax cuts and public spending increases.*

#### Strong growth ahead

Real GDP is estimated to have grown by 4.9% in 2016, a new post-crisis high. Growth was driven by fiscal stimulus and supported by successive increases of the minimum wage and public sector wages, which pushed up private consumption growth to 9%. Investment grew by an estimated 5.5%, mostly on the back of private investment, while public investment recorded its weakest year since Romania joined the EU due to the drop in investment financing from the EU linked to the cycle of EU funding programmes. Net exports subtracted 2.6 percentage points from growth, as robust domestic demand stimulated imports and export growth abated, widening the current-account deficit to 2.2% of GDP in 2016.



Romania's output gap is estimated to have closed in 2016. A new round of fiscal stimuli amounting to about 1% of GDP has been adopted for 2017. With the positive output gap and the fading impact of previous indirect tax cuts, despite a reduction in the standard VAT rate by one percentage point from January 2017, consumer prices are expected to increase gradually in 2017 and more briskly in 2018. Private consumption is expected to grow steadily in 2017, before it moderates slightly in 2018 as consumer prices pick up. After a

deceleration in 2016, investment growth is projected to speed up over the forecast horizon, with public investment gradually recovering as the implementation of projects financed by EU funds in the 2014-2020 financing period catches up. Real GDP is thus forecast to grow by 4.4% in 2017 and 3.7% in 2018.

Export growth is projected to gradually accelerate over the forecast horizon as external demand strengthens. However, with strong import growth driven by robust domestic demand, the current-account deficit is forecast to widen to 2.9% of GDP in 2017 and 3.1% of GDP in 2018. Risks to the macroeconomic outlook are broadly balanced.

#### Inflation is picking up

HICP inflation remained negative in 2016 (-1.1% over the year on average) mainly due to the reduction of the standard VAT rate from January 2016, combined with low imported inflation. Robust domestic demand, boosted by the additional 16% increase of the minimum wage in February 2017 should result in a positive output gap and inflation picking up. Annual average inflation is therefore forecast to turn positive in 2017 (1.6%) and increase further to 2.9% in 2018. Risks to the inflation outlook are tilted to the upside by the combination of strong domestic demand with a positive output gap, growing wages and increasing international oil prices.

#### Unemployment is approaching pre-crisis lows

The labour market continued to improve on the back of strong economic growth. The unemployment rate fell to an eight-year low in 2016. Low unemployment, combined with a shrinking labour force and persistent skills shortages, led to a tighter labour market and economy-wide wage increases. Total employment decreased slightly in 2016 as the decline in self-employment more than offset the increasing number of employees. In 2017-2018, total

employment is forecast to grow driven by strong economic growth, while the unemployment rate is projected to continue declining. With the hikes in the minimum wage and public wages adopted in 2017, unit labour costs are expected to increase over the forecast horizon.

### The general government deficit is widening

In 2016, the headline deficit is projected to have increased to 2.8% of GDP, from 0.8% of GDP in 2015. The tax cuts enacted at the end of 2015, particularly the four-percentage point cut in the standard VAT rate, had a negative effect on tax revenues. On the expenditure side, public wages were increased considerably while public investment is estimated to have dropped due to the slow implementation of large projects in the 2014-2020 programming period of EU funding.

In 2017, the general government headline deficit is projected to deteriorate further, to 3.6% of GDP. The standard VAT rate was cut by an additional one-percentage point from January 2017 and the

extra excise duty on fuel and the special construction tax were abolished. The 2017 budget adopted by the new government contains a number of other tax cuts (in particular, tax exemptions for pension income) as well as expenditure increases such as a significant increase in old-age pensions and public wages. The general government headline deficit is projected to further widen to 3.9% of GDP in 2018, due to the full-year effect of the significant increase in old-age pensions scheduled for July 2017.

As a consequence of the fiscal easing, Romania's structural deficit is forecast to increase from around ½% of GDP in 2015 to about 2½% in 2016 and around 4% in 2017 and 2018. Despite strong GDP growth, Romania's debt-to-GDP ratio is thus projected to rise from 38% of GDP in 2015 to 42.3% in 2018 as a result of the loosening in the fiscal position.

The 2017 budget was adopted by the government but not yet voted by the parliament by the cut-off date of this forecast (1 February 2017).

Table II.23.1:

### Main features of country forecast - ROMANIA

	2015		97-12	Annual percentage change						
	bn RON	Curr. prices		% GDP	2013	2014	2015	2016	2017	2018
GDP	711.1		100.0	2.5	3.5	3.1	3.9	4.9	4.4	3.7
Private Consumption	440.5	61.9		4.5	0.7	4.7	6.0	9.0	6.7	4.2
Public Consumption	97.5		13.7	0.3	-4.6	0.8	0.1	4.5	3.5	3.0
Gross fixed capital formation	176.1		24.8	5.2	-5.4	3.2	8.3	5.5	6.2	6.3
of which: equipment	74.5		10.5	6.2	4.8	-5.1	9.0	8.5	7.5	6.9
Exports (goods and services)	292.3		41.1	8.7	19.7	8.0	5.4	4.7	5.0	5.4
Imports (goods and services)	296.7		41.7	10.9	8.8	8.7	9.2	10.9	9.2	7.3
GNI (GDP deflator)	697.5		98.1	2.5	3.0	4.0	3.0	5.0	4.4	3.7
Contribution to GDP growth:										
Domestic demand				4.6	-1.7	3.8	5.7	7.5	6.3	4.7
Inventories				-0.2	1.6	-0.3	-0.2	0.0	0.0	0.0
Net exports				-1.8	3.6	-0.3	-1.6	-2.6	-1.9	-1.0
Employment				-1.6	-0.9	0.8	-0.9	-0.4	0.3	0.4
Unemployment rate (a)				7.0	7.1	6.8	6.8	6.0	5.7	5.6
Compensation of employees / head				27.9	3.8	6.7	0.9	8.4	7.8	6.0
Unit labour costs whole economy				22.8	-0.6	4.3	-3.8	2.9	3.6	2.6
Real unit labour cost				-1.6	-3.9	2.6	-6.0	1.3	1.2	0.1
Saving rate of households (b)				-5.5	13.3	14.5	15.5	16.7	18.7	21.1
GDP deflator				24.9	3.4	1.7	2.4	1.7	2.3	2.5
Harmonised index of consumer prices				23.6	3.2	1.4	-0.4	-1.1	1.6	2.9
Terms of trade goods				3.1	4.7	0.8	3.2	1.9	1.8	1.6
Trade balance (goods) (c)				-8.0	-4.0	-4.3	-4.9	-6.2	-7.3	-7.7
Current-account balance (c)				-6.5	-0.6	-0.1	-0.6	-2.2	-2.9	-3.1
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-6.0	1.5	2.5	1.8	-1.5	-1.5	-1.3
General government balance (c)				-3.8	-2.1	-0.8	-0.8	-2.8	-3.6	-3.9
Cyclically-adjusted budget balance (d)				-3.8	-1.0	-0.1	-0.3	-2.8	-3.8	-4.0
Structural budget balance (d)				-	-1.0	-0.6	-0.6	-2.5	-3.9	-4.0
General government gross debt (c)				21.5	37.8	39.4	38.0	39.1	40.5	42.3

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.