ROMANIA

Highlights

- **The economy is recovering quickly after the Covid-19 shock.** Gross domestic product (GDP) has been expanding robustly since the last quarter of 2020 and was already above pre-Covid-19 pandemic levels in the first quarter of 2021. Most of the growth was accounted for by rising private consumption, as the authorities eased containment measures.
- **The National Recovery and Resilience Plan (NRRP) includes key structural reforms.** The approved €29 billion plan combines investments with reforms in sustainable infrastructure, education, health and local development. Public administration, pension and fiscal reforms are also envisaged.
- **Covid-19 and political tensions have held back structural reforms.** The centre-right coalition has focused on addressing the Covid-19 pandemic and preparing the NRRP.

Key priorities for 2022

- **Judicial reform remains a key priority.** Although some amendments have taken place, further efforts are needed to reform justice laws and step up the fight against corruption, as specified by the latest assessments of the European Union (EU)'s Cooperation and Verification Mechanism, the European Court of Justice of the EU and the Group of States against Corruption (GRECO).
- **Improving administrative capacity to absorb EU funds will be critical.** Almost €100 billion will be available to the country until at least 2027, combining new allocations with leftover funds from the previous EU budget. The key challenge remains the administrative capacity to absorb these funds, considering the modest performance previously in this regard.
- **Fiscal consolidation should advance next year, in line with the commitments under the Excessive Deficit Procedure.** With inflation already running significantly above target and external accounts in deficit, there is a risk that financing conditions will tighten in the short term. The authorities should therefore commit to a more ambitious consolidation plan from 2022.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	7.3	4.5	4.1	-3.9	7.2
Inflation (average)	1.3	4.6	3.8	2.6	4.3
Government balance/GDP	-2.6	-2.9	-4.4	-9.4	-6.7
Current account balance/GDP	-3.1	-4.6	-4.9	-5.2	-5.7
Net FDI/GDP [neg. sign = inflows]	-2.6	-2.4	-2.2	-0.9	-1.6
External debt/GDP	52.0	48.8	49.2	58.2	n.a.
Gross reserves/GDP	19.5	16.8	18.0	19.8	n.a.
Credit to private sector/GDP	26.3	25.6	24.6	25.9	n.a.

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Covid-19: macroeconomic implications

The economy is growing rapidly in 2021 after a better-than-expected performance in 2020. GDP declined by 3.9 per cent in 2020, with private consumption and exports being the main headwinds to growth. Strong public investment was a counter-cyclical factor in 2020 and again in 2021, together with recovering private investment. In line with the relaxation of containment measures, private consumption has driven most of the recovery in 2021, mainly on the back of strong demand for durable goods. Export performance was mixed, with some sectors held back by supply constraints in the automotive industry and fluctuating demand in the eurozone, while imports recovered faster. The current account balance reflects this trend, as the trade deficit in goods continued to widen in 2021. The unemployment rate declined from a high of 5.9 per cent in February 2021 to 5.2 per cent in August 2021, but remains above the pre-Covid-19 pandemic level.

The public sector deficit is high but fiscal consolidation is under way. The high structural deficit and Covid-19-related support measures aggravated the government balance significantly to a deficit of 9.8 per cent of GDP in 2020. A budget revision in August 2021 raised expenditure plans, mainly for health and regional transfers, in line with the higher GDP growth and revenue targets, but the deficit target for 2021 is still 7.1 per cent of GDP in cash-based terms. The medium-term fiscal framework envisages a deficit below 3 per cent of GDP by 2024 and public debt is expected to hover below 60 per cent of GDP in the medium term. In April 2021 ratings agency Standard & Poor's upgraded its outlook for Romania from negative to stable, given the lower fiscal risks.

Accommodative monetary policy supported economic recovery and credit growth, while inflation increased. The National Bank of Romania (NBR) reduced the policy rate to a record low of 1.25 per cent in January 2021 to support economic recovery. Inflationary pressures increased in 2021 due to the liberalisation of the electricity market and recovering global energy prices. The inflation rate reached 6.3 per cent in September 2021. The NBR started to wind down liquidity from the market through its deposits facility before hiking the policy rate to 1.5 per cent in October 2021 to counter rising inflation. Nevertheless, credit growth continued accelerating in the first half of 2021, driven by a strong demand from corporates supported by the state credit guarantee schemes.

The economy has strong growth momentum in the medium term. Overall, the economy's current momentum is expected to lead to 7.2 per cent GDP growth in 2021. In 2022 the NRRP should start boosting investments, in particular, which, together with private consumption growth and gradually improving net exports, will translate into projected 4.4 per cent growth. The downside risks to the forecast are related to the evolution of the Covid-19 pandemic amid the slow progress of vaccination, while the twin (fiscal and current account) deficits and high inflation indicate a deepening of macroeconomic imbalances.

Policy response to Covid-19

Policy support in the first half of 2021 amounted to 0.7 per cent of GDP. Support measures worth about 4.5 per cent of GDP in 2020 included tax deferrals, preserving employment through subsidies and facilitating access to finance. In 2021 spending on Covid-19-related support significantly decreased, in line with the drop in requests for employment support. However, demand for state credit guarantees has been robust and the impact on credit growth has been visible, which has led to an extension of the small and medium-sized enterprise (SME) investment programme until the end of 2021. As of the end of May 2021 state credit guarantees totalled €2.6 billion, mostly in investment loans, out of a total of €6.9 billion allocated in 2020 and 2021. The authorities also devised three grant schemes for working capital and investments and a dedicated scheme for the hospitality sector financed by EU funds. By August 2021 about €600 million had been disbursed through the working capital scheme, while the other two schemes encountered problems with budgeting. The hospitality scheme was open to applications until the end of July 2021 and will disburse grants of €500 million to June 2022, covering 20 per cent of the difference between revenue recorded in 2020 and the level of revenue in 2019.

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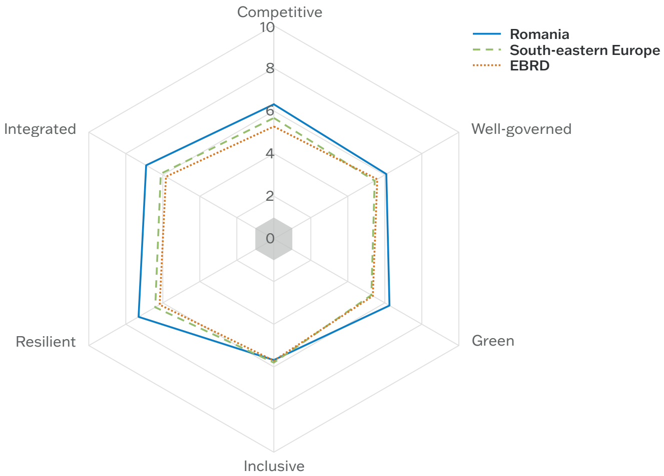
Assessment of transition qualities (1-10)



Structural reform developments

Infrastructure works have accelerated in the past year. A number of large highway projects have advanced rapidly, with the Ministry of Transport fast-tracking the award of contracts on key highway projects that had stalled in the past. The RRF will finance some sections of highway, most notably the A7 highway linking Bucharest with the Moldova region, which is expected to be finalised in 2024.

A new renewables support scheme is in preparation. The scheme, announced in spring 2019, with a memorandum signed in mid-2020, is based on a contracts-for-difference mechanism (CfD) and is being designed as the new procedure for supporting low-carbon electricity generation. It is expected to enter into force by the end of 2022. Moreover, in an amendment to the Energy Law in May 2020, the ban on over-the-counter power purchase agreements (PPAs) was lifted.

A law subsidising the development of offshore wind farms was adopted. The law, adopted by the Senate in November 2020, regulates the subsidies that investors receive when producing electricity, which will differ based on the mechanism for awarding the contract (auction or direct licensing). However, Romania has yet to prepare a maritime spatial plan and a framework law that would enable offshore wind investments, while subsidies following auctions will need to be aligned with the CfD mechanism, which (as noted above) is not yet finalised.

A new law on agricultural land may hold back the development of renewables. The law regulating the sale of agricultural land, adopted in August 2020, heavily constrains the sale of arable land to buyers without pre-emptive rights, especially foreign investors, while imposing an 80 per cent tax on the difference between the sale price and purchase price if the land is sold earlier than eight years after purchase. While the law does not explicitly change the procedure to change the use of the land, the business community has voiced concerns over the impact of the law on developing both onshore renewables and gas infrastructure. Nevertheless, it remains to be seen if the law will have a visible impact on potential investment.

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The government announced plans to list 15 per cent of Hidroelectrica's shares next year. The Ministry of Energy announced that it intends to list a minority package of the most profitable state-owned enterprise (SOE), Hidroelectrica, in the second half of 2022. The process recently started with the company launching a tender for auditing the SOE, a first step in the initial public offering process. For now, a listing is not possible due to the law suspending any privatisation for two years, adopted last year. Hidroelectrica supplies about 30 per cent of electricity in Romania and is seen as a central actor in future investment in offshore wind and solar infrastructure.

Tax incentives have been introduced to firms that improve their equity positions. The low equity of most Romanian firms limits their access to finance. To counter that, a reduction of 2 per cent of the tax due will be granted to companies and to the permanent establishments of non-residents if their equity is positive, while certain increases in equity capital compared with previous years will be rewarded as well. The scheme will be active from 2021 until 2025.

A law regulating 5G networks has been adopted. In June 2021, after several delays, parliament gave the green light to 5G auctions being held in 2021. However, the auctions will depend on (among other things) implementation of the European Electronic Communications Code, which has yet to be adopted by the government. Previously, both public- and private-sector actors had criticised the draft law for its lack of alignment with EU regulations.