

Country note, July 2018

Key messages:

- After very strong growth of 6.9% in 2017, the GDP advance is estimated to record a somewhat slower advance in 2018.
- In 2017 the Government's target of 3% of GDP for the headline deficit was met on the account of much lower than planned investment spending, while the structural deficit widened up to 3.3% of GDP.
- For 2018, the headline deficit target of 3% of GDP is projected to be attained upon large one-off revenues, while the structural deficit is estimated to deepen with another 0.4 pp compared to 2017, even if Romania is already under the Significant Deviation from MTO Procedure. Moreover, the balance of risks is significantly tilted on the downside.
- In its Opinion on the 2018 Draft Budget, the Romanian Fiscal Council noted the continuous derogation from both national and European fiscal rules, the deepening of the deviation from MTO and from the path towards it and warned about the high possibility of breaking also the 3% of GDP limit for the headline deficit.

Macroeconomic outlook

Economic growth accelerated strongly in 2017, with a real GDP advance of 6.9%, being mostly driven by private consumption stimulated by the continuation of a loosening fiscal policy (tax cuts, significant increases in public wages), the low inflation rate and a positive and widening output gap. In 2018 real GDP growth is expected to record a smaller pace, albeit above potential, between 4.5% and 6.1% (European Commission's, respectively, Romanian authorities' estimates).

Short-term and medium-term fiscal outlook

The general consolidated budget deficit for 2017 reached 2.91% of GDP and for 2018 the government estimates 2.95% of GDP. The fiscal policy stance remains expansionary also in 2018, when the Unified Wage Law entered into force (with additional increases by more than 25% of gross public wages) and the personal income tax decreased from 16% to 10%, both measures being partially offset by shifting the social contributions from 22.75% for employer and 16.5% for employee to 2.25% for employer and 35% for the employee. According to the Convergence Program 2018-2021, the structural balance estimated by the Ministry of Public Finance continues to deteriorate in 2018 (to -3.3% of GDP from -2.9% of GDP in 2017), and only starting 2019 it is planned to enter on the adjustment path towards the MTO (a structural deficit of 1% of GDP) by an adjustment pace of 0.4-0.5 pp/year.

Fiscal framework and national fiscal rules

On several occasions, the Romanian Fiscal Council warned about the non-compliance with the majority of fiscal rules when drafting the budgetary laws, to the systematic recourse to derogation from the Fiscal Responsibility Law and to the persistence of placing the budgetary deficit in the immediate proximity of the 3% reference level, in contradiction with the fiscal rules established by both national and European laws, an approach that weakens the position of the public finances and, in the context of positive output gaps deepen the deviation from MTO. In its Opinion on the 2018 budget, the Fiscal Council noted that, similar to 2017, for the 2018 budgetary construction only the 3% of GDP for the headline deficit SGP rule was taken into account, all the other rules being broken *ex-ante*, even setting the adjustment path towards MTO starting 2018 as it was recommended by the EC in December 2018 (Romania entered in June 2017 under the Significant Deviation from MTO Procedure, due to the major deviation from the MTO starting with 2016). In addition, the Fiscal Council warned about the high probability for the headline deficit to significantly surpass the assumed target, as the revenue projections included large one-off measures and thus the 3% of GDP reference value is likely to be broken under a no policy-change scenario.

Key indicator forecast

		2017	2018 f	2019 f	2020 f	2021 f	Source
Real GDP growth rate	[% y-to-y]	6.9	6.1	5.7	5.7	5.0	1
Real GDP growth rate	[% y-to-y]	6.9	4.5	3.9	-	-	2
GG balance – targets	[% of GDP]	-2.91	-2.96	-2.96	-2.38	-1.82	1
GG headline balance	[% of GDP]	-2.91	-3.39	-3.81	-	-	2
GG public debt.	[% of GDP]	35.0	35.4	35.8	35.4	34.5	1
GG public debt	[% of GDP]	35.0	35.5	36.4	-	-	2
GG structural balance	[% of GDP]	-2.9	-3.9	-2.8	-2.4	-2.0	1
GG structural balance.	[% of GDP]	-3.32	-3.76	-4.19	-	-	2

Chart 1: Revenue, expenditure and public debt as % in GDP

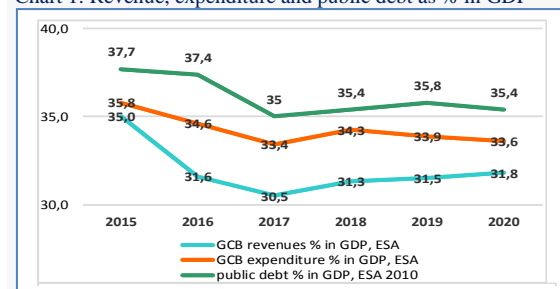
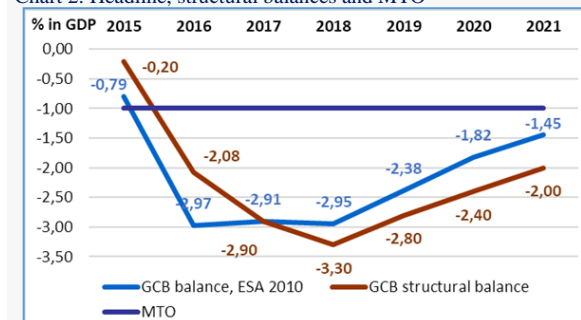


Chart 2: Headline, structural balances and MTO



Source: Eurostat, MPF projections

Sources:

1 - Ministry of Public Finance (MPF), 2018-2021 Convergence Programme;

2 - European Commission (EC), 2018 Spring Forecast

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