



Romania

Highlights

- **The Romanian economy was resilient in the first half of 2022.** After finishing 2021 on a high note, gross domestic product (GDP) growth reached 5.7 per cent year on year in the first half of 2022, driven by strong domestic demand, despite rising headwinds. The currency remained stable in the face of rising inflationary pressures.
- **The government extended its intervention in the energy market in September 2022.** As the previous iteration of the energy price cap brought fiscal uncertainty, the state will regulate the energy market until October 2023 by levying windfall taxes on all market participants.
- **Justice system reform has commenced amid Recovery and Resilience Plan (RRP) milestones.** The government adopted revised justice laws in August 2022, in addition to accompanying operational strategies, but parliamentary approval is pending.

Key priorities for 2023

- **Energy crisis support for households should be targeted at the vulnerable.** The energy price cap introduced in April 2022 has come at a high cost to the government, complicating much-needed fiscal consolidation efforts. This is why support needs to be targeted and tied to incentives to decrease energy consumption.
- **RRP implementation should be prioritised as the main reform instrument.** The authorities included a comprehensive set of reforms and investments in the RRP, presenting an opportunity for structural reforms that should be grasped firmly, with a particular focus on implementation and disbursement.
- **The government should accelerate improvements in the rule of law.** Delays in the revision of the justice laws since 2019 have prompted the European Union (EU) to keep the Cooperation and Verification Mechanism in place. Moreover, further reforms are needed to strengthen anti-corruption measures and media independence.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	6.0	3.9	-3.7	5.1	5.4
Inflation (average)	4.1	3.9	2.3	4.1	13.3
Government balance/GDP	-2.8	-4.3	-9.2	-7.1	-6.4
Current account balance/GDP	-4.6	-4.9	-4.9	-7.3	-8.4
Net FDI/GDP [neg. sign = inflows]	-2.4	-2.3	-1.3	-3.7	-2.5
External debt/GDP	48.5	49.0	57.6	57.3	n.a.
Gross reserves/GDP	17.9	16.7	19.3	19.1	n.a.
Credit to private sector/GDP	25.4	24.3	25.5	26.3	n.a.

Macroeconomic developments and policy response

The economy has performed well so far in 2022, but is coming under increasing pressure.

After a rebound of 5.1 per cent in 2021, mainly driven by strong private consumption, GDP expanded 6.4 per cent year on year in the first quarter and 5.1 per cent year on year in the second quarter of 2022. The buoyant private consumption of services, in particular, as well as fiscal stimulus and an inventory build-up contributed to growth. In the second half of the year, high inflation, deteriorating financing conditions and an uncertain global outlook are weighing more on consumers and, hence, overall economic growth.

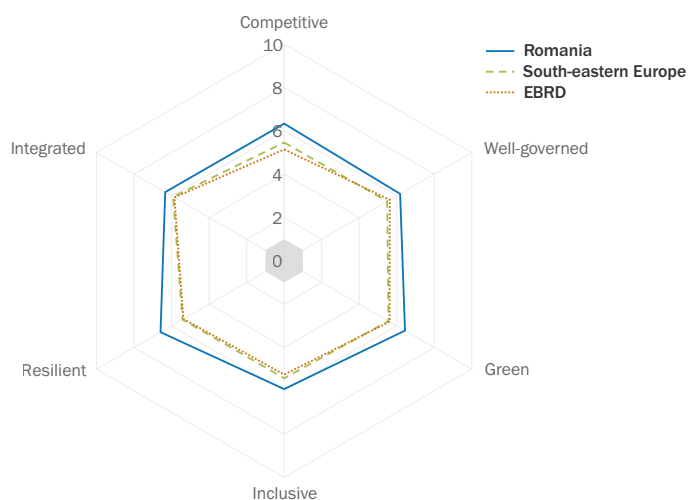
Inflation plateaued at 15 per cent in summer 2022, triggering monetary tightening. The sharp rise in inflation in 2022 has been driven mainly by food and energy prices since the start of the war on Ukraine, but has shown signs of stabilisation since June, although it again accelerated in September 2022 to 15.9 per cent. Inflation depressed real wage growth to an average 0.2 per cent in the first half of 2022, as nominal wages rose at a double-digit rate. The National Bank of Romania raised the policy rate to 6.25 per cent in October 2022. It has also intervened in the secondary market for sovereign debt and has held a tight grip on the RON/EUR rate. The lack of RON liquidity on the market has led to increased financing costs, significantly above the policy rate.

Unforeseen expenses and weaker economic growth are threatening fiscal consolidation.

The August 2022 budget revision maintained the government's fiscal deficit target for the year at 5.8 per cent of GDP, although the Fiscal Council expects the cash-based deficit to reach 7 per cent of GDP. Budget execution for the first half of the year was favourable, with the deficit reaching just 1.7 per cent of GDP. Considerable uncertainty surrounded the cost of capping electricity and gas prices for one year, which has not been fully budgeted; some estimates placed the costs at 3 per cent of GDP. The government modified its main energy measure in September 2022 and extended the price cap to October 2023, along with windfall taxes on all energy market participants, subject to adoption by parliament. A controversial provision includes limits on energy exports, which goes against EU regulations. Other support measures announced by the government include social support – one-off payments to pensioners and payments every two months to vulnerable families – as well as options to defer loan payments, along with extended state aid and credit guarantee schemes for small and medium-sized enterprises and companies in agriculture, production and construction.

The economy remains resilient, but the short-term outlook is highly uncertain. Taking into account the strong economic performance of the first half of 2022, we forecast GDP growth for the year as a whole at 5.4 per cent, but with significant downside risks depending on developments in the second half of the year. Deteriorating savings and income, lower credit demand and the weak performance of Romanian industrial production and exports all suggest a drop in GDP growth to 1.9 per cent in 2023. From an energy security standpoint, Romania largely relies on domestic production, which could help shield it from a shutdown of gas imports, but the spillover effects of any eurozone recession would still be considerable.

CHART Assessment of transition qualities (1-10)



Structural reform developments

Legislation has been introduced to improve governance and policymaking. In March 2022 the government adopted two acts introducing new methodologies for implementing government strategies and institutional strategic plans, including guidelines for the *ex ante* and *ex post* impact evaluation of policies. In April 2022 the government adopted another executive order devising methodology for the better elaboration and monitoring of budgetary programmes, all of which are included in the RRP milestones. The challenge now lies in the application of these guidelines to ensure quality policymaking.

The government has accelerated work on improving the rule of law, albeit with shortcomings. In addition to approving changes to the three central laws that form the justice laws in August 2022, the government, as part of the RRP, also adopted an anti-corruption strategy 2021-25 in December 2021 and a strategy for the development of the justice system 2022-25. A more difficult milestone has been the transposition of EU Directive 2019/1937 on whistle-blower protection. Civil society groups have argued that these amendments have weakened the position of whistle-blowers by removing both the presumption of good faith and the possibility of anonymous reporting of suspected fraud. The President has sent the law back to parliament for re-examination.

Pension reform is under way. As part of the RRP, the authorities agreed to conduct a comprehensive reform of the pension system, mainly to ensure fiscal sustainability. A first step was taken in early 2022, when the government approved the decision to increase the contribution of employees to the second pension pillar from 3.75 per cent to 4.75 per cent, starting in 2024. The Authority for Fiscal Stability approved complementary acts to digitalise the second pillar and diversify investments, but stakeholders have criticised the decision to exclude investments in private equity funds. The authorities have committed to proposing a comprehensive reform of the pension system by the end of 2022.

The governmental cloud project has started, but the schedule has been delayed. The implementation of the governmental cloud is the central element of the digitalisation component of the RRP. However, the first step, to form a working group tasked with defining the scope of the reform, was delayed until the middle of 2022. In June 2022 the government adopted an emergency ordinance on the governance of the public-sector cloud and a law on interoperability. In conjunction, it adopted a cybersecurity strategy for 2021-26.

School dropout rates are being tackled. Romania recorded the highest share of early school leavers in the EU in 2021 (at 15.3 per cent) and this remains a key problem in the educational system. In response, a government decision on implementing a national programme to reduce school dropout rates was adopted at the end of 2021. The project has two main dimensions: first, RRP funding will allocate resources to schools in vulnerable areas, where the share of early leavers is high, and, second, grants will be offered to pupils at risk of not going to high school. School selection will be conducted through a mechanism that considers five key indicators related to educational outcomes.

EU financial institutions will support Romania in channelling RRP funds to the economy. In May 2022 the European Investment Bank (EIB) said that, together with the Romanian Ministry for EU Investment and Projects, it had created a €300 million fund of funds for on-lending under the RRP. The EIB will manage the fund and provide direct and intermediated on-lending to Romanian schemes in line with outlined priorities. This complements the agreement signed with the European Investment Fund (EIF) in December 2021 for the implementation of equity instruments worth €400 million, in addition to the implementation of guarantee instruments worth €500 million under the InvestEU programme. The instruments should be launched in the second half of 2022 and will be injected into the banking sector, which will channel most of the funds to the economy, in early 2023.

The government has launched support schemes to improve the energy efficiency of buildings. A key green measure devised in the RRP is a support scheme for renovation and integrated energy and efficiency renovation, including the seismic strengthening of multi-family residential buildings and public buildings. The government also held a call for tenders on a €595 million scheme of wind and solar investments, which closed in May 2022.