



# **Country Report 2016 Romania**

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## 2016 In-depth review

- **External sector and competitiveness**
  - Net international investment position
  - Current account balance
  - Cost and non-cost competitiveness
- **Financial sector**
  - Banking sector
  - Insurance sector
- **Medium-term risks**
  - Demand side policies
  - Supply side policies

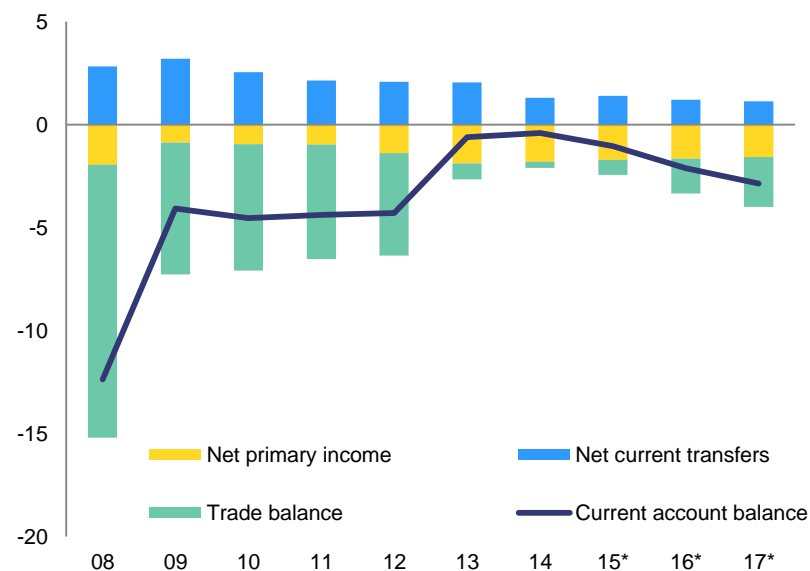
## Scene setter

- Economic growth has been strong over the last three years, gradually broadening its base
- The output gap is projected to close and turn positive in 2016
- The current account balance has improved substantially
- The large negative net international investment position (NIIP) has been improving since 2012 and is expected to sustain this trend in the coming years
- Going forward, risks of less sustainable growth are emerging

## Current account

- The current account deficit has decreased significantly in recent years
- The adjustment has been due to non-cyclical factors, including the structural improvement in the trade balance
- Current account deficit forecast to widen, but to remain contained until 2017, due to a boost to domestic demand leaking out through imports

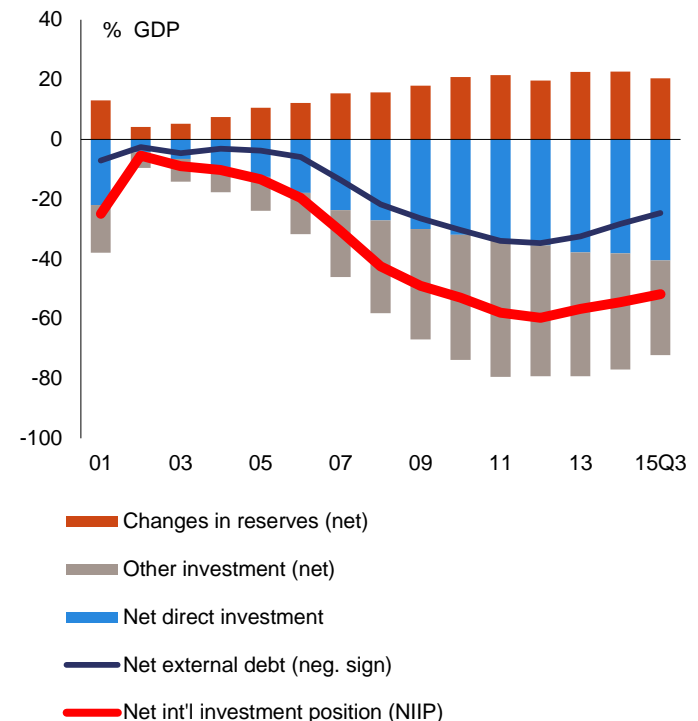
Current account balance by  
components



## External sustainability

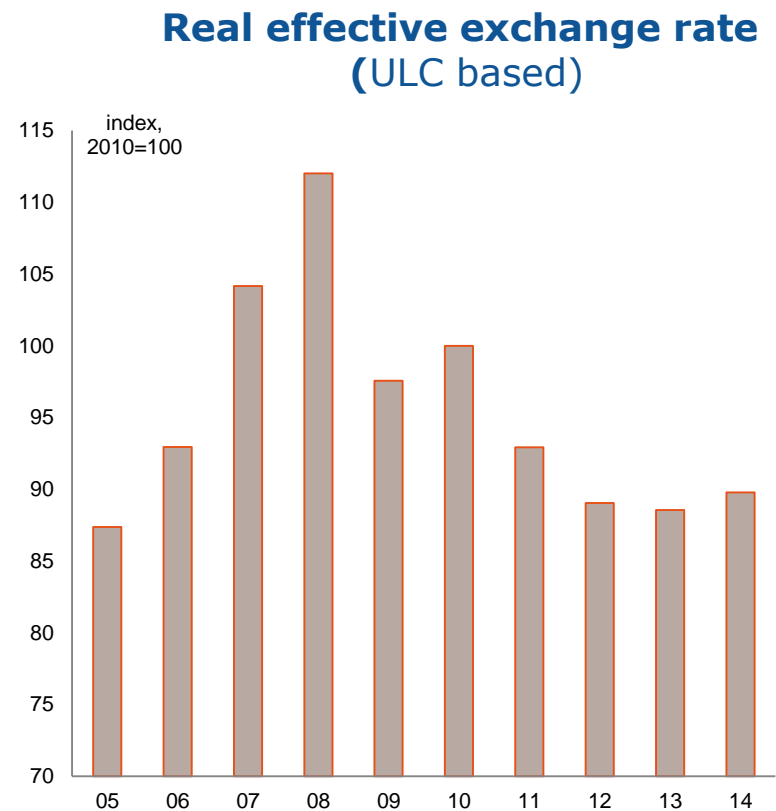
- Relatively large negative net international investment position (NIIP)
- Not unusual for a catching-up economy
- Improving since 2012 and set to sustain this trend
- High share of volatile sources of financing
- Sensitive to macroeconomic shocks

### Net international investment position financing



## Cost competitiveness

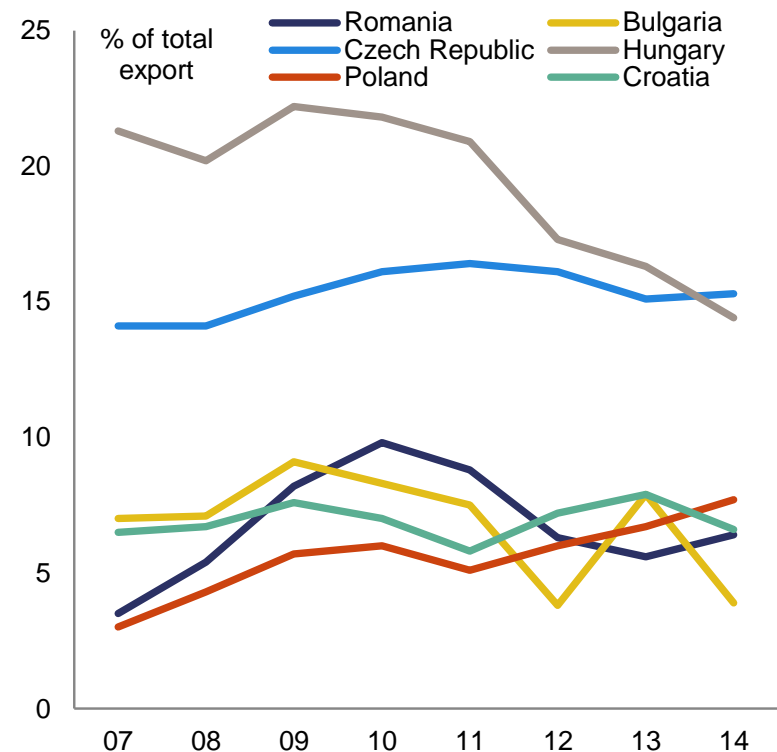
- One of the highest growth rates in export market shares in the EU between 2010 and 2014
- Export performance fuelled by improvements in cost competitiveness
- Real effective exchange rate had negative or low positive growth
- Until recently the expansion in export market share has been associated with contained unit labour costs
- Cut in social security contribution in 2014 helped contain unit labour costs



# Non-cost competitiveness

- Romania competes mostly on price rather than quality
- R&D and innovation expenditure is low and inefficient
- Underdeveloped transport infrastructure
- Unstable regulatory framework
- Access to credit for SMEs is difficult

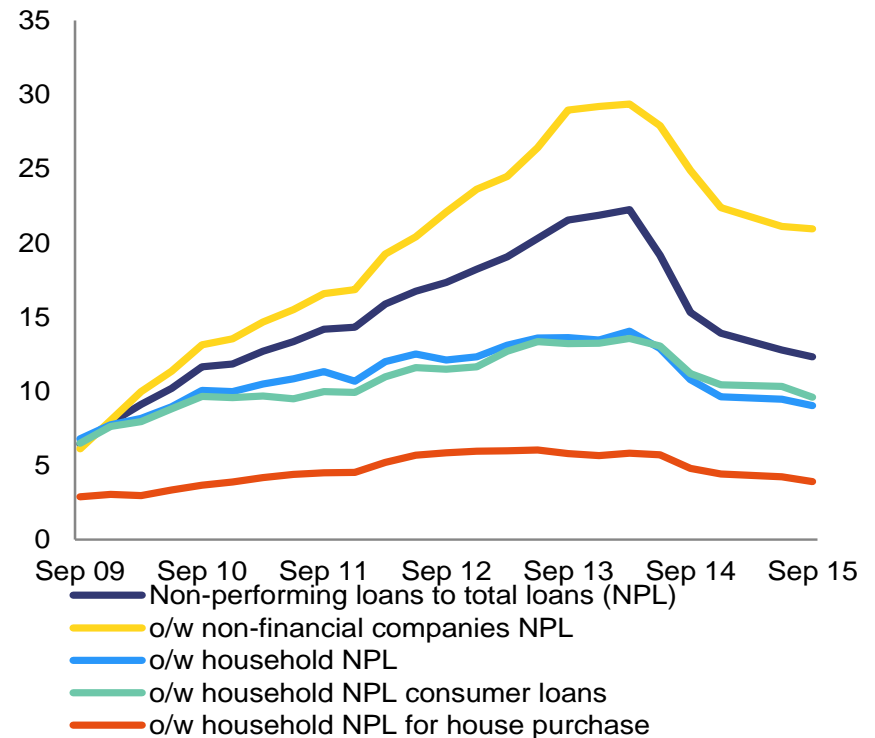
Share of high-tech products in exports  
in Romania and peer countries



# Banking sector

- In 2015 cleaning up of banks' balance sheets continued...
- ...banks profitability recovered...
- ...AQR and stress test are being launched by the NBR
- However, risks have increased due to domestic sources of vulnerabilities:
  - Draft law on debt discharge with risks to financial sector stability and to economic growth
  - Court decisions on unfair contract terms in loan contracts may put significant pressure on banks' capital buffers

## Non-performing loans





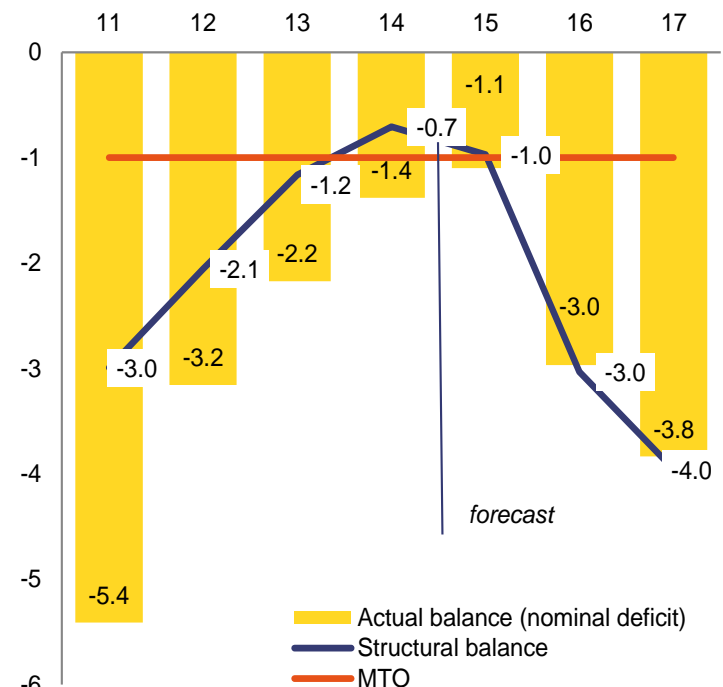
## Insurance sector

- In 2015, a comprehensive balance sheet review (BSR) and stress test was successfully completed, the first such exercise in an EU Member State
- The BSR revealed several deficiencies, which required corrective measures and included putting into insolvency one company
- The BSR also showed that:
  - Several insurance undertakings did not comply with the Solvency I requirements and
  - Most insurance undertakings need further efforts to prepare for Solvency II

## Demand side policies

- Romania achieved fiscal adjustment in past few years...
- ...but fiscal deficit as a percent of GDP is expected to more than triple in only two years
- Lack of strategic planning, and weak implementation of the fiscal rules are key drivers of pro-cyclicality
- Tax cuts and public wage increases will contribute to deficit in 2016-17
- Pro-cyclical fiscal policy in a strong-growth environment could trigger internal and external imbalances in the absence of supply-side measures

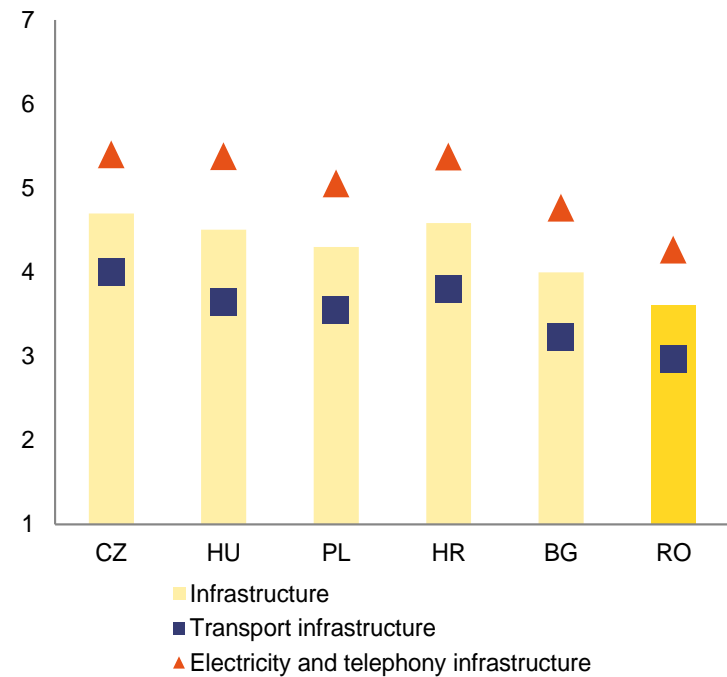
**Fiscal deficit, structural balance and MTO**



## Supply side policies

- Lack of medium- to long-term strategic planning on infrastructure development
- Constrained capacity to absorb EU structural funds
- Insufficient or low-quality infrastructure reduces accessibility and may limit investment
- Low and inefficient R&D and innovation expenditure
- Government regulation and legal uncertainty continue to weigh on competitiveness
- The effectiveness and efficiency of public administration remain limited

### Quality of public infrastructure index, Romania and regional peers

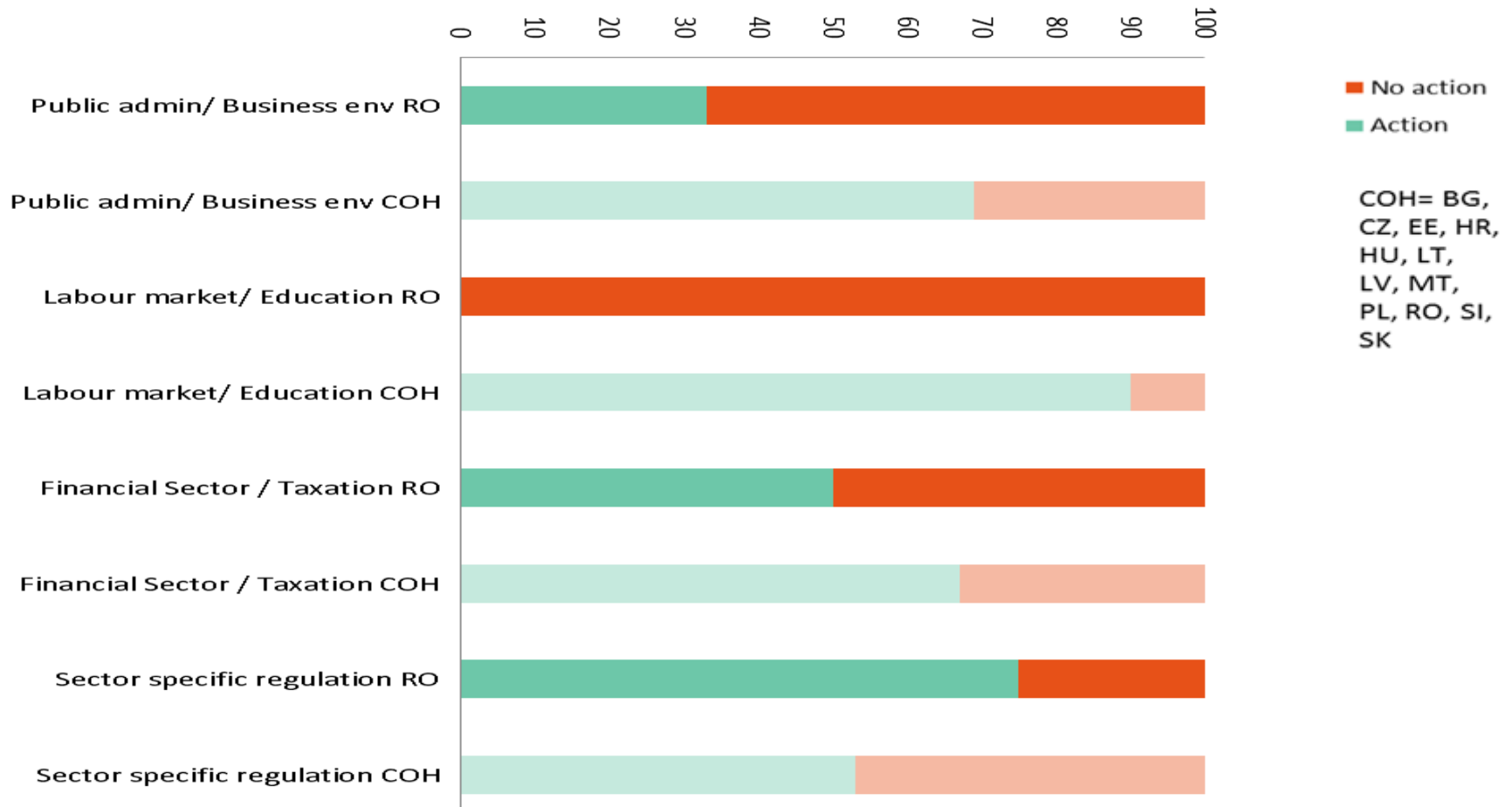




## Barriers to investment

- Ineffective public administration
- Red tape
- Legal uncertainty due to frequent changes of tax and other business-related legislation
- Predictability and enforcement of judicial decisions
- Corruption
- Inefficient and insufficient investment in infrastructure
- Limited access to financing for SMEs

# Barriers to investment



# CONCLUSION

- Romania has reduced internal and external imbalances
- However...
- ...vulnerabilities for the Romanian economy may re-emerge:
  - legislative initiatives with potential impact on the banking sector
  - pro-cyclical fiscal policy
    - accelerating wage growth
    - no counterbalancing supply-side measures.
- Sustainable growth would require boosting investment and increasing the pace of structural reforms

# THANK YOU

# Vă Mulțumesc

**Link to the 2016 country report:**

[http://ec.europa.eu/europe2020/pdf/csr2016/cr2016\\_romania\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_romania_en.pdf)