Romania

Highlights

- **Economic growth has slowed significantly.** After real gross domestic product (GDP) growth decelerated to 2.4 per cent in 2023, the economy grew by only 1.3 per cent year on year in the first half of 2024, despite strong real wage growth boosting consumption. The fiscal position has also deteriorated further.
- **Pension reform was adopted.** This reform is part of the country's commitments under the Recovery and Resilience Plan (RRP), and addresses inconsistencies in pension formulas alongside introducing new indexation criteria. The recalculation of pensions, starting from September 2024, will cost around 1.5 per cent of GDP in 2025.
- **Despite fiscal pressures, the government continues to support transport infrastructure projects.** Romania's investment in its transport infrastructure has historically fallen below its needs. The authorities have therefore significantly accelerated work on a number of key highway projects, including one to eventually connect Bucharest with northern Ukraine.

Key priorities for 2025

- **The need for fiscal reform is becoming more urgent.** In line with recommendations from the European Union (EU) and other international organisations, Romania should create a more efficient, fair and transparent tax system and administration aimed at increasing fiscal revenues and controlling spending more effectively.
- **Implementation of the RRP must remain a priority.** Amid the growing delays in reaching RRP milestones and the lack of disbursements in 2024, the authorities need to re-energise their efforts to deliver the necessary reforms and investments.
- **Continued reforms and investments to green the energy sector are needed.** Romania has great potential to develop the renewable energy market, supported by EU funds and recent reforms, but capacity has increased more slowly than in regional peers in recent years. More work needs to be done to integrate renewables into the grid and to balance the system.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.7	5.5	4.0	2.4	1.4
Inflation (average)	2.3	4.1	12.0	9.7	5.9
Government balance/GDP	-9.3	-7.2	-6.3	-6.6	8.0
Current account balance/GDP	-4.9	-7.2	-9.2	-7.0	-8.3
Net FDI/GDP [neg. sign = inflows]	-1.3	-3.7	-3.1	-2.0	-2.0
External debt/GDP	57.5	56.6	50.6	51.9	na
Gross reserves/GDP	19.3	19.0	18.4	20.3	na
Credit to private sector/GDP	25.5	26.2	24.7	22.8	na

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Macroeconomic developments and policy response

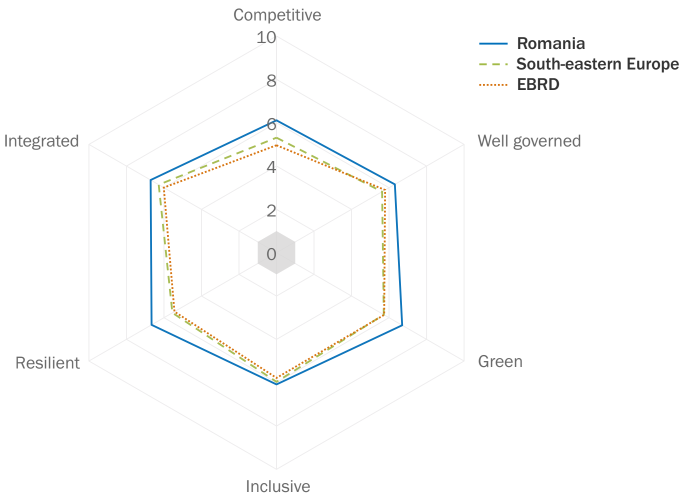
Economic growth in 2024 has been disappointing. In the first half of 2024, real GDP grew by just 1.3 per cent year on year, as a strong rebound in consumption was almost fully offset by higher imports and destocking. Infrastructure investment continued to support growth, however. The rise in imports is reflected in a widening of the current account deficit so far in 2024. After robust growth in 2023, growth in the construction sector, including civil engineering, slowed significantly in the first half of 2024, with the residential sector declining by 21 per cent. The information and communications technology (ICT) sector, which has been an important growth driver in recent years, also slowed significantly in line with global trends, while industrial production stagnated on the back of weak foreign demand.

Inflation is proving sticky amid strong real wage growth and expansionary fiscal policy. Inflation has fallen markedly from its recent peak of 16.8 per cent in November 2022, but was the highest in the EU at 5.4 per cent as of July 2024. Goods inflation has increased on the back of higher taxes and growing consumption while services inflation is still elevated at around 9.0 per cent, albeit on a downward path. Higher core inflation suggests a more difficult disinflationary path in Romania compared with regional peers, mainly as real wage growth has averaged 7.4 per cent so far in 2024, the highest level since 2019. The central bank cut its policy rate twice in summer 2024, to 6.5 per cent. Ample interbank liquidity kept market borrowing rates below the policy rate, stimulating credit demand, especially for consumer loans.

Despite some tax changes, the fiscal position continues to deteriorate in 2024. Fiscal policy continues to be expansionary in Romania, with the half-year deficit at 3.6 per cent of GDP, higher than in the three previous years. While revenues performed well in the first six months, following the tax package announced towards the end of 2023, spending has surged, as capital expenses, salaries and goods and services all increased by over 20 per cent year on year. In July 2024, spending accelerated by an even higher 36 per cent year on year. The most recent estimates by the Fiscal Council see the deficit soaring past 8 per cent of GDP in 2024, which will put consolidation on a long path towards normalisation. Romania has been under the European Commission's excessive deficit procedure since 2020.

Slow growth is likely in the short term. Household consumption will remain strong on the back of a tight labour market and wage growth, but agriculture is being affected by droughts, construction is held back by high interest rates and costs, and foreign demand for exports and ICT services has declined. In addition, the expected fiscal consolidation will further reduce demand in the economy. Another risk is further delays in implementation of the RRP. Considering all the factors, we forecast real GDP growth of 1.4 per cent in 2024, followed by an improvement to 2.6 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

RRP implementation is facing delays. As of mid-2024, Romania had received €9.4 billion from its pre-financing and two payment requests. The third payment request, initially scheduled for June 2023, is still under assessment by the European Commission (EC), while the fourth request, also originally planned for 2023, is yet to be submitted. The accumulated delays may lead to another renegotiation of the schedule. Among the main delayed deliverables from the first three payments are milestones related to the decrease of the turnover threshold of microenterprises from €500,000 to a lower level, still to be negotiated. Other delays include signing the contracts for hydrogen capacity, and some milestones related to improving corporate governance in state-owned enterprises (SOEs). Another contentious milestone is public pay reform, which will start after the general election in December 2024.

The government adopted a tax package and administration reforms to increase fiscal revenues. The package, adopted in October 2023, contains multiple fiscal changes worth around 1.2 per cent of GDP, with revenue-side measures accounting for 0.8 per cent of GDP. Among the main tax measures were the partial removal of preferential tax regimes for employees in construction, agriculture and ICT, the removal of some reduced value added tax (VAT) rates, increased microenterprise taxes, and higher turnover taxes for large corporates and financial institutions. The tax authority is also implementing various digitised tools such as e-invoicing, Standard Audit File for Tax (SAF-T), and e-VAT forms to digitise interactions and thus decrease tax evasion.

The digitalisation of the public sector is ongoing. In April 2024, the government launched the procurement process for implementing the dedicated governmental cloud, a project worth €80 million included in the RRP. The cloud infrastructure will host the platforms of the central authorities, a crucial part of the digitalisation of public administration. Other ongoing projects in this area are the digitalisation of interactions with the tax authority (mentioned above), and a framework project for the customs authority, aimed at aligning and updating IT systems.

Pension reform will bring long-term savings but carries significant short-term costs. In November 2023, the government adopted a general pension reform aimed at ensuring the long-term fiscal sustainability and increasing the fairness of the system. The new system introduced a pension calculation formula, which excludes ad-hoc increases and links it to life expectancy, strengthens incentives for longer working lives, and reduces early retirement options. The reform is expected to bring long-term fiscal savings of around 3 per cent of GDP, but the recalculation of entitlements adopted in September 2024 is expected to lead to a significant fiscal impact in 2025 of around 1.5 per cent of GDP.

SOE corporate governance reform has been patchy. An important part of the RRP covers the improvement of SOE corporate governance, in line with Organisation for Economic Co-operation and Development (OECD) standards. The government established a new monitoring agency (AMEPIP) and appointed its management in 2023, but the management resigned in July 2024, leaving the agency's future in doubt. Nevertheless, the updated SOE law to remove existing exceptions was adopted in June 2024. However, the three RRP milestones related to appointing full-term management in key SOEs have only been partially reached so far. As of May 2024, only 25 out of 142 SOEs that operate under the SOE law at central level have appointed full-term boards.

Road infrastructure investments are progressing but metro projects are facing delays. A considerable share of EU funding has been dedicated to infrastructure investments, given Romania's large gaps relative to EU standards. While RRP-financed highway sections are progressing relatively well, the two metro projects included in the RRP – the new line connecting the airport in Bucharest and the Cluj metro – are facing some delays and will likely extend beyond the deadlines, especially in Cluj where there is a significant financing gap.

Important energy infrastructure investments are being launched. As part of the RRP, the Ministry of Energy signed two contracts for high-efficiency gas power plants and for hydrogen production. In June 2024, the ministry announced the signing for five combined-cycle gas turbine power plants with a total capacity of 486 MW, also producing district heating. Around half of the target capacity was also signed under the hydrogen production support scheme. The ministry also finally approved the contracts-for-difference (CfD) scheme for supporting renewable investments, although the auctions are yet to be held. Other investments that are behind schedule are in battery storage and supporting relevant projects that would enhance the local value chain for the green transition.