26. ROMANIA

After a milder-than-anticipated decline in 2020, Romania's economy is set to recover from the COVID-19 crisis and return to pre-crisis levels of economic activity before the end of 2021. Nevertheless, uncertainty remains high given the unpredictable evolution of the pandemic and possible disruptions in the supply of vaccines. The budget deficit is projected to decline gradually on account of incipient fiscal consolidation efforts and strong GDP growth.

Resilient investment limits output loss

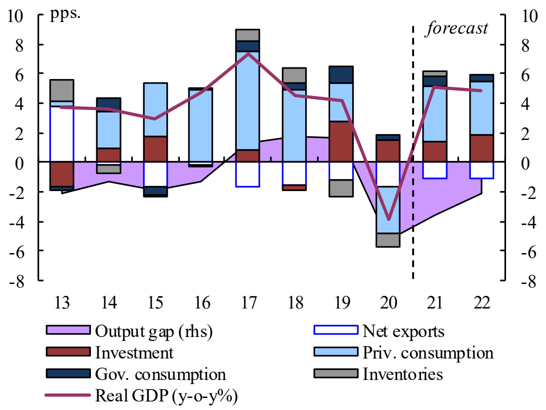
Real GDP fell by 3.9% year-on-year in 2020. The 11.8% quarter-on-quarter drop in the second quarter was followed by a 5.6% rebound in the third quarter. Output growth remained strong in the last quarter of the year, at 4.8% quarter-on-quarter, as the more limited restrictions introduced during the second wave of the pandemic allowed economic activity to continue. The strict lockdown measures introduced in the first half of the year were particularly damaging for consumer spending, the main growth driver in recent years. Investment, by contrast, made a significant contribution to growth, due to the strong performance of construction activity throught the year. Turning to the external sector, the disruption of international supply chains and weak external demand slowed production and exports. A smaller decline in imports resulted in a further deterioration of the trade balance. The improved secondary income surplus was not enough to compensate for the sharp rise in the primary income deficit, contributing to an increase in the current account deficit.

Strong recovery ahead

Real GDP is forecast to increase by 5.1 % in 2021 and 4.9% in 2022. Private consumption is expected to recover as the vaccination roll-out progresses and social distancing measures are gradually lifted. The phasing in of projects under the RRP is set to lend new impetus to investment growth. After a sharp contraction in 2020, exports are expected to rebound in 2021, supported by the gradual recovery of global trade, while higher consumer spending should spur import growth. Overall, the contribution of net exports to growth over the forecast horizon is set to remain negative. The current account deficit is expected to decline slightly to 4.9% in 2021 and 4.6% in 2022[65] .

Policy measures to limit job losses adopted in 2020 helped contain the rise in the unemployment rate to only 5% from 3.9% in 2019. Unemployment is projected to reach 5.2% in 2021 as headcount employment looks likely to be almost stagnant and because of growth in the labour force. In 2022, the unemployment rate is expected to decline on the back of a rise in employment. Nominal wages growth is projected to be relatively steady over the forecast horizon, but clearly lower than the double-digit rates seen in recent years.

Graph II.26.1: **Romania - Real GDP growth and contributions, output gap**



HICP inflation declined from 3.9% in 2019 to 2.3% in 2020, largely on account of the sharp drop in oil prices but also due to falling food and services prices. Inflation is projected to increase to 2.9% in 2021, mainly as a result of the recovery in oil prices and the rise in electricity tariffs following market liberalisation. It is subsequently expected to decline to 2.7% in 2022.

[65] Figures are based on the Commission services' calculations using the latest published available data.

Risks to the growth forecast

Risks to the growth forecast are broadly balanced. On the one hand, confidence effects and a better than expected progress of projects financed under the RRP could provide an extra boost to domestic demand. However, delays in the implementation of the RRP could result in a more muted recovery. The forecast follows the authorities' backloaded projection on the plan's implementation, according to which only a limited amount of the grant allocation will be used in 2021 and 2022.

Public deficit on a downward trend

The general government deficit was 9.2% of GDP in 2020, almost 5 pps. of GDP higher than in the previous year. This increase was mainly the result of pre-existing expansionary policies, including double-digit increases in pensions, as well as of the impact of temporary measures against the COVID-19 pandemic and the overall deterioration in the macroeconomic environment. However, the government avoided an even larger increase in the deficit and in its debt by reversing earlier decisions to increase pensions by 40% and to double the child allowance.

The deficit is forecast to fall to around 8% of GDP in 2021. This improvement is mainly due to a suspension of new increases in pensions and public wages, additional cuts to some bonuses and other expenditure, and the partial withdrawal of emergency measures. Moreover, the fiscal position is forecast to benefit from higher revenues thanks to the recovery of the economy.

As the economic recovery continues in 2022, and crisis-related measures are discontinued the budget deficit is expected to fall further, to 7.1% of GDP. Moreover, the suspension of increases in public wages is set to continue, while pensions are expected to increase following a standard indexation rule, instead of the faster pace that had previously been planned.

General government debt increased substantially in 2020, to 47.3% of GDP. In 2021, public debt is forecast to increase at 49.7% of GDP and continue increasing in 2022, mainly due to the still high primary deficit.

The fiscal forecast is subject to upside risks as the Romanian government put forward a medium term fiscal policy plan to reduce its deficit to less than 3% of GDP by 2024, which should be accompanied by deficit-reducing measures as of 2022.

Table II.26.1:

Main features of country forecast - ROMANIA

	2019		Annual percentage change						
bn RON	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	1058.2	100.0	3.8	7.3	4.5	4.1	**-3.9**	**5.1**	**4.9**
Private Consumption	664.2	62.8	5.7	10.8	7.7	4.1	**-5.2**	**6.1**	**5.9**
Public Consumption	186.6	17.6	-0.4	4.4	3.3	6.9	**2.0**	**3.5**	**2.4**
Gross fixed capital formation	239.4	22.6	6.3	3.5	-1.1	13.0	**6.8**	**5.8**	**7.4**
of which: equipment	87.1	8.2	4.3	-9.9	11.6	9.5	**-4.2**	**6.7**	**5.9**
Exports (goods and services)	427.7	40.4	11.2	7.8	5.3	4.6	**-9.7**	**9.8**	**8.7**
Imports (goods and services)	471.5	44.6	12.9	11.5	8.6	6.8	**-5.1**	**11.4**	**10.1**
GNI (GDP deflator)	1043.3	98.6	3.8	7.2	4.0	4.7	**-3.7**	**5.3**	**5.2**
Contribution to GDP growth: Domestic demand			5.6	8.2	5.1	6.5	**-1.3**	**5.8**	**5.9**
Inventories			-0.3	0.8	1.0	-1.2	**-0.9**	**0.4**	**0.0**
Net exports			-1.4	-1.7	-1.6	-1.2	**-1.6**	**-1.1**	**-1.0**
Employment			-1.5	2.4	0.1	0.0	**-1.8**	**0.2**	**0.7**
Unemployment rate (a)			7.0	4.9	4.2	3.9	**5.0**	**5.2**	**4.8**
Compensation of employees / head			13.8	14.8	12.9	10.8	**7.3**	**5.8**	**6.1**
Unit labour costs whole economy			7.9	9.6	8.2	6.3	**9.6**	**0.9**	**1.9**
Real unit labour cost			-2.6	4.7	1.9	-0.4	**5.6**	**-2.2**	**-0.8**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			10.8	4.7	6.2	6.8	**3.8**	**3.2**	**2.7**
Harmonised index of consumer prices			8.2	1.1	4.1	3.9	**2.3**	**2.9**	**2.7**
Terms of trade goods			2.3	-2.3	0.6	-0.1	**3.4**	**0.1**	**-0.3**
Trade balance (goods) (c)			-10.2	-6.8	-7.5	-8.0	**-8.8**	**-9.3**	**-9.8**
Current-account balance (c)			-5.7	-3.2	-4.4	-4.7	**-5.0**	**-4.9**	**-4.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-4.5	-1.8	-3.2	-3.3	**-3.4**	**-3.2**	**-3.0**
General government balance (c)			-3.2	-2.6	-2.9	-4.4	**-9.2**	**-8.0**	**-7.1**
Cyclically-adjusted budget balance (d)			-3.4	-3.0	-3.5	-4.9	**-7.5**	**-6.9**	**-6.4**
Structural budget balance (d)			-1.0	-3.0	-3.2	-4.7	**-7.5**	**-6.9**	**-6.4**
General government gross debt (c)			26.2	35.1	34.7	35.3	**47.3**	**49.7**	**52.7**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.