Romania

Highlights

- **The economy has slowed after resilient growth in 2022.** Despite numerous headwinds, gross domestic product (GDP) growth reached 4.7 per cent in 2022, but then slowed markedly in the first half of 2023 on the back of falling industrial production and moderating consumption.
- **Reform delays under the Recovery and Resilience Plan (RRP) are accumulating.** As of the end of September 2023, the government was behind on implementing the RRP, delaying future disbursements. For the third payment request, delays relate to investments and reforms in green transition and energy storage, and to corporate governance improvements at state-owned enterprises (SOEs).
- **Hidroelectrica's initial public offering (IPO) has boosted the local stock market.** The large listing brought new investors to the local stock market, boosting its liquidity and regional attractiveness, and acting as a model for the potential listing of other SOEs.

Key priorities for 2024

- **The administrative capacity to implement the RRP needs to be improved.** With increasing delays in reaching RRP milestones, the authorities need to allocate sufficient resources and organise those institutions responsible for delivering the requisite reforms and investments.
- **Fiscal consolidation should be achieved through systematic fiscal reform.** In line with recommendations from the European Union (EU) and other international organisations, the authorities should embark on creating a more efficient, inclusive and straightforward tax system that will yield higher fiscal revenues.
- **Continued reforms and investments aimed at greening the energy sector are needed.** Romania has great potential to develop its renewable energy market, supported by EU funds and associated recent reforms. More work is needed to integrate renewable energy into the grid and adopt a regulatory framework for offshore wind energy.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.8	-3.7	5.9	4.7	1.8
Inflation (average)	3.8	2.6	5.0	13.8	10.7
Government balance/GDP	-4.6	-9.6	-6.7	-5.8	-6.3
Current account balance/GDP	-4.9	-4.9	-7.2	-9.1	-7.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.3	-3.7	-3.1	n.a.
External debt/GDP	49.0	57.5	56.7	50.3	n.a.
Gross reserves/GDP	16.7	19.3	19.0	18.3	n.a.
Credit to private sector/GDP	24.3	25.5	26.2	24.6	n.a.

Macroeconomic developments and policy response

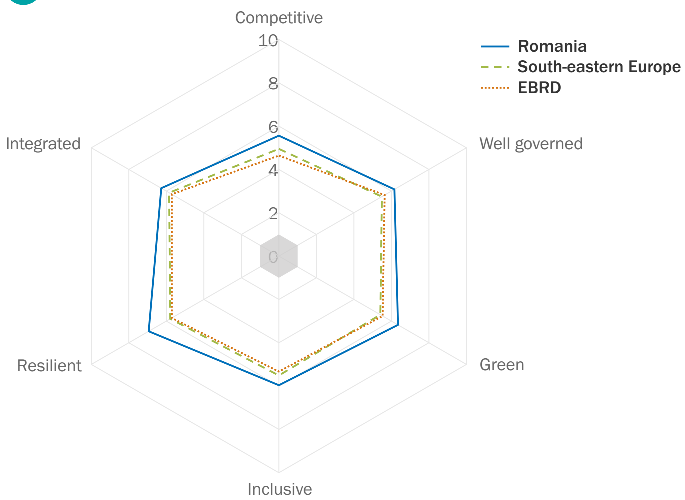
Despite a slowdown, the key economic drivers show resilience. The economy performed strongly in 2022, expanding by 4.7 per cent, despite significant external headwinds, and driven by robust domestic demand and accumulating inventories. In the first half of 2023, growth decelerated to 1.7 per cent year on year, with a notable slowdown in the second quarter. Domestic demand remained resilient amid higher government spending and investment, but falling inventories and an annual decline of goods exports dragged on growth. Industrial production has failed to return to growth so far, reflecting the considerable supply-side shocks in 2022 and weaker foreign demand.

Inflation is on a slow downward path despite stubborn food and core prices. After peaking at 16.8 per cent in November 2022, inflation fell to 8.8 per cent in September 2023. While this trajectory is aligned with the National Bank of Romania's forecast of 7.5 per cent at the end of 2023, risks of stickier inflation remain, especially following the recent increase in a range of taxes (see below). Services inflation is growing steadily, reaching 12.1 per cent in September 2023. The National Bank of Romania has kept the 7 per cent policy rate since January 2023 and signalled that rate cuts were unlikely this year. With stable policy and exchange rates, significant foreign capital inflows and lower credit activity, interbank liquidity reached record levels by the middle of 2023, driving down the three-month money market rate from a peak of 8.2 per cent in November 2022 to 6.4 per cent by September 2023. Still, credit growth in local currency has essentially turned negative in 2023 as companies switched to cheaper foreign-currency loans.

The fiscal position has worsened despite some consolidation efforts. In 2022 the government missed the opportunity to lower the planned deficit by using inflation-boosted revenues and extraordinary budget revenues, such as windfall taxes from energy SOEs. By the middle of 2023, the cash-based fiscal deficit was higher than the corresponding period in 2022, with projections showing a year-end deficit of above 6 per cent of GDP, instead of the targeted 4.4 per cent. Value-added tax (VAT) revenues increased by just 7 per cent in the first half of 2023, reflecting more subdued economic activity, while government spending increased by 16.5 per cent. The government has therefore introduced revenue and spending-side measures to reduce the budget imbalance. Among the key measures are VAT increases on specific products and services, a revenue tax, the elimination of tax benefits for employees in information technology (IT), construction and agribusiness sectors, and lowering administrative spending by cutting advisors and senior management posts. The 2024 deficit is targeted at 3 per cent of GDP, but the International Monetary Fund (IMF) expects a deficit slightly above 5 per cent of GDP, including the effects of the adopted fiscal package.

Moderate growth is likely in the short term. Considering the slowdown in the first half of 2023, we forecast GDP growth for the year as a whole at 1.8 per cent. More moderate private consumption, together with a potential tax reform, will likely define the growth path this year. Stronger agricultural production and exports, EU-funded investments and a tightening labour market provide upside potential, while weaknesses in sectors such as industry and construction will drag on growth. In 2024, amid a normalisation of inflation and easing financial conditions, growth should accelerate to a projected 3.2 per cent in the absence of major shocks.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission has closed the Cooperation and Verification Mechanism (CVM) for Romania. In November 2022 the Commission concluded that the progress the Romanian authorities had made with judicial reforms was sufficient for the mechanism to be closed, with remaining issues to be addressed through continuous dialogue and the rule-of-law mechanism. The last CVM report noted the progress Romania had made in strengthening the judiciary and combating corruption. The Commission formally started the process of repealing the CVM in June 2023.

The RRP is facing mounting delays. As the authorities had not satisfactorily completed two milestones (investments in new electrolysers for hydrogen production and projects on gas co-generation and district heating) from the second payment request from the Recovery and Resilience Facility (RRF) by December 2022, the Commission triggered a payment suspension procedure that envisages only partial disbursement if the items have not been completed by January 2024. Other milestones with a missed deadline in 2022, which will also affect the third payment request, include two investments in battery storage and supply chains, and improvement to the corporate governance of SOEs. The wider pension system reform, another key requirement of the RRP, was due in the first quarter of 2023. The third payment request, which was initially planned for March 2023, is likely to be submitted around November 2023, meaning Romania may miss out on the funds allocated for 2023.

A minority stake in Hidroelectrica was listed on the local stock exchange. After years of preparation and delays owing to Covid-19 and the war on Ukraine, investment fund Fondul Proprietatea listed almost 20 per cent of Romania's largest energy SOE on the Bucharest Stock Exchange. Local and foreign institutional investors have subscribed to around 80 per cent of the shares. The IPO was valued at €1.9 billion, the largest listing in the history of the local capital market. The deal contributes to the growth and liquidity of the local stock market, as it was reported that new foreign investors had subscribed for the first time in Romania.

The contract-for-difference mechanism was adopted to support renewable energy, and the Neptun Deep offshore gas project was given the green light. In August 2023 the government adopted a regulatory framework to implement the mechanism. The first contracts for 2,000 MW of onshore wind and solar capacity should be assigned towards the end of 2023. The mechanism should stimulate the renewable energy market and accelerate deployment. Another highlight is the Neptun Deep project being developed by the state-owned Romgaz and OMV Petrom, which was approved in June 2023. The project will cost €4 billion and, from 2027, will supply Romania with 10 years' worth of gas.

Three key judicial laws were modified as part of an RRP milestone. In November 2022 the government modified the laws regarding the status of magistrates, judicial organisations and the Superior Council of the Magistracy. The laws aim to improve the efficiency and staffing of the justice system and introduce some digitalisation measures. The government also initiated amendments to the penal code, which the parliament adopted, but which may be sent to the Constitutional Court for approval as some key changes were not aligned with the Court's past recommendations.

A long-term care strategy was adopted with support from the World Bank. The strategy, which was a milestone in the RRP, was adopted in December 2022 and defines the country's priorities until 2030. As the size of the elderly population is expected to increase significantly, the strategy prioritises prevention measures and person-centred care. The strategy also looks to streamline organisational processes for more effectiveness. EU funds and local budgets will finance investments in relevant infrastructure. While the number of private care centres for the elderly has more than doubled in recent years, some of these centres have been exposed as housing residents in dire conditions.